

The Role of Audit Quality as a Moderator in the Determinants of Earnings Management

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ABSTRACT

Objective: This study aims to analyze the influence of audit committees, free cash flow, and tax planning on earnings management, with audit quality as a moderating variable, specifically in the consumer goods industry sector companies listed on the IDX during 2019-2023. **Method:** A quantitative approach is employed, utilizing multiple linear regression analysis and Moderated Regression Analysis (MRA), with data processed using SPSS 23 software. **Results:** The findings reveal that the audit committee does not significantly affect earnings management, free cash flow has a negative and significant impact, and tax planning shows a positive and significant effect. Audit quality does not moderate the relationship between the audit committee and free cash flow on earnings management, but it negatively moderates the relationship between tax planning and earnings management. **Novelty:** This study introduces tax planning as an independent variable and investigates the role of audit quality as a moderating factor in the context of earnings management, offering new insights into corporate financial practices.

INTRODUCTION

In the rapidly evolving industrial sector and the accelerating pace of globalization, companies are required to adapt quickly in order to survive and stay competitive in the business world. In this era, every company must continuously innovate to ensure the continuity of its business and maintain a competitive edge. Therefore, companies must implement various strategies to achieve the expected profit targets. Additionally, good performance is also crucial to attract investor attention. This can be achieved through the periodic monitoring of high-quality, objective, and transparent financial statements, enabling the company to generate optimal profits and attract investors [1]. Financial statements provide information about profits that can be used to assess the quality of a company based on its profit achievements over a certain period [2]. This information can help communicate relevant data to shareholders and assist management in predicting the company's future profits. Since a company's profit reports are closely scrutinized by stakeholders, this often leads managers to engage in earnings management practices to align financial reports with stakeholder expectations [3]. Earnings management refers to deliberate actions taken by management to adjust financial statements in order to present an optimized profit performance [4].

In Indonesia, earnings management is a common practice that can undermine ethics, morale, and, most importantly, reduce external trust in the integrity of the financial statements [5]. One real-world example of earnings management surfaced in 2019 involving PT. Tiga Pilar Sejahtera Food Tbk (AISA), a consumer goods company

accused of manipulating its 2017 financial statements by inflating its net income. The case arose from its subsidiary, PT. Indo Beras Unggul, which was found guilty of mixing subsidized rice with premium rice. This caused a significant revenue decline of IDR 2 trillion annually. In an effort to restore its image, the management of AISA inflated various accounts in the 2017 financial report, including revenue by IDR 662 billion, accounts receivable and inventory by IDR 4 trillion, and EBITDA by IDR 329 billion. This manipulation was revealed in an investigative report by Ernst & Young (E&Y) commissioned by AISA's new management (CNBC, 2019). Another earnings management case currently under public scrutiny involves PT. Indofarma Tbk (INAF). The case came to light after the Supreme Audit Agency (BPK) issued an Investigative Audit Report for the period of 2020 to the first half of 2023, uncovering financial manipulation that resulted in state losses of IDR 371.8 billion. BPK's findings included fictitious revenue recognition, inflated assets, and disguised financial obligations, misleading shareholders and investors about the company's actual financial condition [6].

These examples indicate that some companies still engage in earnings management practices by significantly altering their financial reports to cover up losses. The information presented in financial reports, particularly related to profits, often does not reflect the actual condition of the company. This is driven by the external perception that profit is the primary measure of a company's performance, which pressures management to present more attractive financial statements through earnings management [7]. In this context, the audit committee plays a crucial role in preventing such practices. The audit committee is responsible for overseeing the effectiveness of financial reporting, ensuring compliance with accounting standards, and maintaining adequate internal controls [8]. The audit committee ensures transparency, accuracy, and fairness in financial disclosures, which in turn guarantees fairness for shareholders. The diversity of skills and expertise among the audit committee members enhances the effectiveness of the oversight function [9]. Therefore, a larger audit committee improves oversight and prevents earnings management practices, ultimately enhancing the quality of earnings reported in financial statements [10]. Previous studies have shown that the audit committee can influence earnings management [11], although other studies suggest that it has no effect on earnings management [12].

In addition to the audit committee, another factor influencing earnings management is free cash flow. Free cash flow is the cash available to investors after a company uses part of it for investments in fixed assets, new product development, and working capital required to sustain operations [13]. Free cash flow is an important indicator for investors and financial analysts to assess the financial health of a company, as it reflects the company's ability to generate income. In cases of low free cash flow, management may resort to earnings management practices, such as delaying expense recognition or taking other actions that affect the financial statements. These actions aim to maintain a positive image of the company in the eyes of investors and creditors [14]. Previous studies have indicated that free cash flow can affect earnings management,

suggesting that the level of free cash flow may influence management's decision to manage earnings [15], [16]. However, other studies have found no effect of free cash flow on earnings management [17], [18].

