CHAPTER II
LITERATURE REVIEW

2.1 Earnings Management

In general, earnings management is interpreted as an intentional of attaining private gain by intervene the external financial reporting process. Even though management may interference the financial reporting process to provide more informations for users in the financial statements (which is useful for users), their focus is on the negative aspect of earnings management, such as mislead the investors about the firm's performances (Bédard, Chtourou, & Courteau, 2004). Accounting Standards that is applied by Indonesia called IFRS, have limitations that can make the financial statements presented to be unreliable. Because IFRS provides flexibility in applying accounting methods, a lot of managements use this flexibility to involve their subjectivity in determining the accounting method chosen and the time for discretionary expenditures that can affect earnings, ways such as accelerating or slowing down these expenses to other periods (Fitria, 2013).

This limitation causes earnings management practices. Some studies define that earnings management is an action to regulate corporate profits by rising or lowering it according to managers desire, utilizing certain accounting policies so they can manipulate financial statements to maximize personal interests, which can harm the interests of external parties of the company (Nuryaman, 2009).

There are three categories of earnings management according to Dechow and Skinner (2005) findings: Accruals Management, Fraudulent Accounting and Cash Flow Earnings Management (CFEM), they usually reffer it as Real Earnings Management (REM). Accruals Management implicates choices within accounting policies of GAAP that attempt to dim out or hide the actual company performance. Fraudulent Accounting implicates accounting choices that invade GAAP; the action of managers that implicate in changing companies principal operations in order to push the current earnings is when the earnings management occurs. Accruals management and fraudulent accounting are not accured by the change of firm's principle economic activities, but thru the use of choice in accounting methods to deputize the principle activities. Dechow and Skinner (2005) confirmed that we can manipulate the earnings recognition period so the earnings may increase or decrease by using accruals.

Burgstahler and Eames (2006) presented two theories to explain the main reason of earnings management on avoiding to report decreasing-earnings and losses, the first one is to decrease the cost charged from the transaction between the firm and shareholders and the second explanation is postulate the rejection of absolute and relative losses. Bowen, DuCharme and Shores (1995) discussed incentives to higher earnings reporting as:

1. Customers are most likely want to pay more for products because the firm provides guarantees and service commitments.
2. Suppliers propose better term payment, because the firm has the possibility to pay on time for current liabilities and higher chance to make a bigger purchases in the future.
3. Lenders propose better conditions, because the firm has a smaller possibility to go into liquidation or postpone their loan payments.
4. Qualified employees have a smaller possibility to either leave or ask for a higher salaries to stay.

The act of regulating financial statement earnings by using methods such as manipulation of the numbers so that the profits are high or low according to the wishes of the manager is the definition of earnings management the other study stated. In that case, the financial statements may look good for the users of financial statements who make decisions by considering the numbers listed in the financial statements (Amijaya, 2013). Walker (2013) identified three main sets of instruments that influence earnings management choices in a company:

1. To reach the contract target related to reported earnings. This contract is an income-based contract or equity compensation related to the company's performance. It usually happens, but not always there.
2. To form expectations of future cash flows or perceptions of company risk in order to manipulate investors or external parties to make a financial decisions.

3. To influence the third parties that have an interest in the financial strength of the company. Such as, competitors' potential, suppliers, customers, workers, pressure groups, regulators, politicians, etc.

Therefore, it can be said that the action of earnings management deludes the financial statements users in making a financial decisions. In addition, earnings management can also be defined by Enomoto, Kimura and Yamaguchi (2015) as a manager's choice of accounting policies used, or a concrete action that can affect company profits so that the achievement of specific reporting objectives is achieved. Earnings management is a management consideration that is used to choose an accounting policy to present a financial statement within the limits of accounting principles that are accepted by general, in order to benefit oneself or the company's value (Nini & Trisnawati, 2009).

There are two categories of earnings management practice that can be clarified, namely real earnings management, which can be done through accrual transactions that can directly affect cash flows and the second category is accrual eparnings management where accrual transactions cannot directly affect cash flows, but through changes in accounting methods. Accrual earnings management practices are often used by companies at the end of the period when managers know the company's profits, so managers can determine how much manipulation will be done to achieve the desired profit (Aeni, 2017). The earnings management according to (Azlina, 2010) is to regulate the company's profits in such a way by playing the revenue and expense items contained in the income statement, it can be through the utilization of alternativef methods or through operations. Thus, in order to measure variabel dependent of this research, earnings management, this study use discretionary accruals and non-discretionary accruals.

