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The Effect of The Audit Committee, Company Size and Audit Tenure on Earnings Management

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ABSTRACT

This study aims to empirically test and empirically prove audit committees' effectiveness, firm size, and tenure audits on earnings management. The population in this study are companies in the goods and consumption industry sector listed on the Indonesia Stock Exchange. The sample selection method in this study used a purposive sampling method. This study's total number of samples was 15 goods and industrial consumption companies listed on the Indonesia Stock Exchange during the 5-year observation period (2017-2021). The analytical tool for testing the hypothesis is EViews version 10. The data analysis method uses descriptive statistical analysis, panel data test, classic assumption test, and hypothesis test. The results of this study indicate that the audit committee, firm size, and tenure audit simultaneously influence earnings management. While the partial firm size and audit tenure do not affect earnings management, the audit committee affects earnings management.

Keywords: *audit committee, company size, audit tenure and earnings management.*

1. INTRODUCTION

The main long-term goal of the company is to maximize its value of the company. High company value will describe the company's welfare. Financial reports can describe the value and benefits of a company and as a channel for companies and capital owners to obtain helpful information. Material information in financial reports is essential for parties inside and outside the company (Alfiyasahra, 2022).

As manufacturing companies develop, they have managers who provide financial reporting as a form of accountability to managers and sources of accurate information about the company's performance. Several essential factors in measuring managerial performance are profits. Management is the art of getting things done through other people. However, earnings management is defined in various ways and is most commonly used in legal practice to implement favorable accounting

policies. However, earnings management is a method by which management manages a company's financial statements by choosing specific accounting policies to increase net income and company value based on expectations. management (Susanti, 2020).

One of the phenomena of earnings management in Indonesia is PT Tiga Pilar Sejahtera, Tbk (AISA), where in 2017, the Indonesia Stock Exchange (IDX) plans to bring in an auditor or public accounting firm (KAP) to audit the 2017 financial statements. The Indonesia Stock Exchange wants to obtain an explanation regarding the audit process carried out on AISA's financial statements, which were inflated by IDR 4 trillion. Based on the 2017 financial reports submitted to the IDX, those assigned to carry out the audit were KAP Amir Abadi Jusuf, Aryanto, Mawar & Rekan, affiliated with the world's leading audit, tax, and consulting firm, namely RSM

International. The KAP has audited AISA's financial statements since at least 2004 financial statements. The process for requesting clarification will be to confirm the stock exchange to the directors of TPS Food was currently serving. Some things that must explain are the alleged manipulation of the financial statements related to the presentation, overstatement, and accounts and how to use the company's assets because the transaction beats affiliated transactions. After the case, PT Ernst & Young Indonesia (EY) KAP investigation results reopened. The results of the EY report found that funds inflated to Rp. 4 trillion and an alleged flow of Rp 1.78 trillion from the TPS

2. LITERATURE REVIEW

Agency theory is a theory regarding the ownership structure of companies managed by non-owner managers, based on the fact that professional managers are not perfect agents of company owners. Thus, only sometimes acting in the interests of the owner. In other words, managers, as rational human beings making company decisions, will maximize their satisfaction. Agency relationships occur when one party (principal) hires another party to carry out a service and delegates authority to make decisions to the agent. The CEO is the company's agent, and the shareholders are the principal. One element of agency theory is that principals and agents have different preferences or goals (Chaniago, 2021).

Agency theory was founded on understanding and solving problems when information is incomplete at signing a contract. The contract is between the principal (employer, shareholder) and the agent (management). If the agent has an advantage, agency theory will appear that there is a difference between information and the subject for the benefit of both parties. A principal-agent problem will occur where the agent will take actions that benefit him but harm the principal.

Earnings management is part of manipulating reports for personal gain by management. The company's stockholders, who are only concerned with making a profit, are in the dark about what is happening inside. Earnings management is an action referred to as

Food group to parties allegedly affiliated with the old management (www.cbncindonesia.com, 2019). Auditors in the big four consider having greater competence and expertise in conducting audits to reduce dubious accounting practices and point out material misstatements caused by directors' suffering. Auditor size hurts earnings management, as measured by discretionary accruals. Companies that use performance management practices by the four leading auditors within the company will perform worse than those audited by auditors other than the four leading auditors (Kurniawansyah, 2016).

an intentional error in reporting concerning the correctness of accounting data so that falsifying all information can ultimately change the opinion or decision of the person who reads it (Manurung, 2022).