Additionally, tax planning is another factor that can affect earnings management. Taxes incurred by companies can reduce the profits generated, as higher taxes result in lower profits. This practice is known as tax planning [19]. By reducing tax expenses, the company's cash flow increases, providing more freedom for operational activities and business expansion [20]. The higher the level of tax planning conducted by a company, the greater its efforts to apply earnings management to achieve the desired profit target [21]. Previous studies have shown that tax planning influences earnings management, while other studies found that tax planning does not affect earnings management [22], [23].

Earnings management has been chosen as the dependent variable in this study because it is a common practice among various companies in Indonesia. This practice not only negatively impacts the economy but also damages the reputation of the company [24]. Based on these phenomena and the inconsistencies in previous research findings, the researcher assumes that there is another variable that can strengthen or weaken the relationship between the audit committee, free cash flow, and tax planning on earnings management, namely audit quality as a moderating variable. Audit quality reflects the auditor's ability to ensure that a company's financial statements are trustworthy and comply with applicable audit standards [25]. High-quality audits can detect financial statement manipulations that may go unnoticed by the company's internal auditors [26]. As such, earnings management practices can be minimized through auditing of financial statements, with audit quality playing a crucial role in determining the credibility of audited financial statements and the audit opinion given. Financial statement users often rely on the audit opinion as a basis for assessing the company's survival, considering audit quality based on projections of Big Four and Non-Big Four audit firms. Big Four audit firms, with higher reputations, tend to have greater independence in conducting audits as they seek to maintain public trust and market share. As a result, financial statements audited by Big Four firms often receive greater trust from investors [27].

Based on previous research, audit quality plays a moderating role in the relationship between the audit committee and earnings management, which has been proven to moderate this relationship [28]. However, other studies found that audit quality does not moderate this relationship [29]. Furthermore, previous research also shows that audit quality can moderate the effect of free cash flow on earnings management, while other studies suggest that audit quality does not moderate the relationship between free cash flow and earnings management [30]. Prior studies have shown that audit quality can moderate the impact of tax planning on earnings management [31]. In contrast, other research indicates that audit quality does not moderate the relationship between tax planning and earnings management [32].

This study builds on research conducted by Kusuma & Fayliencent. The authors have added tax planning as an independent variable for further development. The

addition of the tax planning variable is supported by research by Ayem & Subekti, which shows that the higher the level of tax planning conducted by a company, the more likely it is to engage in earnings management. The company's attention to tax is reflected in its tax planning efforts to optimize tax rates, thereby maximizing net profit after taxes [33]. This study focuses on consumer goods sector companies listed on the IDX from 2019 to 2023. This sector is selected because its business has the potential for earnings management, as the consumer goods sector is one of the few sectors that has been able to survive amid the challenges of Indonesia's economy. This is because products like food and beverages are basic necessities for society [34]. This study aims to examine the role of audit quality as a moderator in the influence of the audit committee, free cash flow, and tax planning on earnings management. This research is expected to contribute to helping companies avoid earnings management practices that may harm stakeholders. Moreover, the findings of this study are expected to serve as useful information for investors in making future investment decisions and can be used by the government as a reference in assessing tax planning practices and earnings management in consumer goods sector companies from 2019 to 2023. This will allow the government to create more effective tax supervision policies, ensuring better compliance with tax obligations, which will contribute to increasing state revenues.

Literature Review and Hypotheses

Agency Theory

Agency theory serves as the primary basis for this research as it is often used to understand the phenomenon of earnings management. Earnings management practices frequently arise due to conflicts of interest between the owners of the company (principal) and management (agent). This conflict typically arises when a company achieves its set targets, and earnings management is implemented to benefit certain parties [35].

The Effect of the Audit Committee on Earnings Management

The audit committee plays a crucial role in overseeing management's performance to prevent fraudulent actions that could harm the company's owners [36]. The larger the audit committee, the more effective the oversight function becomes, minimizing opportunities for management to engage in earnings management [37]. According to agency theory, the presence of an audit committee enhances corporate governance oversight, ensuring that financial statements are reliable. A larger audit committee is believed to ensure that financial statements are free from earnings management practices, thus improving the integrity of the company's financial reports. Previous research supports this by showing that the audit committee has a negative influence on earnings management [38]. Based on this, the first hypothesis proposed in this study is as follows: **H1:** The audit committee has a negative effect on earnings management.

The Effect of Free Cash Flow on Earnings Management

Earnings management is related to free cash flow, where the amount of free cash flow reflects the financial condition of a company [39]. According to agency theory, companies with low free cash flow are more susceptible to earnings management, as

managers tend to manipulate earnings to compensate for suboptimal performance in managing company assets [40]. Companies with low free cash flow are often perceived as financially unhealthy, encouraging managers to engage in earnings management. Therefore, companies strive to increase their free cash flow to maintain investor trust. However, if high free cash flow is not properly managed, it may lead to earnings management practices. Previous research supports this, finding that free cash flow negatively affects earnings management [41]. Based on this, the second hypothesis proposed in this study is:

H2: Free cash flow has a negative effect on earnings management.