Discretionary accruals (DA) can freely choose accounting policies such as accounting methods option and estimation methods to be used, because this kind of accruals are controlled or determined by management. With accrual accounting, managers also can take control of the revenue and cost recognition period so they can utilize the firm's profits for a certain period (Shah, Butt, & Hasan, 2009). For example, when management wants to increase net receivables, they will reduce the allowance for doubtful accounts. Therefore, the author uses discretionary accruals as a proxy that determines whether there is an earnings management conducted by a company, because this kind of accruals are related to non-cash transactions, so it's easier for management to arrage the financial informations as they desired.

It is the opposite from Discretionary Accruals (DA), Non-Discretionary Accruals (NDA) are determined according to the economic conditions, so managers cannot control it. Non-Discretionary Accruals are occured by the company's business model, accounting policies and its operational environment (Christensen, Frimor, & Şabac, 2013). Thus, NDA is related to the business activity level and external parties or any binding regulations. The example of NDA is amortization; manager cannot manipulate the amortization's amounts, because it has bound with intangibles and with the certain rules or laws. Other examples such as business volume increase, tax rates, etc. are cash-based transactions that cannot be regulated by management because such transactions will be traced and will be prosecuted with the available evidence to reflect the cash flow that occurred (Amijaya, 2013).

In addition, Ewert (2011) interprets earnings management as gray earnings management, white earnings management and black earnings management. Earnings management profit or white earnings management increases the financial report transparency; black earnings management, reduce transparency or even fraud; while gray earnings management, chooses an opportunistic accounting method – which mean, maximizing manager's wealth, or it can be economically efficient for the entity concerned. Eventhough Ewert (2011) recognized that earnings management might have a positive impact (white or gray variant), in their conclusion, earnings management is a bad practice. This conclusion has the same definition as (Healy & Wahlen, 1999).

In addition, agency issues have a relation with the splitting ownership and control that cause the needs for audited financial statements by external auditors. Initially, agency problems arise when there is an asymmetric information between principal-agent contracts. It indicates to a circumstance that one party received more informations compare to the other party. This kind of condition allows for earnings management practices to occur. In that case, shareholders have limited incentives, resources or access to related informations in order to oversee the managers' actions (Gerayli et al., 2011). Richardson, Tuna, and Wu (2003) found the main reasons for managers to do earnings management practice:

1. A desire to get external funding at a lower cost.
2. Companies that review financial statements, always try to maintain a series of positive revenue growth in a row.
3. There is capital market pressure, which acts as a motivating factor for companies to adopt aggressive accounting policies.

2.2 Prior Researcher Models

Several studies have examined to determine which factors can influence the behavior of earnings management practices. Nini & Trisnawati (2009) conducted a study of the effect of audit fees, non-audit services and professional ethics on earnings management with Basic-Chemical and Consumer Good Industries listed on the IDX as samples. The conclusion of the findings is the auditors who work at Big-Four Public Accountant Firms that apply the principles of professional ethics are proved to have an influence on earnings management practices. Auditors who are working in Big-Four public accounting firm tend to have a high independence, so the audit fees can not prevent the auditor in limiting the occurrence of earnings management practices. As for non-audit services, the more the auditor provides non-audit services at Big-Four public accounting firm, the less likely the earnings management practices will occur.

Azlina (2010) conducted an analysis of whether boards of directors size, leverage, and the percentage of shares offered to the public, and firm size can affect the earnings management. He found no significant relationship between board of directors, leverage, and shares percentage that offered to public with earnings management. Meanwhile, he found a significant effect of firm size on earnings management. Ningsapiti (2010) research was about the effect of ownership concentration, company size, and corporate governance mechanisms on discretionary accrual as earnings management proxy, with the aim of obtaining empirical evidence. The results show that firm size, ownership concentration and audit quality with auditor industry specialization as proxy, have a negative significant effect on discretionary accruals. Meanwhile, the board of commissioner's size and audit committee size do not significantly effect the earnings management. Shah et al. (2009) also examined the effect of corporate governance quality on earnings management using the ownership structure, board structure and the audit committee expertise as a measurement of the corporate governance quality and found that, the corporate governance quality is positively significant to earnings management.

