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on Management, Finance and Entrepreneurship
ICMFE-2015

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Ankara, Turkey

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Preface

Dear Distinguished Delegates and Guests,

The Conference Committee warmly welcomes our distinguished delegates and guests to the 2015 International Conference on Management, Finance and Entrepreneurship (ICMFE-2015) held on April 11-12 in Medan, Indonesia.

ICMFE-2015 is organized by International Foundation for Research and Development (IFRD). The conference is aimed at discussing with all of you the wide range of problems encountered in present and future issues in economies and Societies. ICESS-2015 is organized in collaboration with Universitas Islam Sumatera Utara, Medan, Indonesia, Yildirim Beyazit University, Turkey, Shinawatra International University, Thailand, PERTRE ANDERI of IASI, Romania and National Academy of Management, Ukraine where researchers from around the world presented their work. The conference committee is itself quite diverse and truly international, with membership around the world.

Proceeding records the fully refereed papers presented at the conference. Main conference themes and tracks are Management, Finance and Entrepreneurship. Conference aims to bring together researchers, scientists, engineers and practitioners to exchange and share their experiences, new ideas and research results about all aspects of the main conference themes and tracks and discuss the practical challenges encountered and the solutions adopted. The main goal of the event is to provide a scientific forum for exchange of new ideas in a number of fields that interact in depth through discussions with their peers from around the world.

Conference has solicited and gathered technical research submission related to all aspects of major conference themes and tracks. All the submitted papers have been peer reviewed by the reviewers drawn from the scientific committee, external reviewers and editorial board depending on the subject matter of the paper. Reviewing and initial selection were undertaken electronically. After the rigorous peer-review process, the submitted papers were selected based on originality, significance, and clarity for the purpose of the conference. Conference program is extremely rich, featuring high-impact presentations. The high quality of the program guaranteed by the presence of an unparalleled number of internationally recognized top experts. Conference will therefore be a unique event, where attendees will be able to appreciate the latest results in their field of expertise, and to acquire additional knowledge in other fields. The program has been strutted to favor interactions among attendees coming from many diverse horizons, scientifically, geographically, from academia and from industry.

We would like to thank the program chairs, organization staff, and members of the program committee for their work. We are grateful to all those who have contributed to the success of ICMFE-2015 especially our partners. We hope that all participants and other interested readers benefit scientifically from the proceedings and find it stimulating in the process. Finally, we would like to wish you success in your technical presentations and social networking.

We hope you have a unique, rewarding and enjoyable time at ICMFE-2015 in Medan.

With our warmest regards,

Conference Committee
April 11–12, 2015
Medan, Indonesia.

ICMFE-2015

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PAPERS

THE INFLUENCE OF AUDIT COMMITTEE EFEKTIVITY TOWARD EARNING MANAGEMENT PRACTICES

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Abstract

Earning Management practices caused a lot of money scandals toward big companies, like enron scandals. To overcome those impact, stakeholder parties asked monitoring focus on management and operational company activities. Audit committee played important role in the monitoring company process. Audit committee had to make sure that company activity and management business on the right track. So that, earning management practices could be minimized and investor obtained reliable information about the company.

The purpose of this study was to examine whether Audit Committee Size, Meeting Frequence, Audit Committee Independence and Audit Committee Financial Expertise influenced earning management practices. Earning management was proxied by discretionary accruals. This research used manufactures company annual report as population. Using a purposive sampling method, 143 companies data were selected as samples. Three years companies annual report, during 2011 to 2013 are used as secondary data. The data was analyzed by multiple regression.

The results indicated that 125 data, about 87,4% companies sample proper based on Bapepam rules. Those data were free from outliers and met the classic assumption criteria. Other result showed that Audit committee size, Meeting Frequence and Financial Expertise did not have any influence toward earning management. While, Audit Committee Independence had influence.