The Effect of Tax Planning on Earnings Management

The relationship between tax planning and earnings management can be explained through agency theory, which arises from the conflicting interests between the government (principal) and the company (agent). Companies seek to minimize their tax liabilities because they view tax payments as reducing their profits, while the government requires tax revenue to fund national expenditures [42]. Companies often attempt to minimize their tax burden as their profits increase, leading them to apply earnings management strategies through tax planning [43]. The more frequently a company engages in tax planning, the more likely it is to engage in earnings management. This is because the company can adjust its financial conditions to achieve the desired level of profit. Previous research indicates that tax planning has a positive effect on earnings management [44]. Based on this, the third hypothesis proposed in this study is:

H3: Tax planning has a positive effect on earnings management.

The Effect of the Audit Committee on Earnings Management Moderated by Audit Quality

In corporate management, audit quality is considered an external mechanism that has the potential to influence earnings management. Auditors, especially from Big Four audit firms, have the ability to safeguard shareholders' interests by detecting potential manipulations by management and ensuring alignment between management's goals and shareholders' interests. The audit committee plays a vital role in overseeing the financial statement preparation process [45]. In this context, the audit committee's understanding of financial statement structures, supported by high-quality audit services from independent auditors, strengthens the audit committee's efforts to reduce earnings management [46]. According to agency theory, the audit committee enhances oversight over corporate governance to ensure reliable financial statements, thus reducing conflicts between management and shareholder. High-quality audits can detect manipulations in financial statements that internal auditors may overlook [47]. This is supported by previous research showing that audit quality strengthens the relationship between the audit committee and earnings management [48]. Based on this, the fourth hypothesis proposed in this study is:

H4: Audit quality positively moderates the effect of the audit committee on earnings management.

The Effect of Free Cash Flow on Earnings Management Moderated by Audit Quality

High-quality audits can help reduce the risk of earnings management in managing free cash flow [49]. According to agency theory, companies with low free cash flow are more vulnerable to earnings management because managers tend to increase earnings to cover their suboptimal actions in managing company assets [50]. Without consistent monitoring, the likelihood of earnings management in free cash flow management increases, which can affect the level of earnings management in financial reporting, potentially leading to inefficient cash usage [51]. High-quality audits can detect material misstatements made by management through the examination of financial statements, preventing earnings management practices [52]. Good audit quality is expected to detect earnings management by management, thereby mitigating the effect of free cash flow on earnings management. This is supported by previous research, which found that audit quality weakens the relationship between free cash flow and earnings management. Based on this, the fifth hypothesis proposed in this study is: **H5:** Audit quality negatively moderates the effect of free cash flow on earnings management.

The Effect of Tax Planning on Earnings Management Moderated by Audit Quality

Tax planning is a legally permitted action aimed at minimizing a company's tax obligations, as long as it complies with the regulations in place [53]. This can provide benefits to the company. However, if tax planning is conducted improperly, it may mislead financial statement users, as the information presented may not reflect the true financial condition of the company [54]. According to agency theory, tax planning in relation to earnings management arises due to conflicts of interest between the company (agent) and the government (principal). The company seeks to minimize tax liabilities because it considers tax payments as reducing profits, while the government needs tax revenue for national expenditures. This conflict encourages companies to engage in tax planning to reduce tax obligations and maintain optimal profits [55]. In this situation, the presence of high-quality audits plays a crucial role in reducing agency conflicts by detecting and correcting discrepancies in financial statements, thus curbing opportunistic behavior by management. This behavior includes managers' decisions in tax planning strategies and earnings management [56]. Previous research has shown that audit quality weakens the relationship between tax planning and earnings management [57]. Based on this, the sixth hypothesis proposed in this study is:

H6: Audit quality negatively moderates the effect of tax planning on earnings management.

Conceptual Framework

Based on the development of the hypotheses above, the following conceptual framework is obtained:

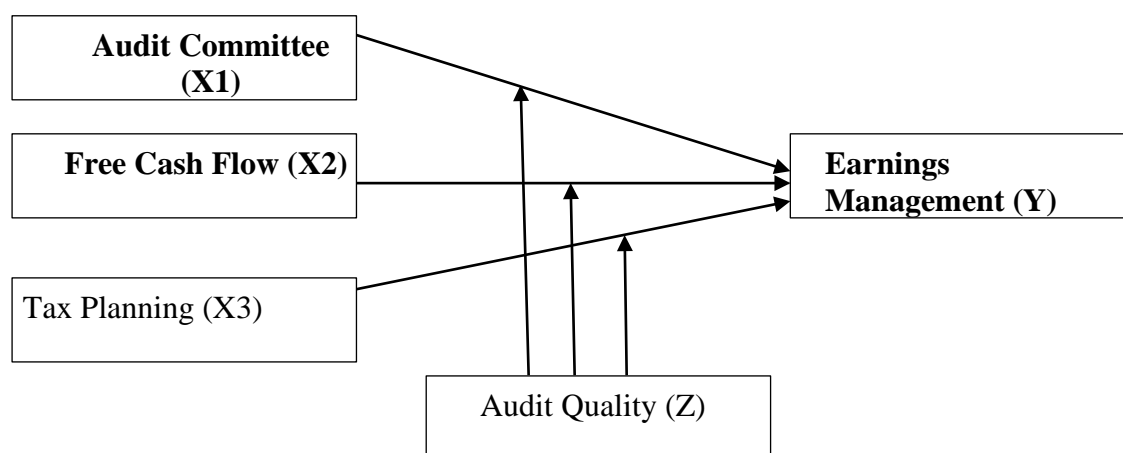


Figure 1. Conceptual Framework

RESEARCH METHOD

Research Type and Object

This study uses a quantitative approach. The research object includes companies engaged in the consumer goods industry sector that are listed on the Indonesia Stock Exchange (IDX) for the period 2019 - 2023.

