ROLE OF AUDIT COMMITTEE FINANCIAL EXPERTISE AND THEIR STATUS IN REDUCING CORPORATE REAL EARNINGS MANAGEMENT

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ABSTRACT

The study aims to examine the role of audit committee financial expertise (measured by audit committee educational background in accounting and finance and CPA certification) and their status (relative to board of directors) in reducing real earnings management. Audit committee status is compared to board of director status and status for both groups measured by the current or previous employment in Indonesia Stock Exchange (IDX) listed companies in Indonesia; current or previous employment in the Indonesia public companies with similar industries; current or previous employment in the Indonesia public financial sector companies or financial institutions; current or previous employment in Indonesia government institutions; and a degree from prestigious educational institutions. Samples of this research consist of Indonesia Stock Exchange (IDX) listed non-financial companies with a period of observation of 2013-2016. The total observations are 1080 firm-years. The result of this study shows that audit committee financial expertise has no impact in reducing corporate real earnings management. Meanwhile, audit committee status can reduce corporate real earnings management. This study also finds that audit committee status has not been able to strengthen audit committee financial expertise to reduce corporate real earnings management.

Keywords: Real Earnings Management, Status, Financial Expertise, Audit Committee.

INTRODUCTION

Low level of financial statement reliability was the cause of accounting scandal happened in Enron and Kanebo. In Indonesia, accounting scandal happened to PT Kimia Farma and PT Kereta Api Indonesia was also because of low levels reliability of finacial statement. Low levels of financial statement reliability happened because manipulation of earnings practice called earnings management. Earnings management divided into two types, accrual earnings management and real earnings management (Cohen et al., 2008; Zang, 2012). The main focus of this research is real earnings management, defined by Roychowdhury (2006) as an alteration from normal business activities to meet certain earnings target. Real earnings management have consequences such as lower subsequent operating performance (Gunny, 2005; Leggett et al., 2009) and lower innovation and adaptation of recent technologies (Bereskin et al., 2017). Because of these consequences, Financial Services Authority (OJK) established a regulation regarding audit committee in 2015 to monitor company financial reporting process and reducing earnings management.

The Board of Commissioners (BoC) is encouraged to establish an audit committee, as it is increasingly seen as an essential element of the corporate governance structure in many countries. Indonesia CG Code Part IV 3.7 stipulated that in carrying out its duty, the BoC is assisted by the audit committees. According to Regulation Number IX.I.5, for publicly listed companies, an audit committee must be established, whereas other committees (risk management, nomination and remuneration) are formed as required. Members of the audit committee must be financial literate. An experienced individual who is a financial expert should chair the audit committee. According to Regulation Number IX.I.5, for public listed company, the head of the audit committee shall be the Independent Commissioner. Further, the member of the Audit Committee shall consist minimum of 2 Independent Commissioner or any other external party. The Audit Committee supports the Board of Commissioners by monitoring, reviewing and providing assurance on the integrity and effectiveness of financial statements, risk management and internal controls, and the Company’s compliance with legal and regulatory requirements. In addition, it monitors the implementation of the internal audit function and the external auditor’s performance, qualifications and independence. The Audit Committee works in close coordination with the Internal Audit Unit and the External Auditor.

To prevent real earnings management, the existence of audit committee is not enough. Audit committees must possess certain attributes to enhance their ability in monitoring, especially financial reporting process. These attributes are financial expertise and status. Financial expertise of audit committee means that audit committee have deep understanding regarding corporate financial reporting so that they can give assessment and evaluation regarding the fairness of corporate financial statement to protect shareholders and do supervision function (Kalbers & Fogarty, 1993; Defond et al., 2005). Beside financial expertise, status is an essential elements that will help to increase audit committee effectiveness in monitoring (Badolato et al., 2014). In relationship between audit committee and management, agency problem might arise because of difference of interests between audit committee and management, especially regarding disclosure and the usage of accounting principles (Haka & Chalos, 1990). Srinivasan (2005) also stated that management have tendency to misstate financial statements for maximize their compensation. In contrast, audit committee have tendency to prevent real earnings management to protect their career and themselves from bad publicity. So, Badolato et al. (2014) state that audit committee must have higher status than management. Higher status of audit committee will bring up a deterrence effect which is a change in the way management views the audit committee (D’Aveni, 1990; Pollock et al., 2010, Makhsun et al., 2018). Management will view the audit committee as a function with higher competence and authority. Higher authority will encourage the audit committee to actively monitor and be willing to investigate the financial reporting issues that may arise so that management will reduce its opportunistic actions and present the financial statements fairly. However the literatures show mixed evidence. The research result from Badolato et al. (2014) is different from Siagian & Siregar (2017). Siagian & Siregar (2017) stated that audit committee status cannot mitigate corporate earnings management which probably because the establishment of audit committees in Indonesia is for the purpose of compliance with the regulations. This research is motivated by the mixed evidence from prior literatures. Besides, it is important to examine how the financial expertise of the audit committee in reduces the earnings management. So far, researches that focus on the status of the audit committee are still limited.