Keywords : audit committee, corporate governance, earnings management

INTRODUCTION

Background of Problems

Earnings management companies issue have started to develop since the financial crisis that occurred in 1997. Earnings management increasingly attracted attention since accounting scandals committed by Enron and Big 5 Accounting Office, Arthur Anderson appeared. The scandal eventually led to other cases were also carried out by high-profile companies such as Worldcom, HealthSouth, and Tyco (Rani, 2011).

In Indonesia also happened several cases of earnings management, such as PT Kimia Farma inflated (overstated) corporate profits in the 2001 financial statements. This case caused imposition sanctions on PT Kimia Farma auditor, because audit risk failed to detect the presence of profit bubbles, although it has been doing the appropriate audit procedures SPAP (Generally Accepted Accounting Standards). In other case, Indofarma company did earning management practices. They presented net profit overstated by manipulating inventories higher than before. So that, sales in that year had understated.

According to Palestine (2009) earnings management can be interpreted as an management act that affected the earning report and provided wrong economic benefits for the company, so that in the future it will be very annoying and even harmful to the company. Company Efforts or certain parties to change, information manipulate, even earnings management actions that could lead financial statements no longer reflect the fundamental value, the financial statements should be serve as a communications management media with external parties or between the company and its stakeholders (Subhan, 2011).

Earnings management practices could be prevented by apply the corporate governance mechanism (Pujiningsih, 2011). Corporate governance mechanism consists of commissioners, independent directors, board of directors, and audit committees. Some audit committee characteristics are used as performance parameters, namely the audit committee independence, the audit committee expertise (financial expertise), the frequency of audit committee meetings, also the size of audit committee. Independence was needed to gave internal auditor performance value, to overcame external auditor conflict also to gave objectivity and external auditor independence value. Audit committee size connected to audit committee total member. Audit committee financial expertise was needed, because this matter related to audit committee objective which were examined and watched out financial reporting process. While audit committee total meeting frequency was to measure audit committee diligence level (IKAI 2004 in Rani 2011).

The existence of some audit committee characteristics which was connected to each other, hopefully could enhanced audit committee performance and effectivity, so that could overcame earning management practices in the company. Research on the effectiveness of the audit committee have been carried out. Several previous studies proved the relevance of audit quality with earnings management practices. Lin (2006) in Putri and Laksito (2011) provided evidence that size of audit committee negative significantly affected on earnings management practices, measured by whether the company did restatements or not.

Research conducted Rahman (2006), quoted in Putri and Laksito (2011), indicated that the audit committee has not have a central role in preventing earnings management insident. This things showed that the formation of an audit committee in listed companies have not been able to achieve its objectives.

Pamudji dan Trihartati (2010) successfully tested on the effect of the independence and effectiveness of audit committee on earnings management. The results indicated that the audit committee independence effect on earnings management. But, on the expertise of the audit committee, the frequency of audit committee meetings, reputable auditors, and external financing had no effect on earnings management. The study differs from Gradiyanto (2012) which stated that the frequency of audit committee meetings have a significant effect on earnings management.

In contrast to research conducted by Prastiti (2013), this study showed no effect between audit committee characteristics on earnings management. The results of the studies were still diverse, this research intended to re-examine according to Pamudji and Trihartati (2010). But there were several differences with the previous research studies, which were (1) the time commitment of the audit committee as an independent variable was omitted (2) (2) size of audit committee was added as independence variable, because Putri and Laksito (2011) also Suaryana founded that size of audit committee influenced earning management practices and (3) differences in the time of study, namely the year 2011 to 2013.

HYPOTHESES FORMULATION

Size of Audit Committee Affected on Earnings Management

In Indonesia, Good Corporate Governance guideline explained that one company should be had at least three audit committee member, which independence commissioner as the head and two member external that had financial and accounting background (Anggarini, 2010)

Yang and Khrisnan (2005) in Putri and Laksito (2011) prooved success that there was negative relation between size of audit committee and earning management. The result showed that the bigger size of audit committee thus financial reporting quality could be quarantee. So that, the size of audit committee could minimize earning management practice on the company.

