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The role of the audit committee to increase the influence of audit quality and internal control on earnings management

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Abstract. This study aims to analyze the effect of audit quality and internal control on earnings management and the role of the audit committee as moderating variable in consumer goods manufacturing companies listed on The Indonesia Stock Exchange for the period 2015 to 2019. The novelty of this study is the measurement of audit quality with a score approach that represents the competence and independence dimensions of audit quality. In addition, the measurement of internal control uses the COSO score.The purposive sampling method resulted in 165 firms-years for analysis. The analytical method used is multiple regression with moderating variables using panel data. Based on the test results, it was found that audit quality has a negative effect on earnings management. Meanwhile, internal control has no effect on earnings management. Furthermore, the results of this study also found that the audit committee was unable to moderate the effect of audit quality and internal control on earnings management.

Keywords. Audit Quality, Internal Control, Audit Committee, Earnings Management

1. Introduction

The Company's management is accountable to stakeholders through financial reporting. This financial report is information that will be used by shareholders and potential investors to make decisions regarding future investments. This financial statement information is also used by shareholders as one of the information to assess management performance. Therefore, the financial statements should reflect the actual financial condition of the company. The occurrence of differences in information or information asymmetry between company's management and company's shareholders can result in various problems. For example, fraud committed by management is related to the existence of certain management interests, by conducting earnings management.

Earnings management is a management intervention in the financial reporting process to external parties with the aim of obtaining personal gain (Schipper, 1989). Audit aims to improve the quality of financial reports as indicated by the low level of earnings management. Therefore, it can be said that a quality audit will be able to suppress the level of earnings management in the financial statements. Several previous studies have tested the effect of audit quality on earnings management, but the results of this previous study are still inconsistent because there

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are differences in results. Therefore, it is still necessary to conduct research on the effect of audit quality on earnings management.

Several previous research results found that audit quality has a negative effect on earnings management (Lin & Hwang, 2010; Gerayli et al., 2011; Ahmadzade et al., 2012; Kaklar, 2012; Kraub & Zulch, 2013; Zuo & Guan, 2014; Okolie, 2014). Meanwhile, several other research results did not find the effect of audit quality on earnings management (Chen et al., 2004; Yeganeh et al., 2012; Yasar, 2013; Moeinadin et al., 2013; Inaam & Khamaoussi, 2016; Habbash & Alghamdi, 2017; Yasser & Soliman, 2018;).

Research conducted by Chen (2016) on the effect of internal control on earnings management found that internal control has a negative effect on earnings management. The results of this study are supported by research conducted by Salehi & Bahrami (2016) and Chen et al. (2018) who found a negative effect of internal control on earnings management. Meanwhile, Jahmani & Niranjan (2015) found that effective internal control can increase the reliability of financial reports and reduce earnings management. Furthermore, Kewo & Afiah (2017) found that the internal control system has a positive effect on the quality of financial reports.

To limit the discretion exercised by corporate managers, one form of control mechanism implemented in the board of directors is the audit committee. Therefore, the majority of regulatory bodies (ruling bodies) have recommended the establishment of an adequate number, independent, competent and active audit committee (Amar, 2014). Previous research has found that the independence of the audit committee has a negative effect on earnings management (Ayemere & Elijah, 2015; Chandrasegaram et al., 2013; Bala & Kumai, 2015). Furthermore, other studies have found that audit committee size has a negative effect on earnings management (Saleh & Haat, 2014; Bala & Kumai, 2015; Ayemere & Elijah, 2015).

The results of research on the relationship between audit committee expertise and earnings management conclude that the expertise of audit committee members has a negative effect on the amount of earnings management (Badolato et al., 2014). Likewise, the results of research on audit committee meetings found that the frequency of audit committee meetings has a negative effect on earnings management (Suarez et al., 2013; Bala & Kumai, 2015). Based on the results of this study, it can be seen that the audit committee has a negative relationship with earnings management. Furthermore, the results of research on the effect of audit quality and internal control on earnings management that have been previously described also show a negative effect. Therefore, it can be concluded that the audit committee will strengthen the influence of audit quality and internal control on earnings management.

2. Literature review

2.1. Agency Theory

The company is a collection of contracts between shareholders or owners (principle) and managers (agents), where managers perform services for the interests of the principal, including delegating power to managers to make decisions (Jensen & Meckling, 1976). This theory assumes that each individual involved in the contract is aimed at maximizing their respective interests.

The existence of differences in information (information asymmetry) between management and shareholders can cause various problems. Management has the potential to take actions with the aim of fulfilling certain interests by ignoring the interests of the company's shareholders. Among the actions taken by management are by performing earnings management in the company's financial statements (earnings management).

Furthermore, shareholders will find it difficult to control the earnings management actions because shareholders only have little information. Therefore, shareholders need a supervisory mechanism that can be done to reduce the problems of earnings management. These mechanisms include the use of external auditors and the existence of an effective internal control system and audit committee as part of good governance.