The purpose of this study is to examine the role of audit committee financial expertise and status in reducing real earnings management. This study is an advanced study conducted by Badolato et al. (2014) and Siagian & Siregar (2017). Following Badolato et al. (2014) and Siagian & Siregar (2017), this study measures the status of the audit committee and the board of directors to see which group has a higher status. This study measures status as independent and interaction variable, meanwhile in Badolato et al. (2014) and Siagian & Siregar (2017), status is a interaction variable. In this study, there are also differences in the measurement of earnings management. Badolato et al. (2014) used Modified-Jones model, developed by Dechow et al. (1995) and Siagian & Siregar (2017) used earnings management model developed by Kasznik (1999) to obtain the level of corporate accrual earnings management. Meanwhile, in this study, earnings management is measured using a model developed by Zang (2012) which measures the level of corporate real earnings management. The measurement of status in this study is also different from the study conducted by Badolato et al. (2014) and Siagian & Siregar (2017) due to the limitations of data sources of one of the status measurement parameters, the private boards' parameter. In addition, Hayes (2014) also stated that the status measurements performed in Badolato et al. (2014) study are relatively complicated. Siagian & Siregar (2017) follow the same method as Badolato et al. (2014) to measure status, which is a relatively complicated method. Therefore, the measurement of status in this study used scoring methods using five parameters adopted from the previous study:

1. The current or previous employment in Indonesia Stock Exchange (IDX) listed companies in Indonesia.
2. Current or previous employment in Indonesia public companies with similar industries.
3. Current or previous employment in the Indonesian public financial sector companies or financial institutions.
4. Current or previous employment in Indonesia government institutions.
5. Degree from prestigious educational institutions.

Financial expertise of audit committee is measured using educational background of audit committee in accounting and finance and CPA certification. Using multiple regressions, it was found that audit committee financial expertise has no impact in reducing real earnings management and status of audit committee can reduce real earnings management. This study also found that audit committee status cannot strengthen audit committee financial expertise in reducing corporate real earnings management.

This study provides contributions to academic research and Indonesia Financial Services Authority (OJK). The first contribution to academic study is that this study provides additional evidence that the audit committee's status is not only capable of reducing accrual earnings management as in the study conducted by Badolato et al. (2014), but also able to reduce earnings management through real activities undertaken by the public company in Indonesia. The second contribution to Indonesia Financial Services Authority (OJK). This study shows an evidence of the importance of audit committee status in reducing corporate real earnings management. Therefore, Indonesia Financial Services Authority (OJK) can consider audit committee status when formulating regulation regarding audit committee.

This study will be organized into five sections. Firstly, introduction comprises background and study purpose. The second section seeks to develop study hypotheses. The third section is methodology comprises data and sample selection, hypotheses testing model, and variable definition. The fourth section comprises empirical results and analysis. The fifth section comprises conclusions and research’s limitation.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Real Earnings Management

Roychowdhury (2006) defines real earnings management as an alteration of corporate financial statements by utilizing corporate real business activities to meet targeted profit. Roychowdhury (2006) categorize three real earnings management activities, which will be described as follows:

1. Manipulation of sales amount through price discount or more lenient credit terms. These activities can increase sales amount in reporting period, so that company can report higher earnings in the financial statement. But, company will report lower amount of cash flow from operations than normal level in the statement of cash flow.
2. Overproduction. Overproduction of corporate products will result in lower production cost per unit. With lower production cost per unit, company can report lower Cost of Goods Sold (CoGS). With lower cost of goods sold, company can report higher earnings. But, the company must record holding costs and production cost for over-produced goods that are not recovered through sales in reporting period. So, the company will record higher production cost than normal level of production cost.
3. Reduction of Discretionary Expenses. Discretionary expenses are the sum of selling, general, and administrative expense, advertising expense, and research and development expense. Reduction of discretionary expenses can lower the amount of expenses reported in financial statements. Therefore, the company can report higher earnings.