Data Type and Source

This study uses secondary data. The data source is obtained from the financial statements and annual reports of companies in the consumer goods industry sector. Data collection is conducted through documentation of financial statements and annual reports of companies in the consumer goods industry sector for the period 2019 - 2023, which can be accessed through the official website of the Indonesia Stock Exchange (IDX) at www.idx.co.id.

Population and Sample

The population of this study includes all companies in the consumer goods industry sector listed on the Indonesia Stock Exchange (IDX) during the period 2019 - 2023. The sample selection process is carried out using purposive sampling, a technique that selects samples based on specific criteria or considerations. The criteria applied in the sample selection are as follows:

Table 1. Data of companies that meet the sample selection criteria

No	Description	Amount
1	Consumer goods industry companies listed on the Indonesia Stock Exchange (IDX) for the period 2019 - 2023	56

No	Description	Amount
2	Consumer goods industry companies that did not publish audited financial statements and annual reports consecutively for the period 2019 - 2023	(12)
3	Consumer goods industry companies with negative profit for the period 2019 - 2023	(17)
Total sample according to criteria (27 companies × 5 years)		135
Outlier data		(39)
Final sample for research		96

Identification and Indicator Variables

In this study, the dependent variable used is earnings management, while the independent variables include the audit committee, free cash flow, and tax planning. Audit quality is also included in this study as a moderating variable. Earnings management in this study is measured using the Modified Jones Model, as it can separate Discretionary Accruals and Nondiscretionary Accruals, and divide total accruals into four main components (total assets, receivables, revenues, fixed assets), making it more accurate in identifying earnings management practices [58]. The following table presents the indicators for each variable in this study:

Table 2. Variable Indicators

Variable	Indicator	Scale
Earnings Management (Y)	Using the Modified Jones Model with Discretionary Accruals:	Ratio
Calculate Total Accruals	$TAC_{i,t} = NI_{i,t} - CFO_{i,t}$	Ratio
Estimate total accruals using the Ordinary Least Squares (OLS) regression equation	$\frac{TAC_{i,t}}{A_{i,t} - 1} = \left[\beta_1 \left(\frac{1}{A_{i,t} - 1} \right) + \beta_2 \left(\frac{\Delta REV_{i,t}}{A_{i,t} - 1} \right) + \beta_3 \left(\frac{PPE_{i,t}}{A_{i,t} - 1} \right) \right]$	Ratio
Using the regression coefficient obtained from the formula, calculate Nondiscretionary Accruals	$NDA_{i,t} = \left[\beta_1 \left(\frac{1}{A_{i,t} - 1} \right) + \beta_2 \left(\frac{\Delta REV_{i,t} - \Delta REC_{i,t}}{A_{i,t} - 1} \right) + \beta_3 \left(\frac{PPE_{i,t}}{A_{i,t} - 1} \right) \right]$	Ratio

Variable	Indicator	Scale
Calculate Discretionary Accruals	$DA_{i,t} = \left(\frac{TAC_{i,t}}{A_{i,t} - 1} \right) - NDA_{i,t}$ <p>Description:</p> <p>$TAC_{i,t}$: Total accruals calculated for company i in period t</p> <p>$NI_{i,t}$: Net income earned by company i in period t</p> <p>$CFO_{i,t}$: Cash flow from operating activities of company i in period t</p> <p>$A_{i,t} - 1$: Total assets value of company i in the previous year (t-1)</p> <p>$\Delta REV_{i,t}$: Value of fixed assets owned by company i in year t</p> <p>$PPE_{i,t}$: Value of fixed assets owned by company i in year t</p> <p>$NDA_{i,t}$: Nondiscretionary accruals of company i in year t</p> <p>$\Delta REC_{i,t}$: Change in accounts receivable of company i from year t-1 to year t</p> <p>$DA_{i,t}$: Discretionary accruals of company i in year t</p> <p>$\beta 1, \beta 2, \beta 3$: Regression coefficients</p> <p>Source : (Faqih & Sulistyowati, 2021)</p>	Ratio
Audit Committee (X1)	$KA = \sum \text{Anggota Komite Audit}$ <p>Source: (Wahyuni et al., 2023)</p>	Ratio
Free Cash Flow (X2)	$FCF = \frac{NOPAT}{\text{Total Aset}}$ <p>Source: (Radyansah & Sulfitri, 2024)</p>	Ratio
Tax Planning (X3)	$TRR_{i,t} = \frac{\text{Net Income}_{i,t}}{\text{Pretax Income (EBIT)}_{i,t}}$ <p>Source: (Foan Olin & Priyadi, 2024), (Faqih & Sulistyowati, 2021)</p>	Ratio
Audit Quality (Z)	<p>Audit quality is measured using a nominal scale through the use of a dummy variable, where companies audited by a Big Four public accounting firm (KAP) are assigned a value of 1, while companies audited by a non-Big Four public accounting firm (KAP) are assigned a value of 0.</p> <p>Big Four KAP: Pricewaterhouse Coopers (PwC), Deloitte Touche Tohmatsu (Deloitte), Ernst & Young (EY), Klynveld Peat Marwick Goerdeler (KPMG)</p>	Nominal