Meanwhile, Indriastuti (2012) examine whether the corporate governance and auditor quality can effect the earnings management in corporate banking. The finding stated a good quality audit might increase the earnings management practice. On the other side, they found the other variables have a significant negative effect on earnings management, namely; managerial ownership and institutional ownership. Neifar, Halioui and Abdelaziz (2016) found a negative relationship between total compensation of CEO, CEO characteristics (age and tenure of CEO) and earnings management. Their research is about the relationship between financial aggressiveness and earnings management motivation, using non-financial American companies after the 2007 financial crisis as research samples.

Mahawyahrti & Budiasih (2016) figure out the relationship between leverage, information asymmetry, firm size and earnings management. They used positive accounting theory and agency theory to explain this relationship and for data analysis technique, they used multiple linear regression. The results show that this study proves that leverage and information asymmetry have a positive effect significantly on earnings management. While firm size is opposite, it has a negative effect. Thi, Khanh and Khuong (2018) verify the relationship of company characteristics and audit quality with company's real earnings management that registered in Vietnam, following Roychowdhury (2006) real earnings management measurement. Their findings are there is a negative relationship between firm size and real earnings management, while firm age and profitability had a positive relationship.

Owens - Jackson, Robinson and Waller Shelton (2009) suggested the firm nature and contracting environments are important elements to determine the possibility of earnings management. Nevertheless, the presence of audit committees with full independence members may decrease the influence of firm's underlying nature and contracting environment on the possibility of earnings management. Meanwhile, research by Alves (2013) contributes that the existence of independen external auditor and audit committee fail to give an effective overseeing on earnings management in companies that are registered in Portugal. But, if audit committee and external auditors work together, they have the ability to help companies reducing earnings management and step forward positively to improve the quality of earnings. This finding is interrelated for countries with the same institutional environment as Portugal.

Based on 434 listed companies in Australian as a cross-sectional sample in 2000, Davidson, Goodwin-Stewart and Kent (2005) found that audit committee and non-executive directors are negatively related to absolute level of discretionary accruals (earnings management). They use a small increase in earnings as a benchmark for additional analysis and the result is the same as before that these two variables have a negative relationship.

Martínez-Ferrero, Banerjee and García-Sánchez (2016) conclude that Corporate Social Responsibility has a beneficial effect on cost of capital, it is consistently stronger in companies that show signs of earnings management, or it can be stated that the market cannot identify earnings management if they use CSR practices as a strategy to cover earnings management. Alexander & Christina (2017) examined the effect of tax ownership, corporate governance and tax aggressiveness on earnings management. From the result, they find out that the board of directors has influence the earnings management positively, while the board independency, audit quality, managerial ownership, and tax aggressiveness had no influence on management profit. The reason of them having this kind of result is because the commissioners in the company do not effectively monitor the managers, so they have not be able to decrease the earnings management practice. They stated, the bigger the board of director's size, the less likely they monitor the management team effectively. The board of directors size must not be too small or too large in decreasing the earnings management practice in the company (Kao & Chen, 2004).

Xie, Davidson and DaDalt (2003) figure out the role of executive committee, board of directors and audit committee on earnings management. They used nineteen independent variables and two control variables to test. The results are nine of the independent variables have a negative relation with earnings management significantly, namely board activity, corporate outside director's percentage, corporate members, book value of total assets, log sales, board size, log market value equity, outside directors, audit committee activity. The other variables that have a significant positive relationship are audit committee size, percentage of external directors, finance external directors, legal external directors, blockholders external directors, blockholder votes, and the number financial expertise of audit committee, banking members, legal members and blockholder members.

Kim and Yi (2006) investigate how deviations of shareholder control and affiliated business group can affect the level of earnings management. Their research prove that there is a significant positive effect of voting rights, cash flow rights, affiliate business, publicly traded firm on earnings management. While Big Six and company size effect the earnings management insignificantly.