Real earnings management has consequences. Gunny (2005) stated that real earnings management can reduce subsequent period operating performance. Leggett et al. (2009) found that real earnings management results in lower Return on Asset (RoA) in the future. From innovation and technology adaptation, Bereskin et al. (2017) state that real earnings management will result in lower patent, innovation, and new technology adaptation rate.

Audit Committee Financial Expertise

The audit committee is a committee that monitors the performance of the board of directors in terms of internal controls on financial reporting (Bedard & Genron, 2010). To enhance its effectiveness in monitoring management, POJK No.55/POJK.04/2015 about Establishment and Implementation Guidelines of the Audit Committee in Indonesia states that each audit committee in Indonesia public company must have at least one member of audit committee that have educational background and expertise in accounting and finance. Expertise of audit committee in accounting and finance means that audit committee has complete understanding of financial statements and financial reporting process. Therefore, audit committee can give assessment and evaluation regarding the fairness of financial statements that will be published by the company to protect shareholders and implement their monitoring function (Kalbers & Fogarty, 1993; Defond et al., 2005). Sarbanes-Oxley Act in Trautman (2013) already established four criteria to define financial expertise of audit committee, which will be described as follows:

1. Educational background in finance and accounting and experience in as section chief of finance or accounting officer, controller, public accountant, or auditor.
2. Experience as supervisor of section chief of finance or accounting officer, controller, public accountant, or auditor.
3. Experience in supervising or assessing management or public accountant in preparation, evaluation, or audit of financial statements.
4. Other relevant experiences.

Audit Committee Status

According to Haka & Chalos (1990), agency problem might arise between audit committee and management regarding disclosure and the usage of accounting principles. Srinivasan (2005) also stated that agency problem can arise in the relationship between the audit committee and board of directors as the management team. Board of directors has the incentive to misreport financial statements and record higher earnings through earning management to maximize their compensation and bonuses. Meanwhile, audit committee also has the incentive to reduce financial statement misreport through earnings management to protect their long-term career and reputation. To mitigate agency problem that arises between the audit committee and board of directors, the audit committee must have the ability which comes from their status to influence management so that management acts in accordance with audit committee commands.

Status is someone's skill in influencing a business decision because certain competencies and social capital associated with the decision (D'Aveni, 1990; Belliveau et al., 1996). Social capital means experience and connection with external parties (Erkens & Bonner, 2013). In practice, the status of an audit committee can improve the quality of financial reporting, for example is reduction of earnings management and corporate fraud risk (Badolato et al., 2014; Mayanda, 2015). Status can reduce agency problem between audit committee and management because status creates a deterrence effect, which is a change in management's way of viewing the audit committee (D'Aveni, 1990; Pollock et al., 2010). Audit committees with higher status will be viewed as a function with higher competence and authority. Higher authority will encourage the audit committee to actively monitor and be willing to investigate the financial reporting issues so that management will reduce its opportunistic actions.

Hypothesis Development

The purpose of establishment of audit committee in general is to supervise management related to internal control over financial reporting (Bedard & Genron, 2010). Based on POJK No. 55/POJK.04/2015 on the Establishment and Guidance of the Implementation of the Audit Committee, educational background and expertise in finance are mandatory in the audit committee membership structure as well as an essential element of supervisory activities. Research conducted by Nelson & Devi (2013), Badolato et al. (2014), and Juhmani (2017) shows that the audit committee's financial expertise is able to reduce earnings management The financial expertise of the audit committee indicates that audit committees have an in-depth understanding of financial reporting so that the audit committee can provide an assessment and evaluation of the fairness of published financial reports (Kalbers & Fogarty, 1993; DeFond et al., 2005, Makhsun et al., 2018). However, research by Siagian & Siregar (2017) and Dwiharyadi (2017) shows that the audit committee's financial expertise cannot reduce earnings management. It is probably because the company recruits audit committee that has financial expertise is only for the purpose to imply with regulation. The regulations on establishing public company audit committees in Indonesia do not specify the characteristics of financial expertise audit committees, from the level of education to certain skills related to corporate finance. So, the first hypothesis of this study is:

H_1: Audit committee financial expertise cannot reduce real earnings management.