Various methods are used to minimize agency costs, for example by implementing a monitoring or monitoring mechanism (Jensen & Meckling, 1976). The use of independent external auditors is a market-driven mechanism aimed at reducing agency costs (Jensen & Meckling, 1976; Watts & Zimmerman, 1990). Shareholders hope that the existence of a qualified external auditor will be able to reduce the possibility of moral hazard by management, so that the agency costs borne by shareholders can be reduced. Furthermore, other monitoring mechanisms that are part of good governance are the existence of an internal control system implemented by the company and the existence of an effective audit committee.

2.2. Theory of Regulation

Stigler's (1971) regulatory theory states that the determination of regulations is a combination of political power from interested groups from the demand side, and the legislature from the supply side. This theory argues that rules or provisions in accounting are needed. The government plays a role in regulating the provisions on what companies must do in determining information. Provisions are needed so that users and presenters of information get the same and balanced information.

Regulatory theory shows the results of public demands for corrections to market failures. In this theory, the central authority, including the supervisory body, is considered to have the best interests in the hearts of the people. Regulations made by governments are seen as a trade-off between regulatory costs and social benefits. Governments in many countries have established regulatory bodies that work independently and strive to produce high quality accounting standards that will meet the needs of users of financial reports in making decisions.

Earnings management is a process for taking certain steps that are deliberate and still within the limits of generally accepted accounting principles with the aim of generating the level of earnings expected to be reported in the company's financial statements (Davidson, et al., 2004). As previously explained, regulators require the preparation and presentation of financial statements in accordance with applicable accounting standards. Therefore, the preparation and presentation of financial statements of companies listed on the Indonesia Stock Exchange must be based on Financial Accounting Standards (SAK) issued by IAI.

2.3. Audit Quality

Audit quality is the combined probability of an auditor's ability to find irregularities in client financial reporting and to report these deviations (DeAngelo, 1981). Previous researchers concluded that there is no single measure of certain characteristics that can represent a complete measurement of audit quality. This is because the quality of the audit is multidimensional (Bamber & Bamber, 2009; Francis, 2004).

So far, the measurement of audit quality has often used a single measurement or a joint test of several measurements that only represent one dimension of audit quality, for example the size of KAP (Zhou & Elder, 2001; Jordan et al., 2010; Kaklar, 2012; Moeinadin et al. al., 2013; Zuo & Guan, 2014), specialized industry auditors (Zhou & Elder, 2001; Balsam et al., 2003; Chen, KY, et al., 2006; Hajiha & Neda, 2012; Ahmadzade et al., 2012), audit tenure (Ghosh & Moon, 2003; Kraub & Zulch, 2013; Okolie, 2014), auditor independence (Reynolds

& Francis, 2001 and Craswell et al., 2002), and going concern audit opinion reporting (Geiger & Rama 2006; Bartov et al., 2000).

This study develops an audit quality measurement that includes the competency and independence dimensions, which are the audit quality measures that have been widely used in previous studies. This competency dimension consists of KAP size (big four), specialized industry auditors, and audit tenure. Meanwhile, the independence dimension consists of auditor independence (client importance) and going concern audit opinion reporting. This measurement is called the Audit Quality Score or abbreviated as AQS, done by adding up the scores of the five dimensions of competence and independence.

2.4. Internal Control

According to the COSO (Committee of Sponsoring Organizations of the Treadway Commission), internal control is the process of providing reasonable assurance to achieve goals. In particular, these controls help to achieve objectives relating to the reliability of financial reporting, compliance with laws and regulations, and effectiveness and efficiency of operations (Hubbard, 2003). There are five components in COSO's (2011) internal control framework, all of which it is management's responsibility to do. The five components of internal control are the control environment, risk assessment, control activities, information and communication, and monitoring activities.

The previous internal control score model used by Dewayanto et al. (2017) in seeing the effectiveness of internal control. In contrast to the research of Dewayanto et al. (2017), the scoring model in this study was developed using illustrative tools from COSO (2012) on the company's annual report. Botosan (1997) uses a disclosure index in assessing the level of corporate disclosure. Annual reports are generally considered to be one of the most important sources of company information (Botosan, 1997).

COSO (2012C) published the illustrative tools as a guide that organizations will use to assess the effectiveness of their internal controls, including examples for each component, principles and all evaluations of internal control (Martin et al. 2014). Illustrative tools developed by COSO (2012) detail principles of evaluation templates for each category of each of the 5 elements of internal control. The overall principles of evaluation, which are details of these elements of control, consist of 17 principles, each of which contains detailed sub-section questions.

2.5. Audit Committee

The audit committee is a part or device of the board of directors that is responsible for the company's financial reporting. The audit committee's responsibilities include financial reporting, including internal control, auditing and supervision of other actions, such as activities in facilitating communication between the board and external auditors (DeZoort, 1998). Companies whose shares have been listed on the stock exchange are required to comply with applicable capital market regulations. The board of commissioners of a company is required to form committees under it according to the needs based on the applicable regulations to assist the board of commissioners in carrying out its responsibilities and authorities effectively.