In Indonesia, an audit committee is mandatory for companies, as confirmed by the 2004 Indonesian Stock Exchange regulations that companies listed on the Indonesian Stock Exchange must have an audit committee. Based on the Decree of the Chairman of the Capital Market and Financial Institution Supervisory Agency Number Kep-643/BL/2012 concerning the Establishment and Implementation of an Audit Committee. Issuance of this regulation should increase the independence and authority of the audit committee in carrying out the functions and duties of the company's audit committee in supervising the company's operations. The Financial Audit Commission in Indonesia began its activities in 2001 with a letter from the Financial Services Authority (OJK) No: SE 03/PM/2000.

Company size is the classification of companies into large companies and small companies. The size of the business will affect its financial structure of the business. Businesses tend to require more capital than small businesses. Additional funding can come from issuing new shares or additional debt (Astuti, 2017).

The audit committee is an influential committee of the company. The audit



committee is a committee consisting of the board of directors. The audit committee is also responsible for overseeing the financial reports prepared by management, the quality of external auditors, internal control systems, and risk management within the company. The audit committee was responsible for overseeing the performance of management responsibilities so as not to harm the company's owners. The audit committee is one of the institutional elements in the concept of good corporate governance to contribute to the implementation level significantly. The audit committee supervises the credibility of financial reports and earnings management practices appointed by the board of directors. Managers tend to act selfishly to increase their welfare. One of the main objectives of forming an audit committee is to minimize earnings management by managers. Components of the audit committee that can affect earnings management oversight include the size of the audit committee. The size of the audit committee is the number of members formed by the board of commissioners to help manage and oversee the implementation of company operations (Chaniago, 2021). According to BAPEPAM Regulation number IX., 1.5, the audit committee members are at least three representatives of shareholders, management, and independent parties. The audit committee members will increase the monitoring of earnings management practices. The results in this study align with research conducted by Manurung (2022), which states that audit committees have a significant effect on earnings management, and research conducted by Lufita (2018), which states that audit committees have a significant effect on earnings management. Therefore, the hypothesis in this study is as follows:

H₁: the audit committee affects earnings management.

Company size is a number that can show how big a company is. The bigger the company, the stronger the internal control to maintain the accuracy of the information reported to the public and investors. Firm size has a negative relationship with earnings management. Larger companies give fewer incentives to manage earnings than smaller ones. Substantial

companies that act as nominees will face pressure from investors who act as principals to provide reliable financial reports. Large companies have more information asymmetry and agency problems than small companies. The fewer earnings management is carried out by management because the company is getting bigger, and the smaller the company, the greater the earnings management (Habibie, 2022). The results of this study align with research conducted by Wardhani (2022), which states that company size has a significant negative effect on earnings management, and research conducted by Sholichah (2022), which found that company size has a significant negative effect on earnings management. Therefore, the hypothesis in this study is as follows:

H₂: company size affects earnings management.

This information asymmetry is exploited by company management, acting as a proxy for earnings management. The purpose of agent earnings management is to maximize their welfare. In addition to earnings management, the agents' performance looks good in the eyes of the company's stakeholders. To overcome this, companies need auditors. Each auditor has a different assignment or engagement period in each company, referred to as a tenure audit. The audit term is the number of years the company can provide to the auditor. The longer the auditor's tenure, the better the auditor's knowledge of the company. The audit program designed by the auditor will optimally run so that it can increase the value of the financial statements that the company has made. Therefore, the existence of an auditor in a company who has been in the company since the previous period (for a long time) will make it easier for the auditor to find out the earnings management that occurs in the company. So, companies will choose earnings management through actual activities because this real earnings management tends to escape company auditors' supervision (Puspitasari, 2016). The results of this study align with research conducted by Senja (2019), which states that tenure audit has a negative but significant effect on earnings management, and research conducted by Kurniawansyah (2016), which states that tenure audit has a positive effect on

earnings management. Therefore, the hypothesis in this study is as follows:

H₃: tenure audit affects earnings management.

3. RESEARCH METHOD

The data type used in this study is quantitative, and the data source is secondary. The quantitative research method is a type of research whose specifications are systematic, planned, and structured from the start to the creation of the research design.

3.1. Data Collection Techniques

To obtain data for the issues being investigated in this study, the authors retrieved data from the financial statements of companies listed on the Indonesia Stock Exchange, which has nine sectors, one of which is the Consumer Goods Industry, which can be downloaded at the following link: www.idx.co.id.