Badolato et al. (2014) stated that financial expertise alone is not sufficient for audit committees to reduce earnings management activities undertaken by corporate managers. The audit committee must also have a certain social capital that makes them respected by management, and can influence every economic decision of the company while minimizing the potential agency problems that arise between the audit committee and management (Haka & Chalos, 1990; Srinivasan, 2005, Ghani et al., 2016). Such social capital is called status. Badolato et al. (2014) stated that audit committee with higher status than management is able to reduce earnings management. However, research by Siagian & Siregar (2017) and Dewi (2018) found audit committee with higher status has not been able to reduce earnings management. With reference to D'Aveni (1990) and Pollock et al. (2010), audit committee with higher status is needed to influence how management views the audit committee as a function with higher competence and higher authority. Higher authority allows the audit committees to more actively supervises and conduct in-depth investigations if there are potential problems related to financial reporting, so management will reduce its opportunistic actions, both through accrual earnings management and real earnings management. Therefore, the second hypothesis of this study is:

H_2: Audit committee status can reduce real earnings management.

Expertise in finance enables the audit committee to provide assessments and evaluations related to financial statements published by the company to stakeholders. The objective is to protect stakeholders from the potential losses arising from management opportunistic actions, as well as the enforcement of good corporate governance (Kalbers & Fogarty, 1993; DeFond et al., 2005). However, based on Badolato et al. (2014), financial expertise alone is not enough to make management reduce its opportunistic actions. The status which is the ability of a person to influence a decision because of certain competencies and social capital (D'Aveni, 1990; Belliveau et al., 1996) is also able to suppress management opportunistic acts because status can affect the way management views the audit committee. The audit committee will be viewed as a function of higher competence and authority, so that if financial expertise is supported by a higher audit committee status, management will reduce its opportunistic actions, either through the accrual level or real business activities. Therefore, the third hypothesis is described below:

H_3: Audit committee status can strengthen audit committee financial expertise in reducing real earnings management.

Research Methodology

Sample and data

Population of this study is listed companies in Indonesia with a total of 537 companies from 2013 to 2016. Sample of this study is selected using purposive sampling with three criteria. These three criteria are:

1. Listed companies in Indonesia Stock Exchange (IDX).
2. Companies in the financial sector are excluded from the sample because the financial sector is highly regulated in Indonesia.
3. The companies provide a complete financial and non-financial data related to the research variables.

The sample data are generated from Thomson Reuters Eikon for financial data and Corporate Annual Report retrieved from Indonesia Stock Exchange official website (www.idx.co.id) and sample company official website for non-financial data. Table 1 presents selected sample according to industry-type used in this study. There are 270 firms used for sample in this study with total observation of 1080 firm-years from 2013 to 2016.

Table 1
LIST OF SELECTED SAMPLE

Industry	Firms	%	Firm-years	%
Consumer Staples	42	15.6%	168	15.6%
Consumer Discretionary	53	19.6%	212	19.6%
Energy	29	10.7%	116	10.7%
Real Estate	31	11.5%	124	11.5%
Materials	42	15.6%	168	15.6%
Industrials	47	17.4%	188	17.4%
Information Technology	5	1.85%	20	1.85%
Health Care	12	4.44%	48	4.44%
Telecommunication Services	9	3.31%	36	3.31%
Total Samples	**270**	**100%**	**1080**	**100%**

Research Model

There are two research models that will be used in this research. The first model is used for testing H_1 and H_2, which test the role of audit committee financial expertise and status in reducing real earnings management. The first research model is as follow:

$$\mathbf{RM_{it}=\alpha+\beta_1 FINEXP_{it}+\beta_2 STATDIF_{it}+\beta_k CONTROL_{kit}+\varepsilon_{it}} \quad \ldots..(1)$$