Gras-Gil, Palacios Manzano and Hernández Fernández (2016) examined the effect of Corporate Social Responsibility on earnings management in Spain using a sample from 2005 to 2012. He used MERCO index as a proxy for CSR and the findings are CSR is negatively effect the earnings management, means the companies that do CSR tend to reduce earnings management practices. Firm size as control variables have a significant negative effect on earnings management, while the other control variables: leverage, ROA, and listing firm have a significant positive effect. This is consistent with Chih, Shen and Kang (2008), Faisal, Prasetya, Chariri and Haryanto (2018) and Gargouri, Shabou and Francoeur (2010) who also conduct research on CSR and earnings management.

Audit quality role, cultural influence and low growth free cash flow also can affect earnings management. Astami, Rusmin, Hartadi and Evans (2017) managed to find evidence that state culture can significantly influence positively on earnings management, while free cash flow in low growth and audit quality have a significant negative effect, consistent with research by Linda Wimelda and

Chandra (2018). Control variables such as company size, leverage and CFO have a insignificant effect on earnings management. Linda Wimelda and Chandra (2018) also examines motivational bonuses variable with ROA as proxies and the result is significantly positive; firm size is significantly negative; while managerial ownership, institutional ownership, proportion of independent commissioners and audit committee size are insignificant to earnings management.

Business groups are a common form of organization throughout the world and are prevalent in most developing countries (Bhaumik & Gregoriou, 2010). Hsieh, Yeh, & Chen (2010) defines business groups as a form of ownership that are legally independent but standing under the same control of ownership, each group member participates to achieve their own company goals and have to contribute in achieving the common goals of business group. Affiliation or business groups are a combination of networks between semi-autonomous corporate organizations through ownership ties, buying and selling kinship between directors, and complex socials Bamiatzi, Cavusgil, Jabbour, & Sinkovics (2014). Affiliated companies in a group have the opportunity to learn from other companies that are part of the group's network (Singla & George, 2013).

Some business affiliations are carried out for mutual use, such as group affiliated companies in Belgium, they manage revenue strategically to take advantage of tax incentives by using intra-group transactions (Beuselinck & Deloof, 2014). Muttakin, Khan, & Mihret (2017) stated that companies are often affiliate with their own families group, in order to support each other when they face some financial difficulties, and most of the affiliated companies are linked through cross ownership or directorate relations, which are interrelated. Companies that are affiliated with business groups are better able to deal with institutional challenges in emerging markets and are more effective in getting the resources or expertise needed from foreign markets than companies that are not affiliated (Singla & George, 2013).

Muttakin et al., (2017) used discretionary accruals’ absolute value to measure earnings management, for measure audit quality; they used auditor size (ie Big Four or non-Big Four) and auditor industry specialization. Their findings were firms business-affiliated groups in Bangladesh manipulated the earnings largely through discretionary accruals (significant positive), and proved that audit quality have an ability to limit earnings management in affiliated companies. This is similar with the findings of Beuselinck and Deloof (2014), which show that we work in an environment with weak investor protection, the complexity of ownership structure in the business groups may create opportunities for managers to take over the minority shareholders and cover it through earnings management. It is consistent to Kim and Yi (2006)'s study, whose show that shareholders in the business group affiliation may take control over higher incentives and better resources group to practice earnings management so they can cover their self-serving behavior.

2.3 Factors Affecting Earnings Management

2.3.1 Effect of the Auditor Size on Earnings Management

DeAngelo (1981) argued that big auditor firm size tend to have a lot of clients and higher total fees, so do their independence. To define whether the auditors have a high independence is by their ability to discover any misstatement in financial statements. Auditor size can be divisibled into Big 4 and Non Big 4, Big 4 Auditors are auditors who have higher reputation and skill than Non Big Four auditors. Auditors from Big 4 company are considered to have a better quality and higher ability to limit earnings management practices, they will be more careful and maintain their independence in act during the audit process and independence in appearance in order to maintain public trust toward auditors compared to non Big Four auditors (Nini & Trisnawati, 2009). Therefore, we can measure an audit quality with which auditors a company has used.

