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by Michelle Tevi

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The Effect of Audit Committee Characteristics on Real Earnings Management: The Moderating Role of Seniority Level and Education Level of Chief Financial Officer

Michelle Tevi Goeinawan^{1,*} Micheline Clarissa² Yulius Jogi Christiawan³

¹Business Accounting, Petra Christian University

²Business Accounting, Petra Christian University

³Business Accounting, Petra Christian University

* Corresponding author. Email: d12180171@john.petra.ac.id

ABSTRACT

Research on the effect of audit committee characteristics, especially on the composition of women on real earnings management, has been widely carried out with mixed results. Upper-echelon theory explains that the characteristics of its leaders will influence the company's performance. The achievement of profits reflected the company's performance. To achieve the profit target, companies need the characteristics of the Chief Financial Officer (CFO). CFOs who have insight, broad experience and good communication skills will be more considerate and careful in carrying out earnings management to strengthen company performance. The characteristics of the company's leadership members are the level of seniority and education of the CFO. Seniority and education level of CFO are thought to influence the relationship between the characteristics of the audit committee and the real earnings management of an organization. This study aims to examine whether the level of CFO seniority and education can affect the relationship between audit committee characteristics and real earnings management. The researchers conducted the study on 351 companies in all sectors, except banking, which were listed on the IDX in 2018-2019. The data analysis used panel data regression using Gretl software. The results of testing the data proved that more women composition in the audit committee would potentially increase the practice of real earnings management. Furthermore, the increase in real earnings management due to the more composition of women on the audit committee will be weaker in companies with a high level of CFO seniority compared to those with low CFO seniority levels. This study failed to prove the moderating role of CFO education on the relationship between female composition in the audit committee with real earnings management. The researchers expect the study results are helpful for shareholders to pay more attention to the composition of women in the audit committee, the level of seniority, and the education of CFOs to avoid real earnings management practices.

Keywords: Audit committee characteristics, Real earnings management, Chief Financial Officer seniority level and education level, Upper-echelon theory.

1. INTRODUCTION

Earnings management is the act of influencing a company's profit figures carried out by management. Influencing profit figures means increasing or decreasing profits. Companies use profit figures as a decision-making tool for external and internal parties such as shareholders, employees, the public, banks, and others where external and internal parties of the company have their respective interests. In achieving these interests, companies need to conduct earnings management actions.

Earnings management actions have two types; real earnings management and accrual earnings management.

The purpose of both real earnings management and accrual earnings management is to prioritize current revenue targets [1]. However, real earnings management carried out in the company's daily activities, while accrual earnings management is an earnings management action related to accounting policies. This study uses real earnings management, one of the practices of earnings management.

This study uses real earnings management because of the shift in earnings management patterns caused by the development of the times [2], and managers more often use real earnings management because it is more difficult to detect by auditors than accrual earnings management [2], [3], [4]. In addition, according to Firmansyah and

Irawan [5], accrual earnings management is riskier in managing period-end reports. Therefore, to supervise management in carrying out real earnings management, an audit committee is needed.

The audit committee has a significant role in conducting supervisory and controlling functions [6]. Therefore, the presence of an audit committee greatly affects the company [7], [8], [9] to supervise the management in doing daily activities transparently, open, and responsibly. Previously, there have been many studies regarding the presence of audit committees, especially on the composition of women in audit committees and real earnings management. Such as research conducted by Thiruvadi & Hua Wei [10], Gavius et al. [11], Setiawan et al. [12], Mardessi & Fourati [13], who found the results that the composition of women in the audit committee affected negatively on accrual earnings management and real earnings management. However, the results of this study are different from the research conducted by Novilia & Nugroho [14], Karen & Oktavia [15], which found that the composition of women in the audit committee did not affect earnings management. Because the results of previous studies have been mixed, it is suspected that there is a connection with CFO characteristics.

Based on upper-echelon theory, each company needs leadership characteristics to achieve and strengthen company performance [16], one of which is CFO characteristics. From the previous research, no research considers the characteristics of a CFO. The characteristics of the CFO are the condition of seniority and CFO education. The condition of seniority and CFO education can strengthen or weaken the relationship between an audit committee and real earnings management. The presumption is that CFOs with a high level of seniority will have extensive experience so that they are more careful in managing earnings than those with a low level of seniority. In Contrast, CFOs with a high level of education can use their insights to strengthen company performance. Therefore, this study aims to examine whether seniority and CFO education level can affect the relationship between the composition of women in the audit committee on real earnings management.