Fama & Jensen (1983) stated that the credibility and transparency of the financial statements of a company depends on the effectiveness of the supervisory mechanisms implemented by the company. However, the problem is that even though the audit committee exists within a company, there are still several cases of manipulation of financial statements. It is assumed that the existence of an audit committee alone is not sufficient to mitigate the tendency of management to manipulate financial statements.

Therefore, the current attention is not only on the formation of an audit committee, but the extent to which the audit committee is effective in increasing stakeholder confidence in the financial statements. Several studies, including Klein (2002) have recommended that there are a number of important attributes that must be met in order for an audit committee to achieve its objectives effectively. These attributes include the independence of the audit committee, the size of the audit committee, the activities of the audit committee, and the expertise of the audit committee.

2.6. Earnings Management

Earnings management can be viewed as a product that occurs as a result or strategic implication in solving agency problems between stakeholders and managers (Jensen & Meckling, 1976). For example, shareholders want the manager to maximize share price, and in many ways, this is positively related to profit. Therefore, shareholders will design a performance measurement system and a compensation contract by linking the manager's compensation to accounting numbers. Although the contract is considered important to reduce agency costs, it creates incentives for managers to manipulate company profits in order to meet certain profit targets or even ignore the interests of certain shareholders (Healy & Wahlen, 1999).

Watts & Zimmerman (1990) states that earnings management occurs when managers have discretionary behavior in relation to accounting numbers, either with or without limitations, and this behavior can be adopted to maximize firm value. Meanwhile, Davidson, et al. (2004) stated that earnings management is a process of taking deliberate steps that are still within the limits of generally accepted accounting principles to produce the level of earnings expected to be reported.

Previous studies have demonstrated various measurement methods for estimating earnings management or discretionary accruals. These methods are the Healy model (1985), DeAngelo model (1986), the Jones model (1991), the Industry model (1991), the Modified Jones model (1995), the Dechow-Dichev model (2002), the Kothari model (2005), and the Stubben model (2010). Research conducted by Stubben (2010) provides evidence that the revenue model is less biased, more specific, and stronger than the accrual model. The use of revenue models in detecting earnings management can also be applied to companies in Indonesia, but there have not been many studies using this model because it is a new model that can be used in detecting earnings management.

2.7. Hypotheses

DeAngelo (1981) states that audit quality can be seen from the size of the KAP (auditor size) that conducts the audit. It is perceived that the big four KAP will conduct audits of higher quality than the non-big four KAP. Several previous studies have found that KAP size is negatively related to earnings management as measured by discretionary accruals (Chen et al., 2005; Lin & Hwang, 2010; Gerayli et al., 2011; Inaam et al., 2012; Kaklar et al., 2012; Zuo & Guan, 2014).

Research conducted by Zhou & Elder (2001) concluded that auditor industry specialization hinders earnings management. Then Chen et al. (2006) found that auditors' industry specialization is related to earnings management. Balsam et al. (2003) concluded that

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discretionary accruals are lower when using specialist auditors where industrial specialty auditors are associated with higher earnings quality compared to non-specialist.

Kaklar et al. (2012) and Moeinadin et al. (2013) found that audit tenure is not related to discretionary accruals. However, it is different with the results of research by Kraub & Zulch (2013) which indicate that audit tenure has a negative effect on audit quality as proxied by discretionary accruals. These results are then also reinforced by the results of research by Okolie (2014) which found that audit tenure has a negative effect on discretionary accruals.

Auditor independence is measured using client importance to test whether auditors have an economic dependence on their clients (Reynolds & Francis, 2001; Francis & Yu, 2009; Chen et al., 2010). If the auditor has more than one client, the financial dependence on one client will be reduced (DeAngelo, 1981). Research conducted by Lin & Hwang (2010) found that auditor independence has a positive effect on earnings management. While Gerayli et al. (2011) and Okolie (2014) found that auditor independence has a negative effect on earnings management as measured by discretionary accruals.

The willingness of auditors to report the occurrence of client survival problems in a going concern opinion shows the independence of the auditor (DeAngelo, 1981; Francis, 2004). Previous studies investigating the relationship between willingness and accuracy of reporting going-concern audit opinion and earnings quality have been inconsistent (eg Geiger & Rama, 2006; Bartov et al., 2000). Previous research has found evidence that big four accounting firms have a higher level of going concern opinion reporting accuracy than non-big four accounting firms (Francis, 2004; Geiger & Rama, 2006).

Based on the explanation of the research results above, it can be concluded that a quality audit will reduce the occurrence of earnings management in the company's financial statements. This is because audits carried out by competent and independent auditors tend to be better at detecting errors or irregularities in the company's financial statements. Therefore, the hypothesis proposed in this study are as follows:

H1: Audit quality has a negative effect on earnings management

Internal control is designed to help achieve reliable financial reporting, compliance with laws and regulations, and to help achieve effectiveness and efficiency of operations within the company (Hubbard, 2003). A good internal control system will increase the reliability of financial statements and therefore will hinder the occurrence of earnings management in the company's financial statements.