Alzoubi (2016) stated that Big 4 audit companies have larger scale of operations, have more capital, human resources, technology and experience that enable them to get higher audit quality than non-Big 4 audit firms. Thus, we can say that qualified and highly reputable auditors make it possible to limit the earnings management practices. Here are the public accounting firms that have classified as Big Four:

1. Deloitte Touche Tohmatsu (Deloitte), affiliated with Osman Bung Satrio & Partners; Osman Ramli Satrio & Partners; Hans Tuanakotta Mustofa & Halim, with revenue achieved in 2017 of US $ 38.8 billion.
2. PricewaterhouseCooper (PwC) affiliated with Tanudiredja, Wibisena & Partners; Haryanto Sahari & Partners, with revenue achieved in 2017 of US $ 37.7 billion.
3. Ernst & Young (EY), affiliated with Purwantono, Sarwoko & Sandjajadengan; Prasetio, Sarwoko & Sandjaja, with the revenue achieved in 2017 amounted to US $ 31.4 billion.
4. Klynveld Peat Marwick Goerdeler (KPMG), which affiliated with Siddharta Siddharta & Widjaja and revenue achieved in 2017 of US was $ 26.4 billion.

Soliman and Ragab (2014) found evidence of negatively significant relation of auditor size and earnings management. Big Four auditors more likely to be more competent and professional compare to auditors from Non-Big 4 auditor, because they have more knowledge about how to detect a manipulated financial statements or how the company performs earnings management practice. This findings are the same as (Chen et al., 2011; Gerayli et al., 2011; Lin & Hwang, 2010; Lopes, 2016).

However, auditors from Big 4 company are not always that promising, just like the cases in Chapter I that I have mentioned, even Deloitte that is belong to Big Four could neglect detecting SNP fraud. This happended, because of the weak investor protection, therefore the profit quality is also low (Francis & Wang, 2008). This statement is supported by Muttakin et al. (2017), where he uses auditor size to measure audit quality and find out that the relationship of auditor size and earnings management is positive, it is the same as well as Ebrahim Nawaiseh (2016) findings. Eventhough, the author formulates the hypothesis as follows:

H1. The size of a public accounting firm has a negative effect on earnings management.

2.3.2 Effect of Auditor Tenure on Earnings Management

Previous research, Becker, Defond, Jiambalvo and Subramanyam (1998) provided evidence that auditor independence increased with increasing auditor tenure. Because they have a better experience and insight on operational and business strategies, including client's internal control of financial reporting, so, longer auditor tenure may have a better assess for the risk of material statements. It is the same as Yang and Krishnan (2005), who reported auditor tenure can effect the earnings management significantly negative. Their conclusions are the increase of auditor's tenure, the better insight and greater experience into business strategies and firm operations benefits is appeared to outweigh the potential of decline in independence.

However, Davis & Soo (2000) have a different opinion, having clients' operations and system information knowledge is important, because they can understand and identify the sources of audit risk and effective audit performances. These understanding can only increase with tenure. Thus, long-term auditor tenure may allow management to participate in broader earnings management due to lack of auditor independence. The implication is that the limitation of the auditor's tenure can strengthen the auditor's independence and improve the auditor's function as an auditor of financial statements. The second implication, companies that have longer ownership auditors tend to have greater discretionary accruals, where the accrual revenue far exceeds what has been estimated. So, this positive effect of auditor tenure on earnings management is hypothesized:

H2. The auditor's tenure has a positive effect on earnings management.

2.3.3 Effect of Audit Committee Size on Earnings Management

The main role of audit committee is to assure a high quality of financial reporting by decreasing the opportunistic of earnings management with evaluated external auditors (Bédard et al., 2004). Audit committee must have adequate resources, like informations about financial report or anything related to the organization in order to complete the tasks effectively. Most studies estimate the company's resources using audit committee size. There are several studies in the United States, found that audit committee size is negatively effect the earnings management (Albersmann & Hohenfels, 2017), while other studies found the effect of audit committee size on earnings management is insignificant (Davidson et al., 2005; Xie et al., 2003)

According to Albersmann and Hohenfels (2017) findings result, less than three members of audit committee is generally considered to be critical in voting procedures and decision-making process. If audit committee size becomes too big, it decreases the positive effect and in its performance too due to poor communication. Thus, the effectiveness of decision-making process will lessen and cause the diffusion of responsibilities. After conducting various studies, the literature concludes that the optimal range for audit committee size is three to six. Davidson et al. (2005) examine whether a bigger size of audit committee may have a negative effect on earnings management in the United States compared to those that have smaller size, like fewer than three members. The results show that the relationship between the two variables is insignificant.