In this study, there is one independent variable, the composition of women on the audit committee; one dependent variable, real earnings management; two moderating variables, seniority level and CFO education; and two control variables, Return On Assets and Leverage.

2. LITERATURE REVIEW

This study uses agency theory, nature theory, and upper-echelon theory to explain the relationship between the existence of an audit committee, real earnings management, seniority level and CFO education.

2.1. Agency Theory

Agency theory is the base for research on the relationship between the existence of an audit committee and real earnings management. Agency theory is a theory that discusses about agents and principals have their focus and interests. According to Jensen & Meckling [17], agents and principals are parties who prioritize their interests and maximize their utility. The principal is the owner of the company, which is more focused on ensuring the company's performance and the correctness of the information in the company. At the same time, the agent is the company's management who puts the responsibility on the principal to gain benefits for the principal.

In this concept, agents and principals are rational parties who prioritize their respective interests. The agent must make a profit for the principal, but the agent is interested in making a profit for himself (bonus plan). At the same time, the principal is interested in ensuring the performance and correctness of the information on the company. Therefore, the existence of an audit committee is expected to be able to supervise management in carrying out real earnings management practices.

2.2. Upper-echelon Theory

Upper-echelon theory discusses that the leader's characteristics influence the company's performance and management techniques [16]. Characteristics of high leadership can strengthen company performance, such as preventing management from doing earnings management. The leader's characteristics can be seniority level, education level, age, and others. According to Andhara et al. [18], seniority is the length of time a person has worked and affects high positions. Usually, a long work experience can increase a person's position in a company. Someone with vast work experience will get a broader insight into the world of work.

According to Nurkholis [19], education is essential for a person to get perfect development. Because the education of company employees tends to influence them to innovate [20], employees with high education will have accessible opportunities to work. A high level of education might influence company performance and company decision making positively. Therefore, the expectation is that CFOs with high levels of seniority and education can influence the relationship between audit committee characteristics and real earnings management.

2.3. Nature Theory

Nature Theory discusses the differences between women and men to provide different circumstances or implications between the two genders. This difference provides different roles and tasks because of biological factors consisting of genes, chromosomes, nerve cells, brain structures and others. According to Azizah et al. [21], if the theory of nature is associated with companies, it will refer to differences in behaviour and traits between women and men.

2.4. Real Earnings Management

Real earnings management is an act of influencing earnings in the company's daily activities in a certain period. According to Roychowdhury [2], management performs real earnings management by paying attention to the company's short-term performance, which causes a long-term decline in value and negatively affects future company performance. Real earnings management is also divided into three measurements; abnormal discretionary expenses, abnormal cash flow operations, and abnormal production costs. Real earnings management in this study uses a measurement with a proxy for abnormal cash flow operations (Ab_CFO). Ab_CFO is the difference between real cash flow operations (CFOR) and normal cash flow operations (NCFO). If Ab_CFO is positive, the real cash flow operations are more significant than normal cash flow operations. This situation means that there is earnings management in the form of increased profits and vice versa. Therefore, the following formula is obtained:

$$Ab_CFO_{it} = CFOR_{it} - NCFO_{it} \quad (1)$$

Description:

CFOR_{it} = Cash Flow from operations / TA_{t-1}

Furthermore, NCFO_{it} is estimated using the following regression model:

$$CFOR_{it} = \alpha_0 + \beta_1 (1/TA_{it-1}) + \beta_2 (Rev_{it}/TA_{it-1}) + \beta_3 (\Delta Rev_{it}/TA_{it-1}) + \varepsilon \quad (2)$$

α_0 = Constant

$\beta_1, \beta_2, \beta_3$ = Regression coefficient

Rev_{it} = Revenue at company i year t

ΔRev_{it} = Revenue at company i year t - Revenue at company i year t-1

TA_{it-1} = Total Assets in company i year t-1

ε = Error

2.5. Audit Committee

The audit committee is formed by the company's board of commissioners and refers to the Financial Services Authority (OJK) Regulations Number 55/POJK.04/2015 concerning the establishment and guidelines for the implementation of audit committee work. The audit committee formed by the board of commissioners has the duties and responsibilities to oversee the activities of the company's management, ensure compliance with company regulations [22]. In addition, the audit committee is also responsible for reviewing the company's financial information such as the reliability of financial statements so that management carries out daily activities of the company in a transparent, open and responsible manner. The supervisory function of the audit committee will encourage company management to manage the company better healthily [6]. The audit committee can be measured by using the characteristics of the audit committee such as age, the composition of men or women in the audit committee, size (number) and others.

