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Effect of Independent Commissioners and Characteristics of Audit Committee on Profit Quality with Earning Management as Intervening Variables

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Abstract. This research objectives is determine whether the audit committee's expertise and the numbers of independent commissioners affect the quality of earnings through earnings management as an intervening variable. Earnings management model using the Modified Jones and earnings quality variables use accrual quality indicators. The study's population are manufacturing companies listed on the Indonesia Stock Exchange from 2014-2018. The sample of this study selected using purposive sampling method. The results of this study indicate that audit committee expertise has an insignificant negative effect on earnings management and earnings quality, the number of independent commissioners has a significant negative effect on earnings management and has a positive effect on earnings quality. While earnings management has an insignificant positive effect on earnings quality. Therefore, earnings management does not mediate the impact between audit committee expertise and number of independent commissioners on earnings quality as intervening variables.
Keywords: Audit committee expertise, earnings management, number of independent commissioners, earnings quality.

INTRODUCTION

The development of the economy and technology is experiencing rapid development, thus creating very tight competition in the business world. From the many sources of information presented by the company, used by investors to assess the company's performance is the financial statements. Financial statements prepared based on Financial Accounting Standards Boards (FASB) are a source of information that is used as a reference by stakeholders and interested parties to assess the company's performance which is then used as a basis for investment decision making. One of the information contained in the financial statements is profit. Profit has a great influence on internal and external parties. Therefore, sometimes profits are often manipulated according to the wishes of certain parties. This action is called earnings management.

According to Abdelghany (2005) earnings management as a management action in the process of preparing financial statements so as to increase or decrease profits in accordance with the wishes of management. This action has led to several accounting reporting cases, one of which is the issue of earnings management by PT. Kimia Farma in 2011. In this case, PT. Kimia Farma marked up the financial statements, which was to increase profits by increasing revenue, as if the company had achieved the sales target that had been set previously. In the case of PT. Kimia Farma is one form of weak corporate governance caused by the inability of company management to eliminate conflicts of interest that arise between owners and managers. The weakness of corporate governance indicates the failure of financial statements to achieve their objectives in conveying the real facts to their users regarding the company's actual financial condition, especially regarding earnings information (Treisman, 2000).

In general, investors prefer companies that produce high profits to invest, this is because investors assume that companies that have high profits have good performance and will provide a large return on investment. The tendency to pay attention to earnings is realized by the management, especially managers whose performance is measured by profit. This motivates managers to conduct earnings management, so earnings information through financial statements received by external parties or investors becomes invalid. Earnings management practices are usually done by manipulating financial statements by utilizing accounting policies by preparing financial statements using accrual basis (K. E. M. Abdelghany, 2005; Wulandari & Budiartha, 2015).

Earnings management will certainly affect earnings quality, if the level of earnings management in a company is high, the profit quality will be lower. In addition, the good or bad quality of earnings in financial statements will affect decision making by interested parties. If the level of earnings management in the company is high, it can lead to errors in decision making. The practice of earnings management is considered to have become a serious problem and is of particular concern to date. To prevent excessive earnings management, better implementation of Good Corporate Governance is needed (Wulandari & Budiartha, 2015). This statement is supported by the results of research by Abdelghany (2005) and Baxter *et al.,* (2009) who concluded that the existence of Good Corporate Governance will weaken earnings management in a company by using four elements of GCG to improve earnings quality, and four GCG mechanisms to control the nature and motivation of agents in conducting company operational performance. Thus, the implications that arise from the existence of strong Good Corporate Governance in a company will affect the relationship of earnings management and earnings quality.