Research conducted by Kewo & Afiah (2011) found that the internal control system has a positive effect on the quality of financial reports. Furthermore, the research results of Jahmani & Niranjan (2015) found that effective internal control will increase the reliability of financial statements and reduce earnings management. This is because the existence of effective internal control will encourage the creation of an internal mechanism that can limit management discretion in the preparation of corporate financial statements.

Research conducted by Van de Poel, K. & Vanstraelen, A. (2011) found that accrual quality has no effect on the description of the internal control system. However, research conducted by Chen (2016) found that internal control has a negative effect on discretionary accruals. The results of this study are reinforced by the results of research conducted by Salehi & Bahrami (2016) and Chen et al. (2018) who found that internal control has a negative effect on earnings management.

Based on the explanation above, it can be seen that with the existence of effective internal control in the company it will be able to help increase the reliability of the company's

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financial reporting. Furthermore, effective internal control will help reduce the occurrence of earnings management in the company's financial statements. In other words, the more effective internal control is applied, the lower the likelihood of earning management in the company's financial statements. Therefore, the hypothesis proposed is as follows:

H2: Internal control has a negative effect on earnings management

The effect of audit quality on the level of earnings management is also determined by the corporate governance factors applied in the company. The better the governance that is carried out in the company, the demand for better audit quality will increase. Therefore, the governance system applied to the company can increase the role of quality audits in suppressing earnings management. This indicates that when a company has a good governance system, a quality audit will play a greater role in preventing earnings management. This argument suggests that the governance system associated with the audit committee will positively influence the relationship between audit quality and earnings management

On the other hand, there is an argument which says that if the governance system is bad, the existence of a quality audit will actually play a big role in reducing the level of earnings management in the company. This means that when the governance system is poor, the existence of a quality audit will be a substitute for a worsening governance system, so that the role of quality audits in reducing earnings management will be even greater. This argument suggests that the governance system associated with the audit committee will negatively affect the relationship between audit quality and earnings management.

Based on the descriptions above, in this study it is assumed that the company's audit committee will affect the relationship between audit quality and earnings management in the company's financial statements. Therefore, the hypothesis put forward is as follows:

H3: The audit committee moderates the effect of audit quality on earnings management

The internal control system in the company will affect the flexibility of management to manipulate financial performance, which in turn will affect the level of earnings management that occurs in the financial statements. The effect of internal control on the level of earnings management is also determined by the corporate governance factors applied in company (Chen, 2016). The better the governance that is carried out in the company, the demand for effective control will increase.

Therefore, the governance system applied to the company can increase the role of internal control in suppressing the occurrence of earnings management (Chen, 2016). This means that when a company has a good governance system, internal control will play a better role in preventing earnings management. This argument suggests that the governance system associated with the audit committee will positively influence the relationship between internal control and earnings management.

On the other hand, there is an argument which says that if the governance system is bad, then the existence of a good internal control system will actually play a big role in suppressing the level of earnings management in the company. This means that when the governance system is bad, the existence of a good internal control system will be a substitute for a worsening governance system, so that the role of a good internal control system will be even greater in reducing earnings management in financial statements.

The above arguments indicate that the governance system associated with the audit committee will negatively affect the relationship between internal control and earnings management. Thus, in this study it is assumed that the company's audit committee will affect the relationship between internal control implemented by the company and earnings management in the company's financial statements. Therefore, the hypothesis put forward is as follows:

H4: The audit committee moderates the effect of internal control on earnings management

3. Methods

3.1. Sample

The sample used in this research is manufacturing companies in the consumer goods industry sector that have gone public and their stocks have been listed on the Indonesia Stock Exchange (IDX) from 2015 to 2019. Data collection for 5 years is based on the need for analysis with using the weighted least square estimation method that requires a lot of data, and for the purposes of calculating several variables that require data from the previous and following years. Sampling in this study was carried out by purposive sampling method, namely the sampling technique with certain criteria.

3.2. Operational Definition and Variable Measurement

3.2.1. Earnings Management

Earnings management, in this case is defined as management's intervention in the financial reporting process to external parties with the aim of obtaining personal benefits (Schipper, 1989). Earnings management involves accounting practices that follow accounting standards and rules, but the essence is that they deviate from the spirit of these standards and rules. To determine the amount of earnings management, this study uses the conditional revenue model from Stubben (2010). This model was chosen because it is still a new model and not many studies in Indonesia have used this model. The conditional revenue model equation is as follows:

Conditional Revenue Model:

$$\Delta AR_{it} = \alpha + \beta_1 \Delta R_{it} + \beta_2 \Delta R_{it} \times SIZE_{it} + \beta_3 \Delta R_{it} \times AGE_{it} + \beta_4 \Delta R_{it} \times AGE\_SQ_{it} + \beta_5 \Delta R_{it} \times GRM_{it} + \beta_6 \Delta R_{it} \times GRM\_SQ_{it} + \varepsilon_{it} \quad (3.1)$$