In this study, the characteristics of the audit committee studied were the composition of women on the audit committee.

2.6. CFO Characteristics

The CFO is one of the members of the company's leadership who is responsible for finance and decision making in the company's operational activities. According to Kurniawan [23], the leader has the task of influencing his colleagues to work with the leader to achieve the desired organizational goals. The CFO has the task of assisting the Chief Executive Officer in solving financial problems of spending, budgeting, finding and preparing financial reports. In addition, the CFO contributes to the company's strategy on financial plans, investment composition and resource allocation for alternative projects [24].

According to Florackis & Sainani [25], the individual characteristics of CFOs influence the choice and results of a company's business. There are several things to consider in choosing a CFO, one of which must pay attention to several characteristics such as education, seniority, age, gender, and others. By paying attention to some of the characteristics above, it will support the selection of a CFO with high integrity in realizing the company's achievements and being an example for other employees to imitate the attitude of their superiors. In addition to influencing other employees, CFOs with good characteristics can estimate earnings accurately so that management does not carry out earnings management opportunistically. In this study, the characteristics studied were the level of seniority and education of the CFO.

2.7. Return On Asset

Return on Assets (ROA) is one of the profitability ratios. The profitability ratio is a ratio that provides an overview of the company's ability to earn profits from company activities. Furthermore, it also provides an overview of the company's ability to generate profits regardless of funding [26]. The higher the ROA value of a company indicates that the company is more effective in obtaining profits by utilizing its assets, and vice versa, the lower the ROA value of a company indicates that the company is less effective in obtaining profits by utilizing its assets. This study uses ROA as a control variable.

2.8. Leverage

Leverage is a loan that is used to increase the return on investment. Leverage can be analyzed by comparing total debt to total assets to measure how much loan or debt funds are used to purchase equipment or other assets. Suppose the leverage ratio has a value above 0. In that case, the company also operates using debt. In contrast, if the leverage ratio has no value or is equal to 0, then the company does not use debt funds or uses its funds in operating the company. In addition, leverage can increase profits, such as lowering taxes, but leverage that

is too large can also harm the company if the company experiences financial problems.

2.9. The Relationship between Audit Committee Characteristics and Real Earnings Management

According to Al-Hadrami et al. [22], the audit committee is responsible for carrying out the supervisory function of the company's management activities so that an audit committee is needed in every company. In agency theory, the company is also directed to involve and have an audit committee to increase supervision of company activities. The audit committee can be seen by using several characteristics, such as the composition of women in the audit committee.

According to Hegelson [27], there are differences in social categories between men and women, such as psychological appearance and roles in social life. Based on the theory of nature, differences caused by genetic factors, nerve cells, brain cells, and others owned by men and women will give different circumstances or implications, giving rise to differences in leadership styles. According to Peni & Vahamaa [28], in addition to differences in leadership styles between men and women, there are also differences in communication skills, conservatism, decision-making, and risk aversion. Based on the previous explanation, the audit committee with a dominant composition of women will encourage earnings management practices in the company. This situation is presumably due to differences in leadership styles between women and men. According to Gibson, male leadership tends to be more assertive and goal-oriented, while female leadership tends to emphasize on the interaction and well-being of subordinates [29].

Furthermore, it is suspected that the appointment of a female audit committee can be called a fortune [30] regardless of its capabilities so that the oversight carried out by the female audit committee on management is looser and causes management to take actions that benefit themselves. Based on this explanation, the conclusion is that the higher the composition of women in the audit committee, the higher the management's intentions to increase profits so that it can be hypothesized as follows:

H1 : The composition of women in the audit committee affects positively real earnings management.

