

The Influence of Surplus Free Cash Flow and Audit Quality On Earnings Management

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Abstract

The purpose of this research is to examine the effect of surplus free cash flow, audit quality, and the interaction between surplus free cash flow and audit on earnings management. This study uses secondary data in the form of annual reports and financial statements of manufacturing companies listed on the Indonesia Stock Exchange in 2015 and 2016. The sampling method used in this study was purposive sampling. The total research sample is 48 samples. The results showed that surplus free cash flow has a positive effect on earnings management, audit quality significantly influences earnings management, but the interaction between surplus free cash flow and audit quality has no impact on earnings management.

Keywords: Surplus free cash flow, Audit quality, Earnings management.

Abstrak

Tujuan dari riset ini adalah menilai pengaruh surplus arus kas bebas, kualitas audit, dan interaksi antara arus kas bebas surplus dan audit terhadap manajemen laba. Data yang digunakan dalam riset ini data sekunder yang berasal dari laporan tahunan dan laporan keuangan perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia pada tahun 2015 dan 2016. Metode pengambilan sampel adalah purposive sampling dan didapatkan total sampel didapatkan adalah 48 sampel. Hasil penelitian membuktikan bahwa arus kas bebas surplus memiliki dampak positif pada manajemen laba, kualitas audit secara signifikan mempengaruhi manajemen laba, namun interaksi antara surplus arus kas bebas dan kualitas audit tidak berpengaruh pada manajemen laba.

Kata kunci: Surplus arus kas bebas, Kualitas Audit, Manajemen Laba.

INTRODUCTION

One of the performance measures of a company that used as a basis for decision making is the profit generated by the company. The company's profit can be seen from the published financial statements. Financial statements are a communication tool used to connect external parties such as shareholders and investors with the company. The earnings information contained in the financial statements will affect the investment decision making by the shareholders. In this case, the company's management knows more details about the company's condition compared to shareholders. Therefore, the shareholders assign management to report information about earnings as a basis for investment decisions. But such information asymmetry will allow management to manipulate earnings (Healy & Palepu, 2001).

Management must be responsible and prioritize the interests of shareholders, but in reality, the manager is concocting information earnings to give misleading information. This deviant action is called earnings management. Earnings management is done by hiding or manipulating conditions regarding earnings so that the company's performance always looks good in front of shareholders (Chung et al., 2005). The purpose of management in carrying out earnings management practices is to maximize personal well-being. Differences in interests between management and shareholders will lead to agency problems. Agency problems arise because of opportunistic actions in management, namely the act of maximizing personal well-being that is contrary to the interests of shareholders (Michael C. Jensen & Meckling, 1976).

Earnings management practices are not new in Indonesia. Some companies practice earnings management due to increased pressure on competition between companies competing to show their best

performance even in the wrong way x. This practice will not reflect the actual state of the company, so investors must be smart in assessing the information contained in the financial statements for not to be disadvantaged.

The motivation of company managers in managing free cash flows and their impact on earnings management is the focus of this study. The motivation is in the context of agency theory, especially in the context of business and financial reporting. Chung et al. (2005) explain that companies with low growth and high free cash flow use discretionary accruals to cover low or negative income. Jensen (1986) states that companies with small growth opportunities tend to invest less in free cash flow in profitable projects. When monitoring and the disciplinary attitude of stakeholders and agents do not run effectively, then the possibility of managers can invest free cash flow in projects that have a negative NPV (Chung et al., 2005). Managers can choose plans that benefit themselves and ignore the interests of shareholders. Managers can hide their bad investment decisions from investors. To disguise the impact of a negative NPV investment, managers can use accounting techniques that increase reported earnings.

Agency problems between shareholders and management must overcome; the role of the external auditor needed. External auditors expected to be able to limit the opportunistic behaviour of the company's management (Rusmin & Bambang, 2014). Therefore, the quality of the auditor considered as an external monitoring centre which is one of the determinants of earnings management practices (Rusmin & Bambang, 2014). The quality of auditing of the company's financial statements will affect the decision making of shareholders. The results of this audit will prove the actual state of a company. Gul et al. (2003) state that higher-quality auditors can agree on earnings management protocols. Watts and Zimmerman (1986); De Angelo (1981) state that the quality of auditors depends on the auditor's report that is relevant in contractual relations and budgeting reporting. Audit quality is usually measured using the size of a public accounting firm, which divided into Big4 and Non-Big4 public accounting firms. Some public accounting firms included in Big4 KAP include Deloitte Touche Thomatsu (Deloitte), Price Waterhouse Coopers (PwC), Ernest and Young (EY), and Klynveld Peat Marwick Goerdeler (KPMG).

Previous research on earnings management mostly based on data in the USA and Europe (Ferreira & Vilela, 2004; Matoussi & Jardak, 2012). Research conducted by Chung et al. (2005) based on company year observations in the 1984-1996 period from US data found that companies with low growth and with high free cash flow would use discretionary accruals to cover low or negative income.

On the other side, Bukit and Iskandar (2009) explained the relationship between free cash flow surpluses and earnings management using data from companies listed on the Bursa Malaysia in 2001. This study replicates the approach used by Chung et al. (2005). Furthermore, research on earnings management was carried out by Rusmin & Bambang (2014). They examined the effect of external supervision by high-quality auditors and free cash flow surpluses on earnings management practices using data from three countries, namely Indonesia, Malaysia, and Singapore, during the period 2005-2010. The results showed that companies with high free cash flow surpluses and low growth opportunities would do earnings management. Besides, results of the study showed that companies audited by Big 4 public accounting firms had lower discretionary accruals compared to companies audited by Non-Big 4 public accounting firms, and Big 4 public accounting firms could hamper earnings management practices.