Variable	Indicator	Scale
Source: (Kusuma & Fayliencent, 2023) (Jannah & Suwarno, 2024)		

Data Analysis Techniques

In this study, the analysis method used is multiple linear regression and Moderated Regression Analysis (MRA) with the help of SPSS 23 software. Moderated Regression Analysis (MRA), also known as interaction testing, is a type of multiple linear regression that involves interaction terms in the regression model [59]. Before conducting this analysis, a descriptive statistical test is required to describe the data obtained by presenting information on the characteristics of each variable based on mean, standard deviation, minimum, and maximum values. Next, classical assumption testing is carried out in four stages:

1. **Normality test** is performed to ensure that the data is normally distributed, with the condition that the significance value is > 0.05 .
2. **Multicollinearity test** is conducted to examine the correlation between independent variables. This testing process is done by observing the Tolerance and Variance Inflation Factor (VIF) values. An independent variable is considered free from multicollinearity if the Tolerance value is > 0.10 and the VIF value is < 10 [60].
3. **Autocorrelation test** is conducted using the Durbin-Watson test to determine whether autocorrelation exists in the regression model, with the criterion being if $dU < DW < 4 - dU$, then no autocorrelation occurs [61].
4. **Heteroscedasticity test** aims to determine if there is a variation in the residuals between observations. Heteroscedasticity occurs if the points in the scatterplot form a specific pattern, such as narrowing, widening, or oscillating. On the other hand, if the points in the scatterplot are randomly scattered without a clear pattern above and below the zero line on the Y-axis, then heteroscedasticity does not occur.

Hypothesis testing is performed through the t-test (partial) to examine the effect of each independent variable on the dependent variable separately [62]. The partial effect in each model is determined by the significance value, where $\text{sig.} < 0.05$ indicates a significant effect and $\text{sig.} > 0.05$ indicates no effect [63]. Subsequently, the coefficient of determination (R^2) test is performed to determine the level of influence of the independent variables on the dependent variable, presented as a percentage [64].

In this study, Moderated Regression Analysis (MRA) is used to examine the interaction effect of independent variables (audit committee, free cash flow, and tax planning) on earnings management, with the moderating variable (audit quality). The criteria for the MRA are: if $\text{sig.} > 0.05$, the hypothesis is not supported; if $\text{sig.} \leq 0.05$, the hypothesis is supported [65]. This study involves two analyses, which are elaborated in the following equations:

Equation 1: Multiple Linear Regression Analysis

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

Equation 2: Moderating Regression Analysis

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

RESULTS AND DISCUSSION

Result

Descriptive Statistical Test

Table 3. Descriptive Statistics Results

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Audit Committee (X1)	96	2.00	4.00	2.9375	0.37871
Free Cash Flow (X2)	96	0.012344	0.292866	0.11281777	0.063934591
Tax Planning (X3)	96	0.672836	0.828048	0.76861821	0.030553290
Earnings Management (Y)	96	-0.11020	0.01055	-0.0450625	0.02802931
Audit Quality (Z)	96	0.00	1.00	0.4271	0.49725

Source: Data processed by SPSS 23

From the descriptive statistical test results in Table 3, it shows that the Audit Committee (X1) has a minimum value of 2 and a maximum value of 4, with a mean of 2.9375 and a standard deviation of 0.37871. The Free Cash Flow (X2) has a minimum value of 0.012344 and a maximum value of 0.292866, with a mean of 0.11281777 and a standard deviation of 0.063934591. The Tax Planning (X3) has a minimum value of 0.672836 and a maximum value of 0.828048, with a mean of 0.76861821 and a standard deviation of 0.030553290. The Earnings Management (Y) has a minimum value of -0.11020 and a maximum value of 0.01055, with a mean of -0.0450625 and a standard deviation of 0.02802931. The Audit Quality (Z) has a minimum value of 0 and a maximum value of 1, with a mean of 0.4271 and a standard deviation of 0.49725.

Classical Assumption Test

Normality Test

Table 4. Normality Test Results

Unstandardized Residual	N	96
Normal Parameters	Mean	0.0000000
	Std. Deviation	0.02408638
Most Extreme Differences	Absolute	0.039
	Positive	0.039
	Negative	-0.036

Unstandardized Residual N	96
Test Statistic	0.039
Asymp. Sig. (2-tailed)	0.200

Source: Data processed by SPSS 23

The normality test in this study was conducted using the Kolmogorov-Smirnov One Sample Test. The result from the normality test in Table 4 shows an Asymp. Sig value of $0.200 > 0.05$. This means that the data in this study are normally distributed [66].