The relationship between audit committee size and monitoring performance is positive in Dalton, Daily, Johnson and Ellstrand (1999) findings. So, Mohd Saleh, Mohd Iskandar and Mohid Rahmat (2007) used the same analogy with the intuition of the bigger audit committee size, the more various ability and knowledge are hired to enhance inspecting. In that case, can decrease earnings management practice.

Yet, the effect of the number of audit committee can be driven by the fact that audit committee size has a greater possibility to also include members with diverse financial expertise, so they will be able to oversee the financial reporting process effectively (Ghosh, Marra, & Moon, 2010). So, based on the previous findings, it can be hypothesized as:

H3. Audit committee size has a positive effect on earnings management.

2.3.4 Effect of Audit Committee Competence on Earnings Management

To carry out its responsibilities in supervising the financial reports of clients and internal control, audit committee must have at least one financial competence auditor (Bédard, Chtourou, & Courteau, 2004). The followings are things that can be considered as a competent auditor:

1. Understand the general accepted accounting principles and have a financial statements knowledge,
2. Experienced in auditing or preparing financial statements and have an ability to make estimations, accruals and reserves with applied accounting principles.
3. Experienced in internal control in accounting
4. Understand the functions of the audit committee (Carcello, Hollingsworth, Klein, & Neal, 2006).

Marrakchi Chtourou et al. (2001) said that, BRC (1999, p.25) stated having financial knowledges are necessary for audit committee. Minimum one of the audit committee member has a degree of accounting expertise or experience related to accounting management. Financial expertise means a person that have an accounting professional certification, who skilled in doing finance or accounting, or any other abilities and background that can produce a competent financial expertise, including being a CEO or any senior officer who acts as the supervisor of financial statements. This financial expertise is believed to increase the possibility of material misstatement to be detected and corrected in a timely manner after being communicated to other audit committee members (Lin & Hwang, 2010). Knapp (1987) stated that the possibility of expertised audit committee to help the auditors when they have an auditor-client dispute issue is higher, compare to the audit committee members with other backgrounds. Yang and Krishnan (2005) also believed audit committees with financial competence member have a better interaction with internal auditors, because they found the association between the existences of financial competence audit committees and earnings management is negative.

So did Bédard et al. (2004), their results showed audit committee that have more financial expertise members, more likely to restrict earnings management effectively. Especially when they found the existence of minimum one financial expertise member, is already enough to decrease aggressive earnings management. But the relationship between financial expertise and earnings management is significant for only on income-decreasing accruals. Marrakchi Chtourou et al. (2001) proved that audit committee expertise has negative significantly effect the earnings management, this result is similar with Alzoubi (2016); Lin & Hwang (2010); Soliman & Ragab (2014). Therefore, we formulate this hypothesis as follow:

H4. Audit committee competence has a negative effect on earnings management.

2.3.5 Effect of Audit Committee Meetings on Earnings Management.

Audit committee is tasked to supervise and monitor the participation of management and auditors in process of making company financial statements. So, Yang and Krishnan (2005) suggested that audit committees should active on holding meetings at least once in a quarter and special meetings when needed.

It is also important to provide sufficient time for the audit committee to carry out their duties (Shankaraiah & Amiri, 2017). Lin and Hwang (2010) said, the BRC (1999) recommends that the meetings should discuss about the corporate financial reporting quality with external auditors. The frequency of this meeting was investigated because for companies that rarely hold meetings or audit committees that are less active, it will be difficult to monitor the work of management effectively. Soliman & Ragab (2014) believed that to prevent the earnings management practices from happening is by having the audit committee to do the duty properly and effectively.

Abbott and Parker (2000) found a relation of the increase of audit firm quality with audit committee meetings. The often they hold the meetings, the more possibility for them to achieve industry specialization, which is an important skill for external auditors. Lin and Hwang (2010) and Shankaraih and Amiri (2017) findings are supports the conducted research that found a negative significantly effect of the frequency of audit committee meetings on earnings management. Following the results of previous research, this variable is hypothesised as follows:

H5. Frequency of Audit Committee Meetings has a negative effect on earnings management

2.3.6 Effect of Audit Quality and Audit Committee on Earnings Management.

Mitchell Van der Zahn, Singh, & Singh (2008) stated that audit quality and audit committee can increase the financial statements quality. The interaction of audit committee's and external auditor may determine the auditor's honesty and objectivity in preparing the financial statements. Therefore, if audit committee work effectively and the quality of audit is good, it is expected to decrease the practices of earnings management (Lin & Hwang, 2010). The possibility of an effective audit committee to preserve the same auditors is lower, if the auditors could limit the earnings management. Certainly, an audit committee that could get along with external auditors may enhance the dependence and confidence level with the manager of the company. Hence, long tenure may increase the earnings management (Meixner & Welker, 1988).