The second research model is used for testing H_3, which is the role of audit committee status in strengthening audit committee financial expertise in reducing real earnings management. The second research model is as follow:

$$\mathbf{RM_{it}=\alpha+\beta_1 FINEXP_{it}+\beta_2 FINEXP{*}STATDIF_{it}+\beta_3 STATDIF_{it}+\beta_k CONTROL_{kit}+\varepsilon_{it}} \quad \ldots.(2)$$

Where, RM_{it}: Real earnings management level. Measured by real earnings management proxy developed by Zang (2012); $FINEXP_{it}$: Percentage of audit committee members with expertise in accounting and finance; $STATDIF_{it}$: Audit committee relative status to board of directors. This variable is dummy variable which scores 1 if audit committee status is higher than board of directors and scores 0 if audit committee status is lower than board of directors; $FINEXP*STATDIF_{it}$: Interaction variable of audit committee financial expertise with audit committee status.

Control variables used in this research are audit committee size (AC_SIZE) which measured by number of audit committee members, board of commissioner size (BOC_SIZE) which measured by number of board of commissioner members, company size (SIZE) which measured by natural logarithm of total asset, leverage (LEV) which measured by total debt divided by total asset, Return on Asset (ROA), Market to Book Value of equity (MBV), and audit firm size (BIG4) which is dummy variable, 1 for big four auditors and 0 for others. Control variables in this study are selected based on corporate governance characteristics and corporate financial conditions that could affect real earnings management.

Variable Definitions

Real earnings management

Real earnings management is measured using the method developed by Zang (2012). Zang (2012) measured real earnings management using two proxies of real earnings management developed by Roychowdhury (2006). The two proxies are overproduction and reduction of discretionary expenses. Regression model for these two proxies are as follow:

1. Overproduction

$$\mathbf{PROD_t/TA_{t-1}=\alpha_0+\alpha_1(1/TA_{t-1})+\alpha_2(S_t/TA_{t-1})+\alpha_3(\Delta S_t/TA_{t-1})+\alpha_4(\Delta S_{t-1}/TA_{t-1})+\varepsilon_t}$$

where $PROD_t$ is the production cost incurred by the company in year t. St is the sales in year t. ΔS_t represents the value of sales growth in year t. ΔS_{t-1} represents the value of sales growth in year t-1. TA_{t-1} represents the company total asset in year t-1.

2. Reduction of discretionary expenses

$$\mathbf{DISEXP_t/TA_{t-1}=\alpha_0+\alpha_1(1/TA_{t-1})+\alpha_2(S_{t-1}/TA_{t-1})+\varepsilon_t}$$

Where, $DISEXP_t$ is the amount of discretionary expenses incurred by the company in year t. Discretionary expenses are the sum of the sales, general and administrative expenses, advertising expenses, and research and development expenses (Roychowdhury, 2006). S_{t-1} is the sales value in year t-1. TA_{t-1} represents the company total asset in year t-1.

Residuals (ε_t) for both models are estimated cross-sectionally each year. Residual for regression model (3) is abnormal production costs, and residual for regression (4) is abnormal discretionary expenses. Then, to measure RM, the first step is multiply abnormal discretionary expenses from regression (4) with -1 and keep abnormal production costs as the residual value of regression (3). After that, the abnormal value of discretionary expenses multiplied by -1 is summed with abnormal production costs to obtain real earnings management as a whole, proxied by RM. Zang (2012) excluded abnormal cash flow from operations (proxy of real earnings management from manipulation of sales) from the calculation of RM because its ambiguous nature. Sales manipulation will decrease the amount of cash flow from operations received by the company, thus will decrease the abnormal cash flow from operations. Meanwhile, reduction of discretionary expenses will increase the cash flow from operations, so that abnormal cash flow from operations will increase. Therefore, Zang (2012) concludes that net effect of abnormal cash flow from operations is ambiguous. Zang (2012) stated that the higher the value of RM, level of real earnings management is higher.

Audit committee financial expertise (FINEXP)

Financial expertise of audit committee is measured using the percentage of audit committee members with educational background, both undergraduate and postgraduate, in accounting and finance and CPA certification.