Where:

ΔAR	= changes in accounts receivable
ΔR	= changes in revenues
SIZE	= natural log of total asset at end year
AGE	= company age (years)
GRM	= gross margin
_SQ	= the square of the variable
ε_{it}	= error

3.2.2. Audit Quality

Audit quality is defined as the combined probability of an auditor's ability to find irregularities in the client's financial statements and report these deviations (DeAngelo, 1981). This study will measure the quality of the audit by using the audit quality score or audit quality score. This audit quality score is a combination of several audit quality measures that have been

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used in previous studies, namely KAP size, auditor industry specialization, audit tenure, auditor independence, and going concern audit opinion.

The audit quality score is the total score of the five proxies of audit quality measures consisting of KAP size (Aud_Size), specialized industry auditors (Aud_Spec), tenure audit (Aud_Ten), auditor independence (Aud_Ind), and going concern audit opinion. (Aud_Opn). The procedure for calculating the audit quality score (Aud_Score) is carried out by giving a score of 1 on each proxy if it meets the criteria, and a score of 0 otherwise. Then add up each score from the five proxies for each observation. The maximum score is 5 and the minimum is 0. Here is the formula for calculating the audit quality score (AQS) in this study:

$$\mathbf{AQS = (Aud\_Size + Aud\_Spec + Aud\_Ten + Aud\_Ind + Aud\_Opn)} \qquad \mathbf{(3.2)}$$

Where:
AQS = Audit Quality Score
Aud_Size = big four auditor
Aud_Spec = auditor industry spesialization
Aud_Ten = audit tenure
Aud_Ind = auditor independence
Aud_Opn = going concern opinion

3.2.3. Internal Control

Internal control is defined as a process developed to ensure the achievement of objectives. Illustrative tools detail the principles of evaluation (principles of evaluation templates) for each category of the 5 elements of internal control (COSO, 2012). The overall evaluation principles which are the details of the control elements consist of 17 principles, and in this study, 17 principles will be taken by matching whether each of these questions can be accommodated in the company's annual report.

The score for the disclosure of the elements of internal control uses the value category. Disclosure items will be given a score of 1 (one) if there is disclosure of internal control that is in accordance with COSO's illustrative tools (2012) and vice versa is given 0 (zero) if there is no disclosure of internal control in accordance with COSO's illustrative tools (2012). The entire value of each of the internal control system disclosure assessment criteria is added up to produce a total score for the internal control system disclosure. The total number of questions is 17 (seventeen), so the maximum score is 17 (seventeen) and the minimum is 0 (zero).

3.2.4. Moderating Variable

The moderating variable is a variable that affects, weakens or strengthens the relationship between the independent variable and the dependent variable (Sekaran, 2009). In this study, the moderating variable is the audit committee as measured by the expertise of the audit committee. An expert audit committee is defined as a member of the audit committee who has knowledge and experience in accounting and financial reporting, internal control and auditing (Goodwin, 2003). Audit committee expertise is measured as the ratio between the number of committee members who have educational backgrounds and experience in accounting, auditing and finance to the total number of members of the company's audit committee.

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3.2.5. Control Variables

Control variables are variables controlled by the researcher to eliminate the influence that can disrupt the relationship between the independent variable and the dependent variable. The control variables used in this study are company age, company size, leverage, operating cash flow and profitability.

3.3. Research Model

To measure the extent to which earnings management is affected by audit quality and internal control, for each time the following models are used:

$$\textbf{Dacc\_Rev} = \beta_0 + \beta_1\textbf{Aud\_Score} + \beta_2\textbf{IC\_Score} + \beta_3\textbf{AGE} + \beta_4\textbf{SIZE} + \beta_5\textbf{LEV} + \beta_5\textbf{CFO} + \beta_6\textbf{ROI} + \varepsilon \qquad \textbf{(3.3)}$$

Where:

Dacc_Rev = discretionary accrual
Aud_Score = audit quality score
IC_Score = internal control score
AGE = company age
SIZE = company size
LEV = leverage
CFO = cash flows from operating activities
ROI = return on investment
β = regression coefficient
ε = error term

Meanwhile, to measure the extent to which the audit committee influences the relationship between audit quality and internal control and earnings management, for each time the following models are used:

$$\textbf{Dacc\_Rev} = \beta_0 + \beta_1\textbf{Aud\_Score} + \beta_2\textbf{IC\_Score} + \beta_3(\textbf{Com\_Exp x Aud\_Score}) + \beta_4(\textbf{Com\_Exp x IC\_Score}) + \beta_3\textbf{AGE} + \beta_4\textbf{SIZE} + \beta_5\textbf{LEV} + \beta_5\textbf{CFO} + \beta_6\textbf{ROI} + \varepsilon \qquad \textbf{(3.4)}$$

4. RESULTS AND DISCUSSION

4.1. Normality, Multicollinearity and Heteroscedasticity

The normality test is a statistical test conducted to assess how distributed data is. In this study, the normality test used the Kolmogorov Smirnov. The normality test shows that the Asymp. Sig. (2-tailed) of 0.74, greater than 0.05, this indicates that the data distribution is normal.