This research focuses on the structure of Good Corporate Governance, through independent commissioners (number of independent commissioners) and audit committees (audit committee expertise). Afshan *et al.,* (2011) analyze whether corporate governance practices have an influence on the quality of published financial information. Their study concluded that earnings management was significantly related to several governance practices by the board of commissioners and the audit committee. In Indonesia, the existence of an independent commissioner is regulated in the OJK (Financial Services Authority) regulation No: KEP - 315 / BEJ / 06 - 2000 which is perfected by decree No: KEP - 339 / BEJ / 07 - 2001 that companies going public must form an independent commissioner whose members are at least 30% of the total members of the board of commissioners. Likewise with the audit committee, which is one of the GCG components that plays an important role in the process of implementing corporate governance. In Indonesia, OJK regulates the membership structure of the audit committee in OJK Regulation No. 55 / POJK.4 / 2015. This regulation requires listed companies to have an audit committee consisting of at least three independent people, one of whom has expertise in accounting and finance. This expertise is expected to make the audit committee able to carry out their duties properly which will further affect the quality of financial reporting, one of which is earnings quality (Kuei et al., 2001).

This study was conducted to examine how the influence of the expertise of the audit committee and the number of independent commissioners on earnings management, and to find out whether the expertise of the audit committee and the number of independent commissioners influence earnings quality through earnings management as an intervening variable.

LITERATURE REVIEW

Agency theory is the theory that underlies the relationship between principals and agents. Jensen and Meckling (1976) defines the relationship between shareholders as principals and company managers (management) as agents. Agency theory assumes that each individual is solely motivated by his own interests, giving rise to a conflict of interest between the principal and the agent. Principals as owners want a large return on investment they invest in the company, while agents want the interests of compensation or a large amount of bonuses for their performance. Based on the assumption that each individual has their own motivations so that this allows a conflict of interest between the agent and the principal. Incompatibility of behavior or goals between the owner and manager of the company which is called the agency cost in the agency relationship.

Earnings management practices cannot be separated from the existence of agency theory and information asymmetry. Managers as managers of the company know more about internal information and prospects of the company in the future than the owner (shareholders) or outside parties of the company. This information imbalance is called information asymmetry, which is used by agents to hide some information that is not known by the principal, which then encourages or motivates management (agents) to take earnings management actions, thus presenting irrelevant information. With this information asymmetry, the agent (management) can be more flexible in influencing the accounting numbers presented in the financial statements to maximize the interests of the agent (management) by way of earnings management (Mohd Radzi et al., 2011).

Positive theory aims to explain the accounting phenomenon that is observed based on the reasons that cause an event. This theory can be interpreted to explain why accounting policies become a problem for companies and parties with an interest in financial statements, and to predict accounting policies that companies want to choose under certain conditions (Dechow, 2006). With this approach, it is expected to produce valid predictions and be able to provide answers to these phenomena. In a positive theory, there are three hypotheses in positive accounting theory that are used to test a person's ethical behavior in preparing financial statements, namely: maximizing bonuses, meeting certain requirements in debt contracts, and politics.

According to Black et al., (2000) earnings management is management behavior in choosing certain accounting policies, which aims to influence earnings to achieve a certain goal. Management can use the leeway in using accounting methods, make accounting policies (discretionary accruals) that can accelerate, or delay costs and funding, so that the company's profits are smaller or larger in line with expectations. . The accrual accounting system as in general accepted accounting principles provides an opportunity for managers to make accounting considerations that will affect reported earnings. Accrual is the difference in earnings with operating cash flow. The greater the difference, the difference is due to the accrual aspect or accounting policy. In

this case income can be manipulated through discretionary accruals. According to Hassan (2012) several motivations that encourage management to manage earnings are tax motivation, CEO turnover, initial stock offering, capital market motivation.

Good corporate governance is closely related to how to make investors confident that managers will benefit them and managers will not steal or embezzle or invest funds from investors for unprofitable projects. Good corporate governance is a concept based on agency theory, which arises as a result of parties involved in companies that have different interests. The existence of good corporate governance is expected to function as a tool to provide confidence to investors that they will receive an appropriate return on the funds they have invested (Ibrahim & Samad, 2011).