2.10. CFO Characteristics Relationship Audit Committee Characteristics and Real Earnings Management

Based on the upper-echelon theory, the characteristics of the CFO will affect management in carrying out real earnings management. The characteristics of the CFO include the seniority level and education of the CFO. According to Thommes & Klabuhn [31], the length of a person's working period will affect his work results. They suspect that the seniority level of CFOs with vast work experience will strengthen the company's performance because they are more considerate and careful in

conducting earnings management and can suppress real earnings management practices. Therefore, the longer the seniority of the CFO can affect the relationship between the existence of the audit committee and real earnings management. A high CFO seniority level can help female audit committees because CFOs with high seniority levels will be more careful and rethink every action taken to help audit committees with a female composition be more assertive in carrying out their duties. Therefore, the conclusion is that the longer the seniority of the CFO, the lower the real earnings management action to increase profits because of women's composition in a company. Therefore, obtained the following hypothesis:

H2 : CFO seniority level weakens the positive relationship between the composition of women in audit committee and real earnings management.

Based on upper-echelon theory, CFO education level is a significant matter to consider in choosing CFO with integrity. The presumption is that CFO with high education will have broader insight to strengthen the company's performance, conduct supervision, and predict profits correctly. The research results by Ginesti et al. [32] also found that CFO with a high educational background is more likely to give more resources for company activities such as company research and development. Moreover, according to Papadakis [33], leaders who have high education can strengthen the company's performance and affect decision-making.

A higher level of CFO education can assist the audit committee in carrying out its duties and responsibilities, especially in real earnings management actions. According to Hans et al. [34], CFOs can be more effective when influenced by a shared understanding of their educational background. This explanation also supports the theory developed by Hambrick & Mason [16], Hambrick [35], which says that a high level of education will affect the company's strategy and performance to achieve the desired goals. Therefore, the conclusion is that the higher the education level of the CFO, the lower the real earnings management action to increase profits because of women's composition in a company. Therefore, obtained the following hypothesis:

H3: CFO education level weakens the positive relationship between the composition of audit committee women and real earnings management.

3. RESEARCH METHOD

This researcher conducted the study on 644 companies from all sectors except the banking sector, listed on the Indonesia Stock Exchange for 2018-2019. Sampling in this study was carried out using the purposive sampling method with the criteria that the company has complete data used to measure real earnings management, ROA, leverage, CFO seniority and education level, and the women audit committee composition during 2018-2019. After sampling with the above criteria, 351 companies met the criteria, so there were 702 data used and processed in this study.

The type of data used in this study is quantitative data obtained from the company's annual report. The data used were operating cash flow, inventory, total assets, income, total debt, the composition of women on the audit committee, seniority level and CFO education.

3.1. Analysis Model

The researchers tested the hypothesis in this study using the panel data regression method to examine the effect of the independent variable, the composition of women in the audit committee; on the dependent variable, real earnings management; with moderating variables, seniority and CFO education; and control variables, ROA and leverage.

The hypothesis is tested using the following equation :

$$Ab_CFO_{it} = \alpha_1 + \beta_1 KwKA_{it} + \beta_2 SC_{it} + \beta_3 PC_{it} + \beta_4 KwKA_{it} * SC_{it} + \beta_5 KwKA_{it} * PC_{it} + \beta_6 ROA_{it} + \beta_7 Lev_{it} + \varepsilon \quad (3)$$

Description:

Ab_CFO_{it} = Real earnings management of company i in year t
 α_1 = Constant
 β_1 - β_7 = Regression coefficient
KwKA_{it} = Female Audit Committee
SC_{it} = CFO seniority level of company i in year t
PC_{it} = CFO education level of company i in year t
ROA_{it} = Return on Assets of company i in year t
Lev_{it} = Leverage of company i in year t
 ε = Error

3.2. Variable Operational Definition

The following are some explanations of the operational definitions of the variables in this study which can be seen in Table 1.