The multicollinearity test aims to assess whether there is a correlation or intercorrelation between the independent variables in the regression model. In this study, the multicollinearity test used Variance Inflation Factor (VIF). Based on the multicollinearity test, it shows that there is no multicollinearity problem in the model. This can be seen from all the independent variables where the VIF value <10.

Heteroscedasticity is the variance inequality of the residuals for all observations in the regression model. The purpose of the heteroscedasticity test is to detect any deviations during the linear regression test. In this study, the heteroscedasticity test used was the Harvey test. Heteroscedasticity problem is shown if the probability value at Obs * R-squared <5%. The test results show that there is no heteroscedasticity problem because the probability value at Obs * R-squared> 5%.

Autocorrelation test using Durbin Watson. The Durbin Watson test will produce a Durbin Watson (DW) value which will later be compared with two (2) Durbin Watson Table values, namely Durbin Upper (DU) and Durbin Lower (DL). Autocorrelation is said not to occur if the value of DW> DU and (4-DW)> DU or it can also be denoted by (4-DW)> DU <DW. Based on the Durbin Watson test, it can be concluded that there is no autocorrelation problem.

4.2. Hypothesis Testing

4.2.1. Effect of Audit Quality on Earnings Management

Based on the results of statistical tests in Table 4.1, it shows that the audit quality coefficient is -0.129. The beta sign or test result coefficient is in accordance with the hypothesis proposed in this study where audit quality has a negative effect on earnings management, so the significance test is continued. The test results show the p-value / 2 of 0.026 / 2 <0.05 (alpha 5%), so H1 is accepted. Thus, it is concluded statistically that at the 95% confidence level, audit quality has a negative effect on earnings management.

The results of testing the first hypothesis in this study support agency theory (Jensen & Meckling, 1976). Audit quality is needed in suppressing earnings management. Audit quality is able to reduce opportunistic actions from company management. Based on the test results, it is evident that audit quality as a form of agency fee is able to reduce conflicts of interest between management and company shareholders.

The audit quality measurement proposed in this study by using the audit quality score is able to measure audit quality in reducing earnings management that occurs in the company's financial statements. The results of this study indicate that the measurement of audit quality with a proven score approach can be used as a new alternative in measuring audit quality for future studies.

The results of this study are in line with the findings of Lin & Hwang (2010), Inaam et al. (2012), Kaklar et al. (2012), Zuo & Guan (2014) who found that quality audits can reduce earnings management. Quality audits result from auditors who are competent and independent because they will be better at detecting errors or irregularities in the company's financial statements. Qualified auditors must know and understand issues about certain industries, understand key organizations in the industry, be active in the industry, and be aware of industry issues in different sectors (Omidfar & Moradi, 2015).

Table 4.1 First Model Testing Results

$$\text{Dacc\_Rev} = \beta_0 + \beta_1\text{Aud\_Score} + \beta_2\text{IC\_Score} + \beta_3\text{AGE} + \beta_4\text{SIZE} + \beta_5\text{LEV} + \beta_5\text{CFO} + \beta_6\text{ROI} + \varepsilon$$

Variable	Prediction	Coefficient	Std. Error	Tstat	P-Value	
(Constant)		-3.022	.678	4.459	.000	
AUDSCORE	-	-.129	.058	-2.251	.026	H_1 accepted
ICSCORE	-	-.035	.030	-1.170	.244	H_2 rejected
COMEXP		.016	.250	.062	.951	
AGE		-.006	.003	-1.967	.051	
SIZE		.270	.038	7.045	.000	

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LEV		.760	.216	3.519	.001	
CFO		-.017	.002	-7.098	.000	
ROI		1.190	.530	2.243	.027	
Adjusted R^2		.472				
Uji F		.000				
Significance		5%				

4.2.2. Effect of Internal Control on Earnings Management

Based on the results of statistical testing, it is known that the internal control coefficient is -0.035. The beta sign (coefficient) of this test result is in accordance with the hypothesis proposed in this study where internal control has a negative effect on earnings management, so the significance test is continued. The test results showed a p-value / 2 of 0.244 / 2> 0.05 (alpha 5%), then H2 was rejected. Thus, it is concluded statistically that at the 95% confidence level there is no effect of internal control on earnings management.

This is thought to be because the sample used in this study is not appropriate to reflect the internal control score based on the COSO (2012) internal control disclosure item because the sample used is the consumer goods sector. It is assumed that in these consumer goods companies, the governance mechanism (good corporate governance) has been running well. GCG is a system designed to direct company management in a professional manner based on the principles of transparency, accountability, responsibility, independence, fairness and equality.