The existence of an independent board of commissioners is needed to encourage the application of good corporate governance principles and practices in the company. In the General Guidelines of GCG in Indonesia published in 2006, the monitoring function of the board of commissioners is expected to be more effective in protecting the interests of minority shareholders with the existence of regulations regarding the composition of the board of commissioners from outside (independent). The composition of the board of commissioners is one of the characteristics of the board related to the information content of earnings. Through its role in carrying out the supervisory function, the composition of the board can influence management in preparing financial reports so that a quality earnings report can be obtained (De Vlaminck & Sarens, 2013;
Robinso & Owens-Jackson, 2010)

The audit committee is one element in the concept of Good Corporate Governance which is expected to be able to make a high contribution in the level of implementation according to National Committee on Corporate Governance Policy. Neswari and Priyadi (2017)states the audit committee contributes to the quality of financial reporting through oversight of the financial reporting process including the internal control system and the use of generally accepted accounting principles, and oversees the overall audit process. So that it can reduce improper accounting measurements and management fraud. From this explanation it can be concluded that the audit committee can reduce earnings management which will further affect the quality of financial reporting, one of which is earnings quality.

Financial statements that describe the company's operational profitability correctly and accurately, can be said to have good earnings quality. Profit is said to be of high quality if reported earnings can be used by its users to make the best decisions. That is, quality reports have a low level of earnings management, so that earnings information in financial statements can be relied upon. Guerreiro et al., (2008) defines earnings quality as the ability of earnings to reflect the truth of a company's earnings and help predict future earnings. This is because earnings quality is an aspect that can be used to evaluate the financial health of a company.

HYPOTHESIS DEVELOPMENT

Effect of Audit Committee Expertise on Profit Management

The audit committee is one of the elements in the concept of Good Corporate Governance that is able to make a high contribution in its implementation (National Committee on Corporate Governance Policy (KNKG, 2001). Its presence is expected to improve the quality of corporate internal supervision, specifically the quality of financial reporting. In accordance with regulations made by OJK that audit committee membership must contain at least one member who has accounting and financial expertise, it is hoped that supervision by the audit committee can be more effective in reducing earnings management. Beasley (1996) said that audit committee expertise has a negative effect on earnings management. The more an audit committee is skilled in accounting or finance, the better it is at analyzing financial statements, the more quality the financial statements are presented, so the better the quality of the profits. This is supported by the results of research by Iyoha and Oyerinde (2010) concluding that audit committee members who have accounting and financial expertise will be easier to detect earnings management. Based on previous researchers, the hypotheses proposed in this study are:

H_1: Audit committee expertise has a negative effect on earnings management

Effect of Proportion of Independent Commissioners on Profit Management

In general, independent boards of commissioners have better supervision of managers so that they are able to influence the possibility of irregularities by managers. Jensen & Meckling (1976) which states that agency theory supports the statement that to increase the independence of the board, the board must be dominated by parties from outside the company. In accordance with applicable regulations that public companies must form an independent commissioner whose members are at least 30% of the total members of the board of commissioners. Abdulmalik and Ahmad (2016) in their research said that the number of independent commissioners had a negative effect on earnings management. The greater the proportion of independent commissioners, the smaller the earnings management. Research by Anglin et al. (2011) that the increasing proportion of the board of commissioners from outside the company can reduce earnings management within the company. Based on agency theory, the greater the number of independent commissioners, the better the independent commissioners can fulfill their role in overseeing and controlling the actions of executives. Based on previous researchers, the hypotheses proposed in this study are:

H_2: The number of independent directors has a negative effect on earnings management

Effect of Earnings Management on Earnings Quality

Clout & Willett (2016) conducted a test between earnings management and good corporate governance on earnings quality having a significant influence. In accordance with agency theory, management tends to choose methods to increase profits according to its motivation. This will affect the quality of reported earnings, because it does not reflect the actual condition of the company. Xiong (2016) concluded earnings management had a negative effect on earnings quality. The lower the earnings management carried out by company management, the higher the profit quality. In the research of Abdulmalik and Ahmad (2016) said that earnings management affects earnings quality. This is because the quality of earnings reflects the company's current financial condition and can be used to predict financial conditions in the future. If the financial statements do not present the actual financial condition of the company, as a result the quality of reported earnings is low. Based on previous researchers, the hypotheses proposed in this study are:

H_3: Earnings management negatively affects earnings quality

Effect of Audit Committee Expertise on Earning Quality

The presence of the audit committee is expected to improve the quality of the company's internal supervision, specifically the quality of financial reporting. Audit committees with accounting and financial expertise will be better at analyzing financial statements. So that it can reduce the measurement and recognition of accounting that is not right, and detect earnings management. From this explanation it can be concluded that the audit committee can reduce earnings management which will further affect the quality of financial reporting, one of which is earnings quality. Research by Davidson et al. (2005) that earnings reported by companies that form audit committees (in accordance with applicable regulations) have better earnings quality than earnings reported by companies that do not form audit committees. This is supported by the results of Saitri (2016) which states that the expertise of the audit committee has a negative effect on earnings management. Thus it can be said that the expertise of the audit committee is able to improve earnings quality by reducing the level of earnings management. Based on previous researchers, the hypotheses proposed in this study are:

H_4: Audit committee expertise has a positive effect on earnings quality

Effect of Number of Independent Commissioners on Earning Quality

Lambert (2006)state that agency theory supports the statement that to increase the independence of the board, the board must be dominated by parties from outside the company. The role of independent commissioners is expected to minimize agency problems that arise between the board of directors and shareholders. Through its role in carrying out its supervisory function, the high number of independent directors can influence management in preparing financial reports so that a quality earnings report can be obtained. Al Daoud et al. (2015) compared companies that did fraud with companies that did not do cheating; they found that companies that did fraud had a significantly lower percentage of the board of commissioners compared to companies that did not commit fraud. This is supported by Lestari and Pamudji (2013)stating that an effective supervisory function by an independent commissioner is able to reduce earnings management which then causes financial statements to be more reliable, so earnings information becomes quality. Based on previous researchers, the hypotheses proposed in this study are:

H_5: The number of independent directors has a positive effect on earnings quality

Effect of Audit Committee Expertise on Earnings Quality with Earnings Management as an Intervening Variable

Some research concluded that audit committee members who have accounting and financial expertise would be easier to detect earnings management. This is supported by which states that audit committee expertise has a negative effect on earnings management. The more an audit committee is skilled in accounting or finance, the better it is at analyzing financial statements, the more quality the financial statements are presented, so the better the quality of the profits. This means that the expertise of the audit committee can minimize earnings management in a company, which in turn affects the quality of financial reporting, one of which is earnings quality. This is in accordance with Kang & Kim (2011) said that earnings reported by companies that form audit committees (in accordance with applicable regulations) have better earnings quality than earnings reported by companies that do not form audit committees. Based on previous researchers, the hypotheses proposed in this study are:

H_6: Audit committee expertise has a positive effect on earnings quality with earnings management as an intervening variable

Effect of Number of Independent Commissioners on Earnings Quality with Earnings Management as an Intervening Variable

Previous researchers have consistently concluded that companies with a higher percentage of independent commissioners will be able to reduce earnings management practices. A higher proportion of independent commissioners is expected to encourage a more effective oversight function, thereby reducing earnings management practices within the company and producing quality earnings. Agrawal & Chadha (2005) states that the independence of the board of commissioners has a significant effect on earnings management. This is supported by Dechow et al. (2010) saying that the number of independent commissioners has a negative effect on earnings management, so as to improve earnings quality.