H_1: size of the audit committee affected negatively on Earning Management

Audit Committee Frequency Meeting Affected on Earnings Management

Effectiveness the role of the audit committee in carried out oversight the financial reporting process and internal controls required regular meetings (McMullen and Raghunandan, 1996) in Anggarini (2010). Bapepam (2004) and the Forum for Corporate Governance in Indonesia (FCGI) required audit committee to hold meetings three to four times in a year. Frequency of these meetings should be clearly structured and well controlled by the chairman of the committee.

Beasley et al. (2004) in Pamudji and Trihartati (2010) found that the company's audit committee who made mistakes in financial reporting had frequency less than audit committee who had no mistakes in financial reporting. Therefore, this study examined the relationship between the frequency of audit committee meetings with earnings management.

H_2: The frequency of audit committee meetings affected negatively on Earning Management

Audit Committee Independence Affected on Earnings Management

In the Idx rules and corporate governance policies on the effective audit committee formed said that, audit committee consist of less than three majority independence member, which was one independence commissioner and at least two outside member. Audit committee member was required came from independence external company, must be consist of independence persons and did not involve with management daily activities, also had enough experience to run monitoring function effectively.

Several studies have been conducted to prove the effect of audit committee independence on earnings management. Xie et al. (2003) in Pamudji and Trihartati (2010) states that the audit committee independence is negatively related to fraud in the financial statements. This is also supported by Ebrahim (2007) in Gradiyanto (2012) proved that there is a negative correlation between the occurrence of earnings management with audit committee which composed of independent members.
H_3: The independence of audit committee affected negatively on Earning Management

Audit Committee Skills Affected on Earnings Management

Securities and Exchange Commission required that each audit committee must consist of at least one member who has a financial expert. Financial expertise was important for the audit committee because the primary function of the audit committee was to oversee the company's financial reporting process (Pamudji and Trihartati, 2010).

Xie et al. (2003) and Choi et al. (2004) in Pamudji and Trihartati (2010) stated that audit committee members were independence commissioners which had financial skill were effective parties to minimized earning management.
H_4: Audit committee expertise affected negatively on Earning Management

METHODS

Population and Sample

Population in this study was manufacturing companies listed in Indonesia Stock Exchange in 2011-2013. The samples in this study were done by using purposive sampling method, with the following criteria: (1) .The company published financial report and annual report for the ended period December 31, during 2011 - 2013. (2) .The companies were manufacturing companies listed in Stock Exchange and its shares are traded during 2011-2013. (3) .The company had the relevant data concerning this research, such as regarding the independence, audit committee backgrounds members, frequency of meetings between the audit committee, the size, and other data needed to detect association with earnings management

Definitions of Operational Variables

1.Dependent Variable

Earning Management

Measurement of earnings management was done by calculating discretionary accruals as a proxy for earnings management. So far only the aggregate accrual-based model that was generally accepted as a model that provided the most powerful results in detecting earnings management (Sulistyanto, 2008) in Pamudji and Trihartati (2010). Model Jones (1991) modified by Dechow et al. (1995) was used as aggregate accrual-based model. This model was used because it was considered the most powerful tool for detecting earnings management.