Table 1. Definition of Variable Operational

Variable	Operational Definition
Real Earnings Management (Ab_CFO)	Real earnings management is measured using one of the proxies developed by Roychowdhury [2], Abnormal Cash Flow Operations which is calculated by the equation $Ab_CFO_{it} = CFO_{it} - NCFO_{it}$
Composition of women of the Audit Committee (KwKA)	The composition of women on the audit committee is measured by the ratio of women audit

	committees to the total audit committee
CFO Characteristics (SC dan PC)	Seniority (using dummy variable) : <ul style="list-style-type: none"> 0 = Work Experience <=20 years 1 = Work Experience >20 years Education (using dummy variable): <ul style="list-style-type: none"> 0 = Degree D3-S1 (Undergraduate Degree) 1 = Degree S2-S3 (Graduate Degree)
Return on Asset (ROA)	Measured using the ratio of income to total assets
Leverage (LEV)	Measured using the ratio of total debt to total assets

4. RESEARCH RESULT AND DISCUSSION

The researchers conducted the study on companies listed on the Indonesia Stock Exchange, except for the banking sector, 702 financial statement data in 2018-2019. The descriptive statistics of each variable are in Table 2.

Table 2. Descriptive Statistics

	N	Mean	Min	Max	St. Dev
Ab_CFO	702	0.0000	-1.2500	2.2500	0.1672
KwKA	702	0.2039	0.0000	1.0000	0.2533
KwKA*SC	702	0.1290	0.0000	1.0000	0.2198
KwKA*PC	702	0.0688	0.0000	1.0000	0.1673
ROA	702	0.0214	-1.8845	0.6072	0.1405
LEV	702	0.5040	0.0000	4.9010	0.4046
AB_CFO dan SC					
0 (work experience <= 20 years)	217	0.0092	-0.4400	0.8700	0.1281
1 (work experience > 20 years)	485	-0.0040	-1.2500	2.2500	0.1820
AB_CFO dan PC					

0 (Education <=S1)	441	-0.0114	-1.2500	0.5900	0.1288
1 (Education > S1)	261	0.0190	-0.4400	2.2500	0.2162

Source: Processed Data Results, 2021

Ab_CFO = Abnormal cash flow operation, KwKA = Composition of women of the Audit Committee, KwKA*SC = Moderation of the composition of audit committee women by seniority CFO, KwKA*PC = Moderate composition of audit committee women by education level CFO, ROA = Return on asset, LEV = Leverage

From Table 2, we can see that the minimum value on variable KwKA is 0, the maximum value is 1, the average value is 0.2039, which means that the female audit committee on a company is 20.39%. The minimum value of ROA is -1.8845; the maximum value is 0.6072, the average value of ROA is 0.0214, which means the company's average profit is 2.14% from the total asset. The minimum value of leverage is 0, the maximum value is 4.9010, the average value is 0.5040, which means the average company has a debt of 50.4% from the total asset.

From Table 2, the study found out from 702 companies in two years; there are 217 CFOs with a level of work experience below or equal to 20 years and as many as 485 CFOs who have work experience level more than 20 years. Furthermore, the study found that 441 CFOs have an education level below or equal to S1 (Undergraduate degree), and as many as 261 CFOs have an education level above S1.

This study begins by selecting the diagnostic panel data model, including the Chow test, Hausman test, and Breusch-Pagan test, where the best results show the Fixed Effect Model. Then proceed with heteroscedasticity testing using white's test, and heteroscedasticity occurs. Based on these results, the conclusion is that the best model is the Fixed Effect Model and the presence of heteroscedasticity so that the model is tested using Weighted Least Squares, with the results attached in Table 3.

Table 3. Weighted Least Squares Analysis Results

		Coefficient	P-value	
Const		-0.0352	0.0000	***
KwKA		0.0741	0.0000	***
SC		0.0140	0.0000	***
PC		0.0226	0.0000	***
KwKA*SC		-0.0830	0.0000	***

KwKA*PC		0.0001	0.9953	
ROA		0.1829	0.0000	***
LEV		0.1168	0.0157	**
Adjusted R-squared	29.91%			
P-value	0.0000			

Based on table 3, the adjusted R-square value is 29.91% which means the composition of the women audit committee (KwKA), CFO seniority level (SC), CFO education level (PC), Return on Assets (ROA), Leverage (LEV)) has an effect of 29.91% on real earnings management (Ab_CFO). At the same time, the rest is explained by other independent variables with value of 70.09%, which affects real earnings management. Furthermore, the p-value shows the number 0.0000, which means that this variable affects real earnings management because the p-value is below 0.05.