H_7: The number of independent directors has a positive effect on earnings quality with earnings management as an intervening variable**RESEARCH FRAMEWORK**

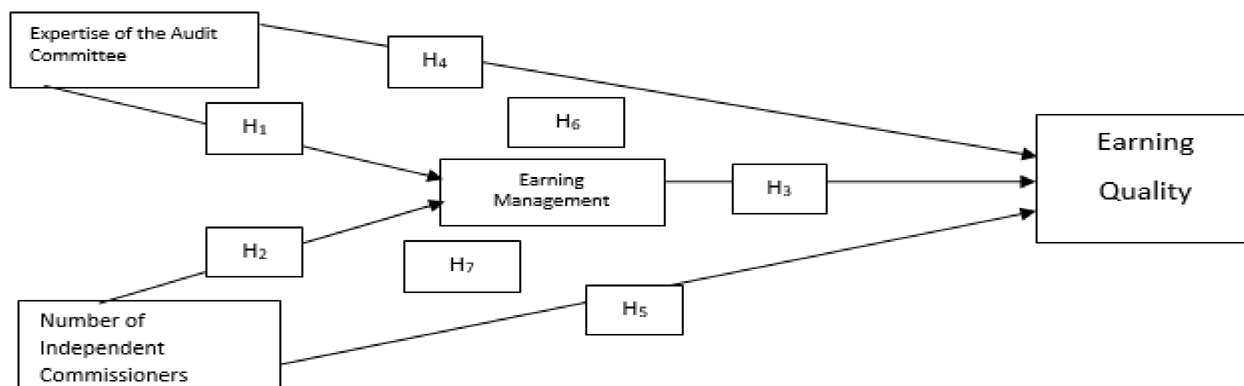

Table 1 Variables, Operational Definitions and Measurements

Variables	Operational Definition	Measurement
Expertise of the Audit Committee	Independent Variable	Accounting and financial background=1 and for others=0
Number of Independent Commissioners	Independent Variable	Total all independent commissioners from outside the company divided by the total number of commissioners
Earning Management	Intervening Variable	Modified Jones (1991) modified by Dechow et al. (1995) use Total Accruals (TACC) = Net income after tax (net income) - Cash flow from operating activities (operating cash flow)
Earning Quality	Dependent Variable	Quality of Accrual= (Operating Profit-Cash FLow Operation) / (Average Assets)

RESEARCH RESULT AND DISCUSSION

The object of this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX) in a row in 2015 to 2018. This study took samples with a purposive sampling method, which is in accordance with predetermined criteria. There are 184 manufacturing companies listed on the IDX, of which only 46 have met the sample criteria used in this study.

Table 2 Sample Selection Results

Description	Number of Company
Manufacturing companies listed on the IDX during 2015-2018	157
Manufacturing companies did not publish consecutive financial statements from 2015 to 2018	(33)
Manufacturing companies that suffered losses during the 2015 to 2018 research period	(73)
Manufacturing companies whose annual reports do not use the value of the rupiah during the period of 2015 to 2018	(5)
Companies that meet the criteria for sampling	46
The number of observations used in the study 4 years	184

Hypothesis Testing Results

Hypothesis Testing aims to determine the direct effect of independent variables on the dependent variable and indirect effect using intervening variables seen from the value of the beta coefficient (β) between variables and the level of probability (P). The results of hypothesis testing using WarpPLS 6.0 are shown in the figure 2.

For H_1 hypothesis testing results show that the expertise of the audit committee does not have a significant effect on earnings management with a significance value of P-value 0.30 (≥0.05). The results of testing this hypothesis are not in accordance with

the H1 hypothesis, which suspects that the expertise of the audit committee influences earnings management, so H_1 is rejected. The results of this hypothesis test are in accordance with Saitri (2016) which states that the expertise of the audit committee has no significant effect on earnings management. This is because the total number of members of the audit committee is an average of 3 people in each company, although it looks relatively large when viewed in terms of the number of personnel, in fact from the average number of audit committee members who have accounting and financial expertise only 1 person, so less effective to reduce earnings management.