2. Independent Variables

a.Size of Audit Committee

Based on Circular Letter of the Board of Directors of the Jakarta Stock Exchange No. SE-008 / BEJ / 12-2001 dated December 7, 2001 and audit committee guideline formed by BAPEPAM about audit committee member, explained that audit committee should had more than three members, include the chief. So that, audit committee could had meeting and discussion each other (Anggarini, 2010). This variable was measured based on audit committee total member, the formula as followed :

ACSIZE = number of audit committee members

b. Audit Committee Meeting Frequency

The frequency of audit committee meetings should be conducted at least 4 times a year, had mentioned in audit committee guideline, in order to discussed financial reporting with external audit. This variable was measured based on total audit committee meeting frequency in related year. The formula as followed (Gradiyanto, 2012) :

ACMEET = number of audit committee meeting frequency

Audit Committee Independence

Audit committee Independence was a condition which audit committee member should be recognized as an independence party or free from any obligation to the company recorded (Putri and Laksito, 2011). Audit committee independence was eligible to Bapepam No. Kep-29 / PM / 2004, as followed:

1. Insider person who did not give audit and nonaudit service also consultant to company.
2. It was not a management executive
3. Did not have shares either directly or indirectly
4. Did not have a family relationship with board commissioners and board of directors
5. Did not have a business relationship, directly or indirectly related to the business of the company

Audit Committee Independence Measurement in this study used percentage audit committee independence member as indicator toward total audit committee member. The formula as followed :

ACIND = (total members – non independence total member) / (total members) x 100%

Audit Committee Expertise

Accountant expert or financial management expert was someone who experienced in accounting or financial fields, certified public accountant or *comparable expertise or Chief Executive Officer* (CEO) or others *senior officer* who had oversee responsible in financial monitoring (Abbott et al (2004) in Pamudji and Trihartati (2010)). Based on these statements, financial expertise in this study was measured by percentage the number of audit committee members who had an accounting or financial background or had held important positions in finance within the organization, the way the calculation by formula (Gradiyanto, 2012) as followed:

ACEXP = (number of audit committee members with expertise) / (number of members) x 100%

Techniques Analysis

This research used multiple regression analysis. Multiple regression analysis was used to test the effect of the independent variable on the dependent variable. Multiple regression models were developed to test the hypotheses that have been formulated in this study are:

$$DACC_{i,t} = \beta_0 + \beta_1\ ACSIZE + \beta_2\ ACMEET + \beta_3\ ACINDEP + \beta_4\ ACCOMP + \beta_5\ BIG4 + \beta_6\ FINANC + e$$

where Is:

DACC: Directionary Accruals as a proxy for earnings management

ACSIZE: audit committee size

ACMEET: Number of meetings (frequency) among the members of the audit committee within one year

ACINDEP: Audit Committee Independence Member

Accomp: Audit Committee Skills Members in Finance

BIG4: Auditors Reputation

FINANCQ: The need for external financing

E: Residual of error

To test this hypothesis test used the coefficient of determination (R2), simultaneous significance test (F test), and the individual parameter significance test (t test).

FINDINGS AND DISCUSSION

Discussion

The results of this study simultaneously succeeded in proving that the audit committee size, audit committee independent and audit committee meetings influenced on earnings management.

Audit Committee Size Effect

Based on the test results showed that the size of the audit committee obtained no significant effect on earnings management actions. It was consistent with previous studies conducted by Anggarini (2010) and

Rani (2011) which stated that audit committee size on earnings management there was no influenced. However, this study did not support Laksito and Putri (2011) also Suaryana (2005) which stated that audit committee size influenced earnings management.

In this study some companies fixed indicated in earnings management practices. This matter indicated that audit committee in sample companies lack of monitoring or tight oversee on financial report internal audit. In other word, minimal requirement audit committee member did not quarantee effective monitoring (Gradiyanto, 2012).

Audit Committee Frequency Meeting Effect

The results showed a significant relationship but in a positive direction. Therefore, this research can be said that the frequency of meetings held by the audit committee has no effect on earnings management practices. The results of this study are consistent with Trihartati and Pamudji (2010), Rani (2011), also Putri and Laksito (2011) which stated that there is no influence of the frequency of audit committee meetings on earnings management. But Gradiyanto (2012) did not support the result, he stated that there is a significant influence between the frequency of audit committee meetings with earnings management practices.