Audit committee status (STATDIF)

In this research, STATDIF is used as both independent and interaction variable. This variable is dummy variable which scores 1 if audit committee status is higher than board of directors status and 0 if otherwise. To measure which group has higher status, this study implement five steps to measure status that used in Belliveau et al. (1996):

1. Calculates the total score that has not been standardized from the status of each individual in the audit committee and the board of directors of each company per year. To calculate the status score, researchers adopted five status parameters, namely:
   a. Current or previous employment in Indonesia Stock Exchange (IDX) listed companies in Indonesia. This parameter is scored 1 if an individual currently or previously serving in an IDX listed companies, and 0 otherwise. This parameter is used in the study by Finkelstein (1992), Belliveau et al. (1996), and Erkens & Bonner (2013).
   b. Current or previous employment in the Indonesia public companies with similar industries. This parameter is scored 1 if an individual currently or previously serving in an Indonesian public company with the same industry field, and 0 otherwise. This parameter is used in the research of Pollock et al. (2010). The inter-industry parameter uses industry type based on Global Industry Classification Standard (GICS) developed by MSCI and Standard & Poor's because the industry grouping standards are already applicable globally.
   c. Current or previous employment in the Indonesia public financial sector companies or financial institutions. Financial institutions are banking and non-banking sub-sector. The non-banking sub-sector companies are insurance companies, pension funds, mutual funds, financial institutions, securities companies, pawn companies, and venture capital firms. This parameter is scored 1 if an individual currently or previously serving in a public company financial sector or financial institution, and 0 otherwise. This parameter is used in the research of D'Aveni (1990).
   d. Current or previous employment in Indonesia government institutions. List of government agencies obtained through the official website of the Ombudsman of the Republic of Indonesia. Score 1 is given if an individual in the audit committee or the board of directors currently or previously employed in the certain government agency, and 0 otherwise. This parameter is used in D'Aveni (1990) study.
   e. Degree from prestigious educational institutions. The measurement of this parameter uses the list of domestic and foreign universities that become the LPDP scholarship partner. Using the methods used by Belliveau et al. (1996), Erkens & Bonner (2013), Score 2 is given to individuals who are graduated from foreign universities who are partners of LPDP scholarships, Score 1 is given to individuals who are graduated from domestic universities who are partners of LPDP scholarships, and 0 otherwise. LPDP scholarship partner universities become parameters of status measurement due to proven quality and high levels of prestige.
2. Calculate the combined mean and standard deviation each year by using the unstandardized score of all company audit committee members and the board of directors.
3. Standardize the scores of individuals in the audit committee and the board of directors. Standardization scores were performed using the following formula:

$$\textbf{Standardized Status Score} = \frac{\textbf{Total Score}_{\mathbf{i,t}} - \overline{\textbf{Total Score}_{\mathbf{t}}}}{\mathbf{s_t}}$$

   Where, $\text{Total Score}_{i,t}$ is the unstandardized status score for each audit committee and board of directors members. $\overline{\text{Total Score}_t}$ is combined mean of score all company audit committee members and board of directors per year. s_t is combined standard deviation of score all company audit committee members and board of directors per year.
4. With the standardized score of each audit committee and board of directors members, sum the score of all audit committee members and board of directors, respectively, to get the overall status score for each group.
5. Using each group status score, develop the dummy variable. 1 if audit committee status score is higher than the board of directors status score, and 0 otherwise.

RESULTS AND DISCUSSION

Table 2 presents descriptive statistics for each variable used in this study.

Table 2
DESCRIPTIVE STATISTICS

Samples	**1080 firm-years**			
Variables	**Mean**	**Std.Deviation**	**Min**	**Max**
RM	0.0073	0.2409	-1.3951	0.8890
FINEXP	0.7018	0.2338	0.2	1
AC_SIZE	3.0898	0.3926	2	6
BOC_SIZE	6.0241	1.877	3	13
SIZE (In Trillion Rupiah)	9.5592	21.1114	0.0453	261.8546
LEV	0.2492	0.1913	0	0.9375
ROA	0.0484	0.0886	-0.3617	0.4316
MBV	2.7146	4.8138	-5.5994	62.9311
Dummy Variables				
STATDIF	Audit Committee Has Higher Status Than Board of Directors		Audit Committee Has Lower Status Than Board of Directors	
	60.37%		39.63%	
BIG4	Audited by Big 4		Audited by Non-Big 4	
	43.70%		56.30%	