Multicollinearity Test

Table 5. Multicollinearity Test Results

Model	Tolerance VIF	
Audit Committee (X1)	0.980	1.020
Free Cash Flow (X2)	0.786	1.272
Tax Planning (X3)	0.711	1.407
Dependent Variable: Earnings Management (Y)		

Source: Data processed by SPSS 23

The multicollinearity test was conducted by observing the Tolerance and Variance Inflation Factor (VIF) values. An independent variable is considered free from multicollinearity if the Tolerance value is > 0.10 and the VIF value is < 10 . Based on the multicollinearity test results shown in Table 5, all independent variables have a Tolerance value > 0.10 and a VIF value < 10 . Therefore, it can be concluded that there is no multicollinearity in this study [67].

Heteroscedasticity Test

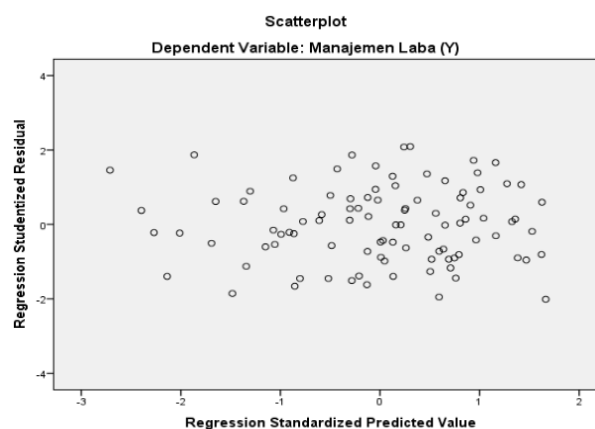


Figure 2. Heteroscedasticity Test Results

Source: Data processed by SPSS 23

Based on the results of the heteroscedasticity test through the scatterplot graph above, it can be seen that the distribution of points is randomly scattered above and below the zero line on the Y-axis, without forming any specific pattern. Therefore, it can be concluded that the data in this study does not exhibit signs of heteroscedasticity [68].

Autocorrelation Test

Table 6. Autocorrelation Test Results

Model R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0.511	0.262	0.229	0.02461

a. Predictors: (Constant), Audit Quality (Z), Tax Planning (X3), Audit Committee (X1), Free Cash Flow (X2)

b. Dependent Variable: Earnings Management (Y)

Source: Data processed by SPSS 23

The results of the autocorrelation test in Table 6 show that the Durbin-Watson (DW) value is 1.776. This value is compared with the significant bounds based on the DW table at a 0.05 (5%) significance level, with a sample size of 96 (n) and 3 independent variables (k=3). The condition that must be met is $du < DW < 4 - du$. Based on the DW table, the value of du is 1.732, which is less than the DW value of 1.776, and the DW value is less than $4 - du$, which is 2.268. Therefore, it can be concluded that there is no autocorrelation [4].

Hypothesis Testing

Coefficient of Determination Test (R^2)

Table 7. Coefficient of Determination Test Results

Model R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.511	0.262	0.229

a. Predictors: (Constant), Audit Quality (Z), Tax Planning (X3), Audit Committee (X1), Free Cash Flow (X2)

b. Dependent Variable: Earnings Management (Y)

Source: Data processed by SPSS 23

From Table 7, the R Square (R^2) value obtained is 0.262. This means that Earnings Management (Y) can be influenced by 26.2% by the independent variables, namely Audit Committee (X1), Free Cash Flow (X2), and Tax Planning (X3). The remaining 73.8% of Earnings Management (Y) is influenced by other factors outside the scope of this study,

such as the Independent Board of Commissioners, Financial Distress, Profitability, Leverage, and Deferred Tax Liabilities [8].

t-Test (Partial)

Table 8. Partial t-Test Results

Unstandardized Coefficients	Standardized Coefficients	t	Sig.
Model	B	Std. Error	Beta
(Constant)	-0.402	0.076	
Audit Committee (X1)	-0.007	0.007	-0.094
Free Cash Flow (X2)	-0.180	0.045	-0.411
Tax Planning (X3)	0.507	0.098	0.553

a. Dependent Variable: Earnings Management (Y)

Source: Data processed by SPSS 23

This table shows the t-statistics and significance levels for each variable in the model. The results indicate that the Audit Committee (X1) does not have a significant effect on Earnings Management (Y) (sig. > 0.05), while Free Cash Flow (X2) and Tax Planning (X3) have a significant effect on Earnings Management (Y) (sig. < 0.05).

Based on the results of the testing presented in the table above, the regression equation model obtained is as follows:

$$Y = -0.402 - 0.007 X1 - 0.180 X2 + 0.507 X3 + e$$

The partial t-test results in Table 8 show that the Audit Committee (X1) has a β value of -0.007 with a sig. value of 0.304, which is greater than 0.05, meaning that the Audit Committee (X1) does not have an effect on earnings management (Y). Therefore, Hypothesis 1 is rejected. Next, Free Cash Flow (X2) has a β value of -0.180 with a sig. value of 0.000, which is less than 0.05, indicating that Free Cash Flow (X2) has a negative effect on earnings management (Y). Therefore, Hypothesis 2 is accepted.