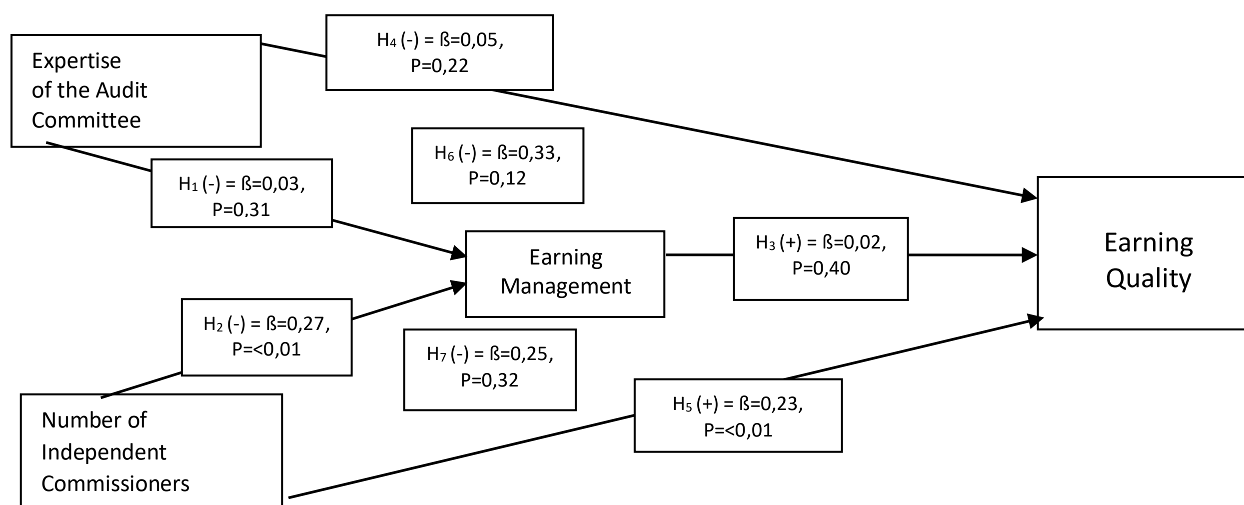

Table 3. Hypothesis Testing Results

Description	Hypothesis	P-Value	Path Coefficient	Result
EAC → EM	H_1	-0,030	0,310	Rejected
NIC → EM	H_2	-0,270	0,001	Accepted
EM → EQ	H_3	+0,020	0,400	Rejected
EAC→ EQ	H_4	-0,050	0,022	Accepted
NIC→ EQ	H_5	+0,023	0,000	Accepted
EAC → EM→EQ	H_6	-0,330	0,320	Rejected
NIC → EM→EQ	H_7	-0,250	0,012	Accepted

Information: * Significant because P_Value ≤ 0.05
Source: WarpPLS6.0 Processing Data

The second hypothesis (H_2) test results show that the number of independent directors has a significant influence on earnings management with a significance value of P-value ≤ 0.01 (<0.05), so the H2 hypothesis is accepted. This means that the role of the independent board of commissioners as part of the corporate governance structure has an influence on earnings management. Companies that consist of a large number of independent directors have strong control over managerial decisions, so it is very possible the number of independent directors can prevent or reduce the occurrence of earnings management in the company (Andini, 2011).

The results of hypothesis testing H_3 indicate that earnings management does not have a significant effect on earnings quality with a significance value of P-value 0.40 (≥0.05). The results of testing this hypothesis are not in accordance with the H3 hypothesis which suggests that earnings management affects earnings quality, so the H3 hypothesis is rejected. The results of hypothesis testing H_3 have not succeeded in providing evidence of a significant influence between earnings management on earnings quality, this indicates the possibility of the influence of other variables besides the variables used in this study.

The results of hypothesis testing H_4 showed that the expertise of the audit committee did not have a significant effect on earnings quality with a significance value of P-value 0.22 (≥0.05). The results of testing this hypothesis are not in accordance with the H_4 hypothesis which suggests that the audit committee's expertise affects the earnings quality, so the H_4 hypothesis is rejected. The results of this hypothesis test are in accordance with Xiong (2016) which states that the expertise of the audit committee has no significant effect on earnings quality. This is because the formation of an audit committee in a company is only a formality to meet applicable regulations, so it is not successful in reducing earnings management, and improving earnings quality.