Real earnings Management (RM) shows average value of 0.0073. It means that average of sample companies conduct real earnings management by 0.73% of its total assets. Positive sign from average value of RM shows that average of samples company conduct real earnings management, in accordance with Zang (2012), stating that level of real earnings management is higher when RM value is higher. Audit committee financial expertise (FINEXP) shows average value of 0.7018. This value means that audit committee with financial expertise have bigger proportion in audit committee membership (about 70% from number of members of audit committee). It also means that audit committee establishment in sample companies has followed the audit committee rule established by Financial Service Authority (OJK), which states each company audit committee must have at least one member with educational background and expertise in accounting and finance. Audit committee status (STATDIF) shows that 60.37% of sample company have the audit committee with higher status than the board of directors, and other 39.63% of sample company have an audit committee with lower status than the board of directors.

Hypothesis Testing

Table 3 below presents regression result for both model used in this study. Research model 1 (without interaction variable) is used to test H_1 and H_2, while research model 2 (with interaction variable) is used to test H_3.

Table 3
REGRESSION RESULT

Sample	**1080 firm-years**	
Dependent Variable	**RM**	
Variable	**Research Model 1 (Without Interaction Variable)**	**Research Model 2 (With Interaction Variable)**

Table 3
REGRESSION RESULT

	Expected Sign	Coefficient	T-stat	Expected Sign	Coefficient	T-stat
FINEXP	H1: -	0.0185	0.254	-	0.0614	0.089*
STATDIF	H2: -	-0.0333	0.006***	-	0.0147	0.365
FINEXP*STATDIF		-	-	H3: -	-0.0679	0.116
AC_SIZE	+/-	0.0303	0.038**	+/-	0.0296	0.042**
BOC_SIZE	+/-	-0.0113	0.004***	+/-	-0.0118	0.003***
COMP_SIZE	+/-	0.0269	0.000***	+/-	0.0278	0.000***
LEV	+/-	0.1025	0.005***	+/-	0.1029	0.005***
ROA	-	-0.5393	0.000***	-	-0.5431	0.000***
MBV	+/-	-0.0151	0.000***	+/-	-0.0150	0.000***
BIG4	-	-0.0087	0.274	-	-0.0092	0.262
Prob>F	**0.0000**			**0.0000**		
R^2	**0.0622**			**0.0725**		

Note: *significant at α=0.1; **significant at α=0.05; ***significant at α=0.01.
Key: RM: Real earnings management level; FINEXP: Percentage of audit committee with financial expertise; STATDIF: Relative status of audit committee to board of directors; FINEXP*STATDIF: Interaction variable of audit committee financial expertise and audit committee status; AC SIZE: audit committee size; BOC SIZE: Board of commissioners size; COMP SIZE: Company size; LEV: Leverage; ROA: Return on Asset; MBV: Market to Book Value; BIG4: Audit firm size.

Based on regression result in research model 1 (research model without interaction variable), audit committee financial expertise (FINEXP) has not been able to reduce real earnings management, seen by t-stat value of the variable is higher than α=0.1. Therefore, H_1 is supported. This finding is in line with Siagian & Siregar (2017), Chandra (2015), and Dwiharyadi (2017). This happens because of two possibilities. The first possibility is that there is a regulation requiring an audit committee with the financial expertise set forth in the POJK Number 55/POJK.04/2015 about Establishment and Implementation Guidelines of the Audit Committee. A fairly low standard deviation of 0.2338 in descriptive statistics indicates a low variation and indicates that the sample company has adopted the rule in establishing its audit committee because it is mandatory. This resulted in a lack of differentiated quality levels of inter-firm financial expertise and made the audit committee's financial expertise less effective in reducing real earnings management. The second possibility is that audit committee rules in Indonesia are still ambiguous. The regulation requires only a minimum of one member with educational background and accounting and finance expertise in the audit committee, but does not specify the level of education and work experience that may indicate that audit committee members have financial expertise to reduce real earnings management (Siagian & Siregar, 2017; Chandra, 2015; Dwiharyadi, 2017). However, the finding is different with the research conducted by Nelson & Devi (2013), Badolato et al. (2014), and Juhmani (2017). Their findings show that the audit committee's financial expertise is able to reduce earnings management. This is because the financial expertise of the audit committee indicates that audit committees have an in-depth understanding of financial reporting so that the audit committee can provide an assessment and evaluation of the fairness of published financial reports (Kalbers & Fogarty, 1993; DeFond et al., 2005).