Based on descriptive data obtained data that the average age of the company is 44 years. This indicates that the companies that are the samples in this study can be said to be in a stable condition. Companies that are getting older, tend to get bigger so that it is possible to have an internal control mechanism that is already running well (Hope & Langli, 2009). Conversely, if the age of the company is still relatively young, the internal control mechanism is relatively more vulnerable because of low experience, which results in the failure of the company concerned.

Based on the research results, the coefficient (beta) is negative. This coefficient value is in accordance with the expected prediction, but the test results are not significant. Based on these test results, it is assumed that the measurement of internal control scores using the COSO (2012) internal control disclosure item in this study has a scope that is too narrow so that it cannot reduce earnings management.

The results of this study are in line with research conducted by Van de Poel & Vanstraelen (2011) who found that disclosure of internal controls has no effect on earnings management (discretionary accruals). The results of this study are also in line with Chen Tingting (2016) who found that internal control has no effect on earnings management (discretionary accruals) in companies that are in the growth stage.

Table 4.2 Second Model Testing Results

$$\text{Dacc\_Rev} = \beta_0 + \beta_1\text{Aud\_Score} + \beta_2\text{IC\_Score} + \beta_3(\text{Com\_Exp x Aud\_Score}) + \beta_4(\text{Com\_Exp x IC\_Score}) + \beta_3\text{AGE} + \beta_4\text{SIZE} + \beta_5\text{LEV} + \beta_5\text{CFO} + \beta_6\text{ROI} + \varepsilon$$

Variable	Prediction	Coefficient	Std. Error	Tstat	P-Value	
(Constant)		-3.844	1.109	-3.648	.001	
AUDSCORE		.059	.117	.508	.613	
ICSCORE		-.036	.064	-.565	.573	

COMEXP		1.436	2.073	.693	.490	
AUDSCORE*COMEXP	-	-.178	.186	-.956	.341	H_3 rejected
ICSCORE*COMEXP	-	-.027	.138	-.195	.846	H_4 rejected
AGE		-.002	.003	-.741	.460	
SIZE		.264	.036	7.394	.000	
LEV		.597	.177	3.368	.001	
CFO		-.017	.002	8.460	.000	
ROI		.860	.449	1.918	.058	
Adjusted R^2		.571				
Uji F		.000				
Significance		5%				

4.2.3. The Effect of Audit Quality on Earnings Management with the Audit Committee as a Moderating Variable

Based on the test results in Table 4.2, it is known that the audit quality coefficient that is moderated by the audit committee is -0.178. The beta sign (coefficient) is in accordance with the hypothesis proposed in this study where the audit quality which is moderated by the audit committee has a negative effect on earnings management, then the significance test is continued. The results of statistical testing show the p-value / 2 of 0.341 / 2> 0.05 (alpha 5%), so H3 is rejected. It is concluded statistically that at the 95% confidence level the audit committee is not able to strengthen the effect of audit quality on earnings management.

The results of this study indicate that the audit committee has no effect on the role of auditors in suppressing earnings management in the company's financial statements. This means that the role of the audit committee in suppressing corporate earnings management will be the same regardless of the resulting audit quality. The audit committee is unable to act as an audit quality driving mechanism in suppressing earnings management in the company's financial statements. This is thought to be due to the inability of the audit committee to carry out its responsibilities optimally. The audit committee's responsibilities include financial reporting, auditing and supervision of other actions, such as activities to facilitate communication between the board and external auditors (DeZoort, 1998).

One reason may be that the existence of an audit committee is only to fulfill the requirements of the Financial Services Authority Regulation Number 55 / POJK.04 / 2015, which requires that every company listed on the stock exchange is required to have an audit committee whose function is to assist the board of commissioners in carrying out their functions. supervision of company performance. However, the audit committee may not be effective in carrying out its functions so that the presence or absence of an audit committee in the company will not have an effect.

The credibility and transparency of the financial statements of a company depend on the effectiveness of the supervisory mechanisms that the company applies. However, the problem is that even though the audit committee exists within a company, there are still several cases of manipulation of financial statements. It is assumed that the existence of an audit committee alone is not sufficient to mitigate the tendency of management to manipulate financial statements (Fama & Jensen, 1983). Therefore, attention is currently being directed not only to the formation of the audit committee organ, but it is necessary to pay close attention to the extent to which the audit committee is effective in increasing stakeholders' confidence in the financial statements.

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4.2.4. The Effect of Internal Control on Earnings Management with the Audit Committee as a Moderating Variable

Based on the test results, it is known that the coefficient of internal control which is moderated by the audit committee is -0.027. The beta sign (coefficient) is in accordance with the hypothesis proposed in this study where internal control, which is moderated by the Audit Committee, has a negative effect on earnings management, so the significance test is continued. The test results showed that the p-value / 2 was 0.846 / 2> 0.05 (alpha 5%), so H4 was rejected. It is concluded statistically that at the 95% confidence level the audit committee is unable to strengthen the effect of internal control on earnings management.