The fifth hypothesis (H_5) test results show that the number of independent directors has a significant influence on earnings quality with a significance value of P-value ≤ 0.01 this means ≤ 0.05, so the H_5 hypothesis is accepted. The results of this hypothesis test support the results of research by Rouf (2011)which states that the greater the number of independent commissioners will lead to

decreased earnings management, so that earnings quality is higher. Hypothesis sixth (H_6) earnings management has not been proven to mediate between the audit committee expertise variables of the earnings quality variable. This is because earnings management as an intervening variable does not significantly influence earnings quality.

According to agency theory, the practice of corporate governance has a significant relationship to earnings management, because of the opportunistic nature of management that results in lower earnings quality. This can be overcome by better corporate governance. The independence of the board of commissioners had a significant effect on earnings management. That is, the large number of independent directors can reduce earnings management, thereby increasing earnings quality. However, the results of this hypothesis test are not in accordance with the statement. The failure of the H_7 hypothesis test, probably caused by the influence of other variables not used in this study. So that researchers have not been able to prove that the number of independent directors influences earnings quality through earnings management as an intervening variable. Finally the results of hypothesis testing H_7 showed earnings management has not been proven to mediate between the variable number of independent directors and earnings quality. This is because earnings management as an intervening variable does not significantly influence earnings quality.

CONCLUSION AND RECOMMENDATION

The following conclusions are drawn from the research finding: audit committee expertise has a negative and not significant effect on earnings management. This shows that the expertise of the audit committee can reduce earnings management, but has not given significant results. This is because the formation of an audit committee is only a form of formality, an audit committee, have not been effective enough to reduce earnings management and create good corporate governance.

The number of independent directors has a negative and significant effect on earnings management. This shows that more and more independent commissioners in companies have succeeded in reducing earnings management. This matter means regarding the existence of independent commissioners have proven to be effective in overseeing the quality of financial reporting in order to limit earnings management. Earnings management has a positive but not significant effect on earnings quality. This means there are still companies that are indicated to do earnings management. This may be because the users of financial statements still assume that reported earnings reflect the performance of the company's management. This means that earnings management is difficult for external parties to detect. This shows the possibility of the influence of other variables besides the variables used in this study.

The expertise of the audit committee has a negative and not significant effect on earnings quality. This shows that the formation of an audit committee in a company is only a formality to comply with applicable regulations, so that it is considered a failure as a function of supervision in the preparation of quality financial statements. The number of independent directors has a negative and significant effect on earnings quality. This shows that the effect of the number of independent directors on earnings quality is inversely proportional to the effect of the number of independent directors on earnings management. The greater the number of independent directors, the less likely there is earnings management will lead to decreased earnings management. Earnings management has not been proven to mediate between the audit committee expertise variables of the earnings quality variable. This is because earnings management as an intervening variable does not significantly influence earnings quality. Earnings management has not been proven to mediate between the variable number of independent directors and earnings quality. This is because earnings management as an intervening variable does not significantly influence earnings quality.

LIMITATIONS AND SUGGESTIONS

This study only uses two variables: the expertise of the audit committee and the number of independent commissioners. In addition, the measurement of earnings quality only uses 1 (one) indicator, namely accrual quality. Future studies are suggested to add independent variables such as: company size, auditor switching, and size of public accountant firms that may be have a stronger relationship to the dependent variable, so that it can better explain its effect on earnings management and earnings quality. For example adding the auditor quality variable, because the supervision of the board of commissioners and the audit committee will be more effective, if the company has good auditor quality. Future studies are also suggested using more competent indicators to measure earnings quality. For example, using Bellavory's (2005) earnings quality indicator, because only a few of the previous researchers used this indicator.

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