From these results it can be concluded that the members of the audit committee that meets at least four times a year was not able to reduce fraud in the financial reporting process. It could be explained that management and external parties rarely to present on audit committee meeting. Moreover Sharma *et al* (2009) in Putri and Laksito (2011) explained that audit committee meeting only a ceremonial also prosentage of attendance changes frequently so that, audit committee meeting was not effevtive.

Influence of the Independent Audit Committee

Based on test results obtained that the independent audit committee significantly had effect on earnings management practices. This result consistent with Pamudji and Trihartati (2010).

From the significant influence result showed that independence audit committee was enough mechanism to prevent earning management practices. Pamudji and Trihartati (20100 explained independence audit committee was the most important thing that audit committee member should had. Audit committee performance became effective if the member had independence in attitude and opini.

However, the results of this study did not support Putri and Laksito (2011) which stated that there was no influence of independent audit committee with earnings management. Anthony (2007) in Putri and Laksito explained the independence of the audit committee might not affect earnings management as long as the audit committee got benefit from the company, they woud be difficult to achieve independence.

Influence of the Audit Committee Expertise

From the significant influence result showed that independence audit committee was enough mechanism to prevent earning management practices. Pamudji and Trihartati (20100 explained independence audit committee was the most important thing that audit committee member should had. Audit committee performance became effective if the member had independence in attitude and opini.

However, the result supported Pamudji and Trihartati (2010) also Putri and Laksito (2011). These results indicated that companies that have audit committee with great competence in finance or accounting did not tend to have lower earnings management. The number of audit committee with accounting economy education background seem less to ensure audit committee performance and better oversight to management. Khomsiyah (2005) in Pamudji and Trihartati (2010) stated that based on the facts, this was due to the fact that the establishment of an audit committee with expertise in accounting and finance was only based on the applicable regulations.

The role of the audit committee was very important in monitoring the company's financial reporting. Characteristics of an effective audit committee was expected to prevent the occurrence of earnings management in the company. However, it was not supported by existing research, between audit committee characteristics such as the size of the audit committee, meeting frequency, independence, and competence of the audit committee, only audit committee independence which had significant effect on the earnings management practices prevention.

The size of the audit committee has not been able to make an effective contribution to the company's financial reporting. The audit committee frequency meeting members, despite being as required by Bapepam, but still there were companies that are likely to carry earnings management.

Audit committee member who had accounting and finance expertise also could not guarrante that they had better performance and control on earning management practices. While audit committee independence had significant influence showed that audit committee independence could prevented enough on earning management. In this condition, audit committee independence was needed for analyzing finance matters, so that could prevented earning management

From the explanation can be concluded that the existence of an audit committee characteristics such as the size of the audit committee, the frequency of meetings, independence, and audit committee members competence in this study can not fully prevent the practice of earnings management in the company.

CONCLUSIONS AND IMPLICATIONS OF RESEARCH

From the analysis of the data from the previous chapter, it can be concluded as follows:

1. The size of the audit committee did not have a significant effect on earnings management.
2. The meeting of the audit committee did not have a significant negative earnings management but have a positive effect.
3. The audit committee independent had a significant negative effect on earnings management.
4. The audit committee competence did not have a significant effect on earnings management.

Suggestion

Advice can be given with regard to the results of this study were as follows:

1. Companies managements need to give special attention to the phenomenon of earnings management in relation to the implementation of corporate governance.
2. Securities and Exchange Commission need to control for the fulfillment of corporate governance at each company would gave investors calm.

Researchers Limitations and Future Research Agenda

Limitations of this study include:

Model accrual Jones had not been able to separate the components of non-discretionary accruals and discretionary accruals appropriately. So there was a possibility of error classification of non discretionary accruals and discretionary accruals.

Agenda for future research are:

Earnings management measurement had to be more accurate, eg per industry. So that the characteristics of different industries that could affected earnings management could be incorporated into the measurement model. By developing a model each industry could also identify differences in the pattern of earnings management in each industry.

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