3.2 Operational Definitions of Variables

Table 1: Variable Measurement

Variable	Measurement
Earnings Management	$DAC_{it} = \left(\frac{TA_{it}}{Sales_{it}} \right) - \left(\frac{TA_{it-1}}{Sales_{it-1}} \right)$
Audit Committee	Where DAC is discretionary accruals and TA is total assets.
Company Size	The number of audit committee members in company i in period t
Audit Tenure	$Size = LN(Total Assets)$ The first year of the audit engagement will start with number 1 and will be added by 1 for the following years. If during the 2017-2021 period the company changes auditors, then the calculation of the audit engagement will start from initial, namely with the number 1

3.2. Sample Collection Techniques

The population in this study were all manufacturing companies in the consumer goods industry sector listed on the Indonesian stock exchange. The selection of the research sample was based on the purposive sampling technique. Sugiyono (2018) states that purposive sampling is a sampling technique with specific considerations. The criteria used to select the sample are as follows:

Table 2: Sample Selection

Description	No Of Companies
Listed on the Indonesia Stock Exchange (IDX) for 2017-2021	53
Companies that do not publish financial reports.	(23)
Companies that experienced profits during 2017-2021	(5)
Complete data available in the financial reports for 2017 – 2021.	(10)
Number of research samples	15
Total sample data for research five years	75

3.3. Data Analysis Techniques

The data analysis method used is a statistical analysis method using E-views 10 software. Before the data is analyzed, for data analysis, it is first tested using the logit method. E-views 10 is computer software that can help analyze data and perform statistical and non-parametric calculations on a Windows basis.

These multiple regression analysis methods were carried out on the model proposed by research using EViews Software version 10 to predict the relationship between the independent and dependent variables. The multiple regression analysis equations are:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Where:

Y = Earnings Management
 α = Constant
 β_1 = Coefficients
 X1 = Audit Committee
 X2 = Company Size
 X3 = Audit Tenure
 e = error



4. RESULTS AND DISCUSSIONS

4.1. Results

Table 3: Statistic Descriptive

Variables	Mean	Standard Deviation	Min	Median	Max
Earnings Management	0.948362	0.276538	-0.052364	0.995553	1.371176
Audit Committee	3.080000	0.273120	3.000000	3.000000	4.000000
Company Size	2.611033	0.202989	2.326750	2.581220	3.334061
Audit Tenure	2.226667	1.681162	0.000000	2.000000	5.000000

Source: Proceed by E-views, 2022

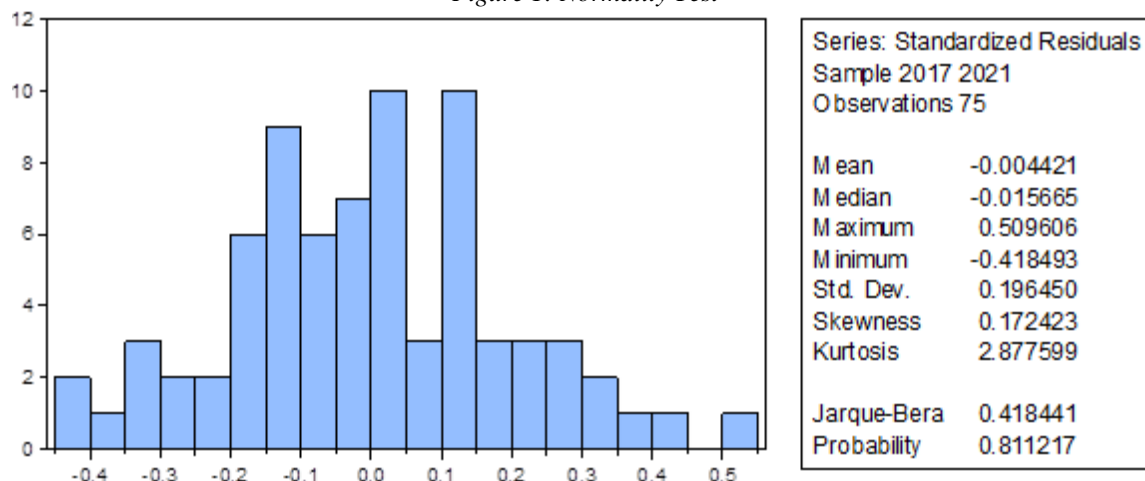
Based on the table above, the analysis results using descriptive statistics can show that earnings management has a minimum value of -0.052364 and a maximum value of 1.371176. The mean value of the earnings management variable is 0.948362. It has a standard deviation value of 0.276538, meaning that earnings management has a low level of data variation, so the data variation is good or homogeneous.