Next, Tax Planning (X3) has a β value of 0.507 with a sig. value of 0.000, which is less than 0.05. This indicates that Tax Planning (X3) has a positive effect on earnings management (Y), so Hypothesis 3 is accepted.

Moderated Regression Analysis (MRA)

Table 9. MRA Analysis Test Results

Unstandardized Coefficients	Standardized Coefficients	t	Sig.
Model	B	Std. Error	Beta
(Constant)	-0.046	0.004	

Unstandardized Coefficients	Standardized Coefficients	t	Sig.
Moderation X1	0.016	0.009	0.855
Moderation X2	-0.109	0.061	- 0.306
Moderation X3	-0.084	0.036	- 1.133

a. Dependent Variable: Earnings Management (Y)

Source: Data processed by SPSS 23

Based on the results presented in the table above, the regression equation model obtained is as follows:

$$Y = -0.046 + 0.016 X1Z - 0.109 X2Z - 0.084 X3*Z + e$$

From Table 9, it shows that the Audit Committee (X1) on Earnings Management (Y) moderated by Audit Quality (Z) has a β value of 0.016 with a sig. value of 0.068, which is greater than 0.05. This indicates that Audit Quality (Z) does not moderate the relationship between the Audit Committee (X1) and Earnings Management (Y), so Hypothesis 4 is rejected.

Next, Free Cash Flow (X2) on Earnings Management (Y) moderated by Audit Quality (Z) has a β value of -0.109 with a sig. value of 0.080, which is greater than 0.05. This indicates that Audit Quality (Z) does not moderate the relationship between Free Cash Flow (X2) and Earnings Management (Y), so Hypothesis 5 is rejected.

Tax Planning (X3) on Earnings Management (Y) moderated by Audit Quality (Z) has a β value of -0.084 with a sig. value of 0.022, which is less than 0.05. This indicates that Audit Quality (Z) can negatively moderate the relationship between Tax Planning (X3) and Earnings Management (Y), so Hypothesis 6 is accepted.

Discussion

The Effect of the Audit Committee on Earnings Management

The results of the t-test presented in Table 8 show that the audit committee has a regression coefficient of -0.007 and a significance value of $0.304 > 0.05$. This indicates that the audit committee does not have an effect on earnings management, and therefore, Hypothesis 1 is rejected. This means that the number of audit committee members does not play a role in controlling earnings management practices within companies [12]. In Indonesia, many companies do not effectively perform the role of the audit committee because the establishment of audit committees is often intended solely to comply with regulations from the Financial Services Authority (OJK). Additionally, the selection of audit committee members is often based on personal relationships with management, rather than professional background. Thus, the number of audit committee members does not guarantee effective oversight of earnings management [15]. Previous research has also shown similar results, where the audit committee does not affect earnings

management practices [16]. However, another study concluded that the audit committee plays a role in controlling earnings management practices [20].

The Effect of Free Cash Flow on Earnings Management

The results of the t-test in Table 8 show that the significance value for free cash flow is $0.000 < 0.05$, and the regression coefficient is -0.180 . This indicates that free cash flow has a negative and significant effect on earnings management, and Hypothesis 2 is accepted. This suggests that companies with low free cash flow are more vulnerable to engaging in earnings management. When free cash flow is limited, managers are often driven to artificially increase earnings to cover the lack of available funds, which can be done through various means in earnings management practices [22]. According to agency theory, low free cash flow conditions make companies more likely to engage in earnings management because managers attempt to improve their performance, which is suboptimal in managing company asset [24]. This result is consistent with previous research, which shows that free cash flow has a negative and significant effect on earnings management [26]. However, it contradicts other studies that found no effect of free cash flow on earnings management [20].

The Effect of Tax Planning on Earnings Management

The results of the t-test in Table 8 show that the significance value for tax planning is $0.000 < 0.05$, with a regression coefficient of 0.507 , indicating that tax planning has a positive and significant effect on earnings management. Therefore, Hypothesis 3 is accepted. This means that tax planning can influence the level of earnings management, where the more effective tax planning implemented, the greater the likelihood of the company engaging in earnings management. Taxes are a primary focus for companies because they are substantial and directly related to the earnings they generate. Therefore, companies engage in tax planning with the aim of reducing tax burdens to maximize after-tax profits. This enables companies to implement earnings management according to their goals through tax planning to maximize net profits [21]. Referring to agency theory, the conflict of interest between the government (principal) and companies (agent) encourages companies to reduce their tax liabilities, as taxes are seen as reducing profits, while the government requires tax revenue to finance the national budget [25]. This result is consistent with previous research that concluded tax planning is associated with earnings management practices [29]. However, it contradicts research that found no connection between tax planning and earnings management practices [31].