Based on regression result in research model 1 (research model without interaction variable), t-stat value of STATDIF is 0.006, which lower than α=0.01 and the coefficient sign is negative. It means that there is significant negative relationship between audit committee status and real earnings management. Therefore, H_2 is supported. This finding is consistent with the research conducted by Badolato et al. (2014). Status is one of the essential elements that is useful for audit committees in monitoring management (Badolato et al., 2014) due to agency issues that may arise in the relationship between the audit committee and management related to compensation for management and reputation and career for audit committee (Haka & Chalos, 1990; Srinivasan, 2005). Therefore, Badolato et al. (2014) states the status of the audit committee should be higher than management. The status of the higher audit committee will lead to a deterrence effect for management which is a change in the way management views in view of the audit committee (D'Aveni, 1990; Pollock et al., 2010). The Board of Directors as the management of the company will view the audit committee as a function with higher competence and authority. Higher authority encourages audit committees to actively monitor activities and is more willing to investigate in depth related to potential problems in financial reporting, one of which is management opportunistic action through both accrual earnings management and real earnings management. Because of this higher authority, management will reduce its opportunistic actions and follow the audit committee's desire to present fair financial statements. However, the finding is different with the research conducted by Siagian & Siregar (2017) and Dewi (2018). Siagian & Siregar (2017) and Dewi (2018) found audit committee with higher status has not been able to reduce earnings management.

Based on regression result in research model 2 (research model with interaction variable), variable FINEXP*STATDIF show coefficient marked negative, but t-stat value is 0.116, which is bigger than α=0.1. The findings indicate that the audit committee's status has not been able to strengthen the audit committee's financial expertise in pressuring real earnings management, which is not in accordance with the third research hypothesis and makes the H_3 is not supported. This happens because of two possibilities. The first possibility is that there is no direct influence of the audit committee's financial expertise in reducing corporate real earnings management that occurs because the audit committee established in the sample company follows only the pre-determined regulation. This resulted in the absence of a difference in the quality of audit committees between companies so that although the audit committee has a higher status compared to management, it still has no effect in suppressing earnings management because there is no difference in the quality of financial expertise of the inter-company audit committee. The second possibility is one of the parameters of measuring the status of experience as current and past government elites is not directly related to the audit committee's financial expertise because the government elite is not only seen from education in accounting and finance.

CONCLUSIONS

This study aims to examine the role of audit committee financial expertise and status in reducing corporate real earnings management. The findings are:

a. Audit committee financial expertise has not been able to reduce real earnings management.
b. Audit committee with higher status is able to reduce real earnings management.
c. Audit committee status has not been able to strengthen audit committee financial expertise in reducing corporate real earnings management.

The result of this study has implication for academic research, because this study will provide additional insight on how audit committee status can influence corporate financial reporting done by management. This study also has implication for the regulator, specifically Financial Service Authority. This study provides empirical evidence that shows audit committee status will reduce real earnings management done by the company. Therefore, this study can be used as a reference in formulating regulation regarding audit committee. Finally, this study also has practical implications for companies, especially listed companies in Indonesia. This study shows the importance of audit committee status in reducing corporate real earnings management. Thus, companies are expected to comply with regulation Number IX.I.5 concerning the necessity of publicly listed companies to establish an audit committee. However, this study has several limitations:

a. Status parameters is only limited to current or previous employment in IDX listed public companies, current or previous employment in intra-industry company, current or previous employment in financial sector companies or financial institutions, current or previous employment in Indonesia government institutions, and degree from prestigious educational institutions from the annual report. Future research may extend the data sources to examine the status, for example status in community or politics.
b. Measurement of audit committee financial expertise is only from the educational background of audit committee in accounting and finance. Further research may include expertise from the relevant working experiences from previous employment.

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