The descriptive statistical test shows that the audit committee has a minimum value of 3.000000, the maximum of which is 4.000000. The mean value of the audit committee variable is 3.080000. It has a standard deviation value of 0.273120, meaning that the audit committee has a low level of data variation, so the data variation is good or homogeneous.

The descriptive statistical test shows that company size has a minimum value of 2.326750 and a maximum of 3.334061. The mean value of the company size variable is 2.611033. It has a standard deviation value of 0.202989, meaning that company size has a low level of data variation, so the data variation is good or homogeneous.

Descriptive statistical tests show that tenure audits have a minimum value of 0.000000 and a maximum value of 5.000000. The mean value of the tenure audit variable is 2.226667. It has a standard deviation value of 1.681162, meaning that the tenure audit has a low level of data variation, so the data variation is good or homogeneous.

Figure 1: Normality Test



Source: Proceed by E-views, 2022

It can be seen from the normality test that the probability value of the J-B statistic is

0.418441. Because the probability value of p is 0.811217 > 0.05, data normally distribute.

Table 4: Multicollinearity test

Variables	Coefficient Variance	Uncentered VIF	Centered VIF
Audit Committee	0.011624	147.3491	1.134403
Company Size	0.019770	179.7786	1.065732
Audit Tenure	0.000289	2.969321	1.068887

Source: Proceed by E-views, 2022

The multicollinearity test above states that at the VIF value obtained, each independent variable obtains an X1 value of 1.134403, X2 of 1.065732, and X3 of 1.068887. With this, all

of these variables obtain a VIF value that is less than 10, so that in this test, there is no multicollinearity between the independent variables in the regression model.

Table 5: Regression test

Variables	Coefficient	Sig.
Audit Committee	-0.546834	0.0000
Company Size	0.067469	0.6328
Audit Tenure	-0.027039	0.1162
<i>R-square</i>	0.260364	
<i>Prob(F-statistic)</i>	0.000019	
<i>Observations</i>	75	

Source: Proceed by E-views, 2022

4.2. Discussion

The audit committee has a negative and significant effect on earnings management. Based on the results of research testing, it found that the measurement of the audit committee using the number of audit committee members, the number of independent audit committees, the total number of audit committee meetings, and the expertise possessed by audit committee members, both accounting expertise and financial expertise as a whole, shows that the audit committee is in this research is not able to reduce earnings management actions. It is due to the self-interest exercised by management and audit committee members following the agency theory, which states that each individual will act following their self-interest. This study's results align with research conducted by Alfiyasahra (2022), which states that independent audit committees have a positive effect on earnings management. M. Mawardi Cholid (2020) states that audit committee skills affect earnings management.

Firm size has no effect and is not significant on earnings management. It shows that the size of a company could be a company benchmark in managing earnings. Company size has no effect on earnings management due to the different views held by several companies.

Some companies believe that if the total assets owned are increasing, the company will be worried about managing earnings because the attention from outsiders will be greater. Several other companies believe increasing assets can be a medium for managing earnings. The results of this study align with research conducted by Karina (2022), which states that company size hurts earnings management, and research conducted by Fathihani (2021), which states that company size has an insignificant effect on earnings management variables.

Tenure audit has no effect and is insignificant to earnings management. It is because the tenure audit engagement period does not affect the earnings management of a company. After all, this research assumes that companies dissatisfied with their auditors' work will end the engagement period before the maximum limit set by the government. So that the length of engagement between the auditor and the company can be independent of earnings management because each company has the authority to decide on cooperation between the company and the auditor. This study's results align with research conducted by Dewi (2021), which states that tenure audits do not affect earnings management, and Senja (2019), which states that tenure audits hurt earnings management.



5. CONCLUSIONS

Based on the research conducted, audit committee, company size, and audit tenure simultaneity on earnings management. The audit committee variable affects earnings management, the company size variable does not affect earnings management, and the tenure audit does not affect earnings management. Several suggestions for future research expect

to increase the observation period. If outliers are to be carried out, the data used as samples is still sufficient for research. It is hoped that future researchers can use other variables to detect the existence of practices related to earnings management. For investors, this research can add insight and be more careful in investing in the desired company.

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