4.1. Composition of Women in the Audit Committee and Real Earnings Management

From table 3 we can see that p-value of the coefficient of the composition of women in the audit committee is less than 0.05. These results support the agency theory where the existence of an audit committee has an effect on real earnings management. However the variable composition of women in the audit committee has a positive coefficient of 0.0741. These results indicate that the more women in the audit committee, the more the abnormal cash flow operations or, the more the real cash flow operations are than normal cash flow operations. Real cash flow operations, which are more significant than normal cash flow operations, indicate management actions to increase profits. This study provided empirical evidence that the more women composition in the audit committee, the lesser strict supervision for management so that management is more daring in increasing profits to benefit themselves. Based on the explanation above, the first hypothesis regarding the composition of women in the audit committee has a positive effect on real earnings management. The results of this study are in line with the argument according to Nugrahani & Yuniarti [36], which says that the nature of women can sometimes miss opportunities that should be able to improve and support company performance. In addition, based on the theory of nature, men and women have differences which also support Gibson's argument that male leadership tends to be more assertive and goal-oriented [29] so that management tends not to do real earnings management.

4.2. Moderating Role of CFO Seniority Level on the Composition of Women in the Audit Committee on Real Earnings Management

Based on table 3, we can see that the p -value of the CFO seniority variable, which moderates the relationship between the composition of women in the audit committee and real earnings management, is less than 0.05 and has a negative coefficient of -0.0830. These results indicate that the increase in earnings caused by the increase in the composition of women in the audit committee will be lesser in companies with experienced CFO conditions than in less experienced CFOs. These results support the upper-echelon theory [16] where leaders with good characteristics will strengthen company performance. This situation is because CFOs who have more extended work experience can be more careful and rethink every action they want to take to help women in the audit committee be more assertive in carrying out their duties. Similarly, according to Setiawan [37], the term of office or the length of time a person works is closely related to the company's experience and expertise to reduce earnings management. In addition, according to Han et al. [34], CFOs can be more effective when influenced by shared understanding with their tenure in the organization. Based on the explanation above, the second hypothesis regarding the level of CFO seniority weakening the relationship between the composition of women in the audit committee and real earnings management is acceptable.

4.3. Moderating Role of CFO Education Level on the Composition of Women in the Audit Committee on Real Earnings Management

Based on table 3, we can see that the p -value of CFO education variable, which moderates the relationship between the composition of women in the audit committee and real earnings management, is more than 0.05 and has a positive coefficient of 0.00000712. These results indicate that the increase in profit caused by the increase in the composition of women in the audit committee is not different in companies with high and low CFO education levels. Then the third hypothesis is rejected. This situation is presumably because many women in the audit committee do not guarantee sufficient expertise. After all, they may be selected due to luck so that even though CFOs accompany them with high and low levels of education, they still do not affect management activities in real earnings management actions.

5. CONCLUSION, AUTHOR'S CONTRIBUTIONS, AND LIMITATION

This study aims to examine whether the composition of women in the audit committee affects real earnings management. This study indicates that the composition of women in the audit committee has a positive effect on real earnings management, which means that the higher the composition of women in the audit committee will make management practice real earnings management in the form of increased profits.

In addition to the above objectives, this study also aims to examine whether the level of seniority and education of CFOs can affect the relationship between the composition of women on the audit committee and real earnings management. This study indicates that management activities increase profits due to the increasing number of women in the audit committee, which will be smaller in companies with a high level of CFO seniority. Moreover, the level of education of the CFO does not affect management activities, increasing profits due to the increasing number of women in the audit committee.

The results of this study are expected to be beneficial for shareholders who wish to form, reorganize or appoint an audit committee and CFO. This study provides evidence that the CFO seniority level can influence the composition of women in the audit committee on real earnings management so that companies can be more careful in appointing audit committees and CFOs. By paying more attention to this, it is hoped that decision-making will be better, effective, efficient, and benefit the company.

This study has limitations, it has not used the banking sector listed on the Indonesia Stock Exchange, the existence of the audit committee only uses the composition of women in the audit committee, and the measurement of real earnings management uses only one of three measurements, the abnormal cash flow operations. Further research can use all company sectors with a more extended year period, add characteristics other than the audit committee and CFO, and add or update control and moderating variables.

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