Lin and Hwang (2010) showed that audit committees has negative significantly affect the earnings management. But, a simple existance of an audit committee does not guarantee the anticipated benefits. So, the author indicate the hypotheses for research analysis as follow:

H6. The audit quality and audit committee has simultaneously affect the earnings management.

2.4 Research Models

To examine the effect of audit quality and audit committee on earnings management, the author develops the research model as follows:

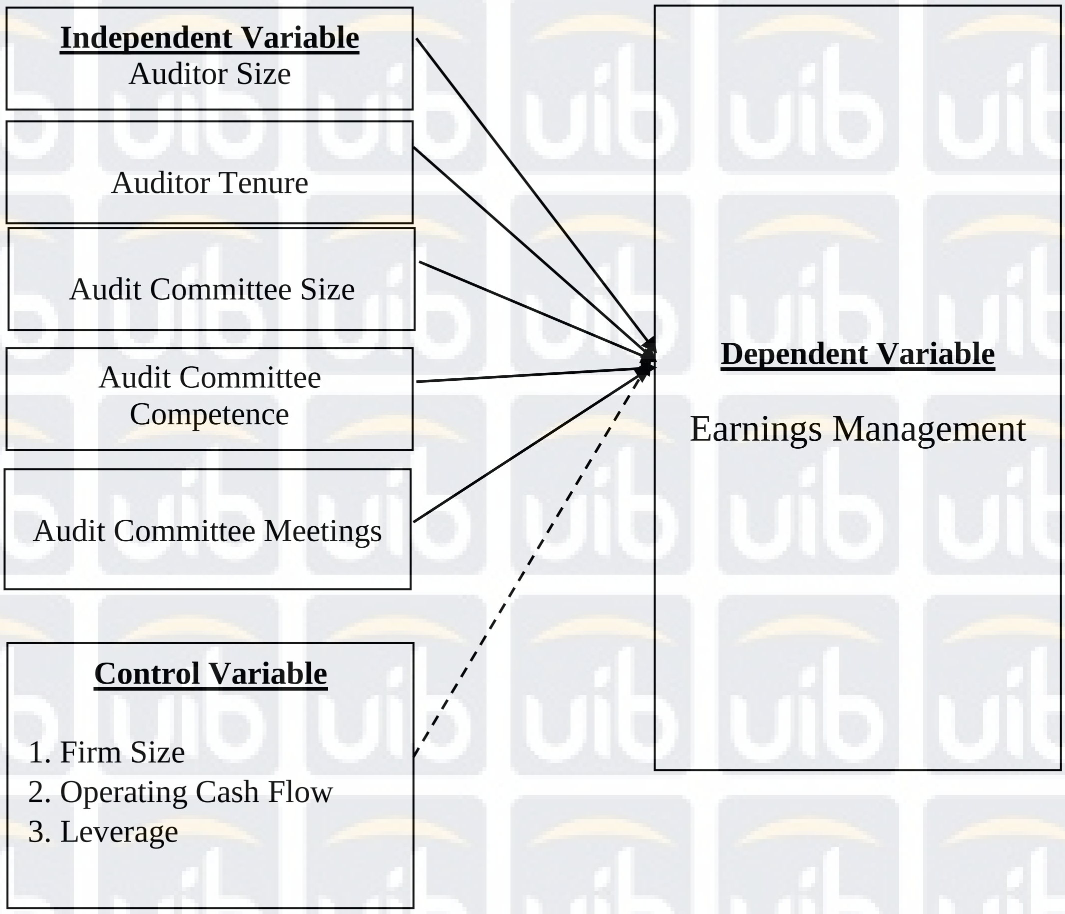

Figure 2.1 Research Model