The results of this study indicate that the existence of an audit committee cannot act as a driving mechanism for the implementation of good internal company controls in suppressing earnings management. This contradicts the results of research by DeZoort (1998) which states that the responsibility of the audit committee is to ensure that the company's internal control runs well. One of the reasons the audit committee variable is unable to moderate the effect of internal control on earnings management may be because the audit committee is more oriented towards regulatory compliance, while the effectiveness of internal control requires participation not only from regulations but also the entire system in the company, including jobs. description and information system.

4.2.5. Control Variables and Earnings Management

Based on the test results, it shows that the age of the company has a coefficient value of -0.006 with a P-value of 0.051. This shows that company age has a negative effect on the occurrence of earnings management in the company's financial statements. The results of this study are in line with research conducted by Gerayli et al. (2011) who found that the longer the company's life, the higher the earnings management that occurs in a company. Companies that have been established for a long time tend to have the experience and ability to manage performance trends from previous periods.

Company size has a coefficient value of 0.270 with a P-value of 0.000. This shows that firm size has a positive effect on earnings management. This result is in line with Gerayli et al. (2011) who found that firm size has a positive effect on earnings management. Large companies have operational activities that are more complex than small companies. Therefore, larger companies have a greater incentive to undertake earnings management than small companies, because these larger companies have a greater political cost.

The leverage coefficient value is 0.760 with a P-value of 0.001. This shows that leverage has a positive effect on earnings management. The results of this study are in line with research conducted by Gerayli et al. (2011) who found that the higher the leverage, the higher the earnings management in a company. Leverage shows how much the company's assets are financed by debt. The higher the leverage, the higher the company's debt. Therefore, based on the results of this study it can be said that the company uses earnings management to meet the achievement of its debt covenants.

The operating cash flow coefficient value is -0.017 with a P-Value of 0.000. This shows that the company's operating cash flow has a negative effect on earnings management. These results are in line with the research conducted by Chen et al. (2005) who found that cash flow has a negative effect on earnings management. Cash flows from operating activities reflect the company's real ability to generate funds. Therefore, if the cash flow from the company's operating activities is high, the motivation to carry out earnings management will decrease. This is because the real company is able to generate sufficient funds so there is no need for earnings management.

The profitability coefficient value is 1.190 with a P-value of 0.027. This shows that the company's profitability has a positive effect on earnings management. The results of this study are in line with research conducted by Gerayli et al. (2011). This proves that profitability has an effect on limiting earnings management. The results of this study indicate that companies with high levels of profitability tend to carry out earnings management.

5. Conclusion

Based on the test results, this study found that audit quality has a negative effect on earnings management. The results of this study support the argument that a competent and independent auditor is better able to reduce earnings management in the company's financial statements. Qualified auditors will know and understand issues about a particular industry, understand the key organizations in the industry, be active in the industry, and be aware of industry issues in different sectors (Omidfar & Moradi, 2015).

Internal control has no effect on earnings management. The results of this study support the argument that although internal control has been designed as best as possible to assist management in carrying out its duties, it will still not be effective. This is presumably because management considers that internal control is a threat or challenge that must be overcome (Sawyer et al., 2005).

The audit committee was unable to moderate the effect of audit quality on earnings management. The audit committee was also unable to moderate the effect of internal control on earnings management. This is allegedly because the audit committee was unable to carry out its responsibilities optimally. The audit committee's responsibilities include financial reporting, auditing and supervision of other actions, such as activities to facilitate communication between the board and external auditors (DeZoort, 1998).

This study provides a theoretical implication that measuring audit quality using audit quality scores can be used as a more comprehensive measure that can add insight to subsequent studies. Agency theory regulates the relationship in the form of a contract between the agent and the principal so that there is no maximization of interests on either party. The results of research on the effect of audit quality on earnings management provide evidence that agency problems can be resolved by audit quality.

The managerial implication of the results of this study for company management is that the measurement of the audit quality score can be considered as a basis for evaluating the quality of information produced by management. Internal control with COSO (2012) is not able to reduce earnings management. Disclosure items with the 17 principles of COSO (2012) need to develop other indicators so that they can be used in measuring internal control.

The results of this study found that the audit committee was unable to moderate the influence of the audit quality and internal control variables on earnings management. This requires that companies have to further enhance their role of governance, especially those related to the external audit function. Good governance will be able to reduce agency problems. For capital market authorities in Indonesia, it is necessary to make rules with clear sanctions related to the effectiveness of the implementation of the audit committee's functions.

The results of this study cannot be generalized to all types of industries and countries. The results of this study only apply to manufacturing companies in the consumer goods industry listed on the Indonesia Stock Exchange during the observation period. This study uses secondary data from the company's annual report, so there is a possibility that the information obtained does not reflect the actual conditions regarding company transparency in disclosing internal control items.

Suggestions for further research are to expand the sample of companies for all industry categories other than the industries sampled in this study. Extending the research horizon in order to obtain more comprehensive data, so as to get better results. COSO's (2012) internal control measurement needs to be expanded on the indicators in each of the disclosure principles of internal control.

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