The Effect of the Audit Committee on Earnings Management Moderated by Audit Quality

Based on the MRA results in Table 9, the significance value for the effect of the audit committee on earnings management with audit quality as a moderator is $0.068 > 0.05$, with a regression coefficient of 0.016 . This indicates that audit quality does not have the ability to moderate the relationship, and therefore, Hypothesis 4 is rejected. This means that although high-quality audits play a role in maintaining the credibility of financial statements, auditors are not directly responsible for controlling earnings management practices. Meanwhile, the audit committee has a broader scope of duties

and responsibilities, including independent oversight, monitoring internal control systems, and evaluating auditor performance. However, the limited ability of auditors to identify earnings management, limited resources and time, as well as factors affecting auditor independence, may hinder the role of audit quality in helping the audit committee prevent earnings management practices [33]. This result aligns with previous findings that audit quality does not have the ability to moderate the relationship between the audit committee and earnings management practices [41]. However, this result contrasts with other studies that show that audit quality can moderate this relationship [45].

The Effect of Free Cash Flow on Earnings Management Moderated by Audit Quality

Based on the MRA results in Table 9, the significance value for the effect of free cash flow on earnings management moderated by audit quality is $0.080 > 0.05$, with a regression coefficient of -0.109 . This indicates that audit quality does not have the ability to moderate the relationship between free cash flow and earnings management, and therefore, Hypothesis 5 is rejected. This means that the role of auditors, whether from Big Four or non-Big Four audit firms, cannot prevent managers from exploiting free cash flow for earnings management purposes. High-quality audits, such as those from Big Four firms, focus more on improving the credibility of financial statements rather than reducing earnings management in the management of free cash flow [47]. Additionally, larger companies tend to provide more extensive disclosures of free cash flow. However, when audit quality is low, the realization of free cash flow disclosures tends to be lower, which allows management to continue engaging in earnings management using free cash flow [50]. This result aligns with previous research by Kusuma & Fayliencent, 2023 and Hidayat et al., 2022, which states that audit quality does not moderate the relationship between free cash flow and earnings management. However, it contradicts research by Gusmiarni et al., 2020, which concluded that audit quality plays a role in moderating this relationship.

The Effect of Tax Planning on Earnings Management Moderated by Audit Quality

Based on the MRA results presented in Table 9, the significance value for the effect of tax planning on earnings management moderated by audit quality is $0.022 < 0.05$, with a regression coefficient of -0.084 . This result shows that audit quality has the ability to negatively moderate the relationship between tax planning and earnings management, and therefore, Hypothesis 6 is accepted. This means that high-quality audits can prevent earnings management practices because a company's reputation can be damaged and its value may decrease if errors in financial reporting are revealed. The reputation of high-quality audit firms, such as Big Four firms, reflects better audit competence, so the higher the audit quality, the lower the tendency of management to engage in earnings management through tax planning [54]. In agency theory, the conflict of interest between the government (principal) and companies (agent) encourages companies to reduce tax obligations, while the government needs tax revenue to fund the national budget [56]. In this case, the presence of high-quality audits aims to reduce agency conflicts between agents and principals [58]. This result is consistent with previous research that found

audit quality can negatively moderate the effect of tax planning on earnings management [60]. However, this result contradicts earlier studies that stated audit quality does not have the ability to moderate the relationship between tax planning and earnings management [61].

CONCLUSION

Fundamental Finding : This study concludes that the existence of an audit committee does not significantly impact earnings management, primarily due to the committee's inability to optimally perform its supervisory functions, which is hindered by a lack of professionalism and regulatory compliance. Conversely, **free cash flow** has a significant negative impact on earnings management, as companies with cash flow constraints tend to engage in earnings management to cover financial shortfalls. **Tax planning** also has a significant positive effect on earnings management, as firms aim to reduce their tax burdens to maximize after-tax profits. Additionally, **audit quality** was unable to moderate the impact of the audit committee on earnings management due to the limitations in detecting earnings management and the independence of auditors. However, audit quality negatively moderated the relationship between tax planning and earnings management, particularly for highly reputable audit firms such as the Big Four. **Implication :** These findings suggest that the effectiveness of the audit committee in managing earnings may be limited by its regulatory role rather than its ability to enforce stricter financial oversight. The impact of free cash flow and tax planning emphasizes the importance of financial liquidity and corporate tax strategies in earnings management. **Limitation :** This research is constrained by its narrow focus on companies in the consumer goods sector listed on the Indonesia Stock Exchange (IDX) and a five-year research period (2019-2023). The study uses the modified Jones model with a discretionary accrual approach to measure earnings management, and it only considers three independent variables: the audit committee, free cash flow, and tax planning, overlooking other potential influencing factors. **Future Research :** Future studies should consider expanding the research scope to include other industry sectors, such as mining, property, and real estate, and extending the study period. Additionally, alternative proxies for detecting earnings management, such as the Stubben Conditional Revenue Model, should be explored. Future research should also consider incorporating other independent variables, such as independent commissioners, financial distress, profitability, leverage, deferred tax liabilities, and other factors related to earnings management.

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