This research is interesting to study because of differences in the results of previous studies regarding the factors that affect earnings management. This study will explore and examine the effect of surplus free cash flow, audit quality, and the interaction between surplus free cash flow and audit quality on earnings management. In this study, the two independent variables, namely surplus free cash flow, and audit quality, combined to form a moderating variable examined to determine its effect on the dependent variable, earnings management. The purpose of this study was to assess the impact of surplus free cash flow and audit quality on earnings management using data from companies listed on the Indonesia Stock Exchange in 2015-2016. What distinguishes this study from previous research is the sample used in the study. In previous studies, the research sample used was a sample of non-financial companies listed on the Indonesia Stock Exchange (IDX), Bursa Malaysia and Singapore Stock Exchange during 2005-2010, while this study used an example of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2015-2016.

The main objective of this study is to examine the effect of surplus free cash flow, audit quality, and the interaction between surplus free cash flow and audit quality on earnings management. The existence of a surplus free cash flow tends to be used to invest in projects that are less profitable so that the potential to improve earnings management practices. Audit quality is an external monitoring center to ensure the company's financial

statements reflect the actual financial condition and can use as information that supports shareholder decision making.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Jensen and Meckling (1976) explain that Agency Theory (Agency Theory) is a theory that explains the relationship between agents (management) and principals (shareholders and investors) while agency costs are the costs incurred by principals to supervise agents. Every company is almost impossible to have zero agency cost due to differences in interests between the two parties. Rusmin dan Bambang (2014) states that financial statements are used as a communication tool for interested parties in a company. Through financial statements, managers can do various ways to report positive indications.

The act of managers manipulating or hiding information about earnings to make it look good is known as earnings management (Rusmin & Bambang, 2014). Chung et al. (2005) state that managers can choose projects that benefit themselves to take economic benefits or personal benefits. This kind of manager's behavior with a reason to detect agency costs from free cash flow (investment in negative NPV projects) is very difficult. There will be commercial secrecy where managers hide their bad investment decisions if there are no regulations that require managers to disclose to investors the projected cash flow of investments including the assumptions behind them. Then Chung et al. (2005) suspect that managers might not project cash flow for some investments because they have personal needs that make them ignore cash and profit projections.

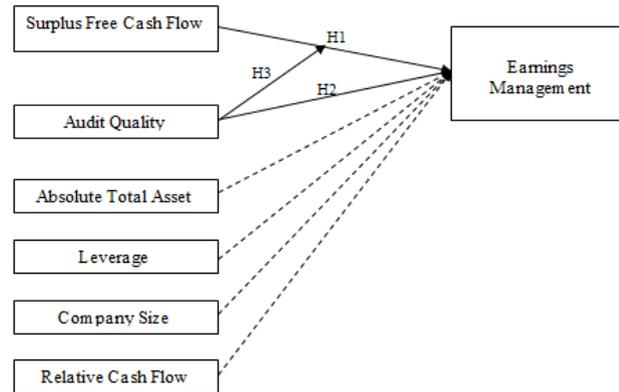
Watts and Zimmerman (1986) and De Angelo (1981) state that one of the determinants of earnings management is the monitoring of quality audits. Becker et al., (1998); Frankel et al., (2002); F. A. Gul et al., (2003); Lin and Hwang (2010) state that auditors with high quality are expected to be able to reveal earnings management practices. Then Bartov et al., (2001); Bliss et al. (2011); Gul et al. (2009) stated that higher quality auditors would choose to report errors and violations and not accept questionable accounting practices.

Previous researchers explained that companies with low growth and high free cash flow use discretionary accruals to balance low profits (Chung et al., 2005). Additionally Chung et al. (2005) stated that Big6 auditors can reduce earnings management practices. The study uses data from companies in the United States from 1984-1996.

Bukit and Iskandar (2009) used data from companies listed on the Malaysian Stock Exchange in 2001 to explain the relationship between free cash flow surpluses and audit committees on earnings management. The study replicates the approach used by Chung et al. (2005). The results of this study indicate that the free cash flow surplus has a positive effect on earnings management, while the audit committee has a negative effect on earnings management.

Rusmin and Bambang (2014) research and explore the influence of external monitoring by high-quality auditors and free cash flow surpluses on earnings management. The data used are from Indonesia, Malaysia, Singapore from 2005-2010. Using this data, the research conducted contributes improvements in companies that practice earnings management and financial reporting, especially in public companies at IMS-GT. The study revealed that the relationship between free cash flow surpluses and earnings management occurs in Asian companies not only occur in companies in the USA and the UK. However, the study showed a significant difference in determinant factors in explaining the relationship between free cash flow surpluses and earnings management in the three countries that were the focus of the study. The results of this study state that free cash flow surpluses have a positive effect on earnings management, audit quality negatively affects earnings management, and audit quality is not significant in moderating the relationship between free cash flow surpluses and earnings management.

The interrelationships between these variables will be explained in the following framework:



Free cash flow is cash flow that remains after the company pays all operating expenses and investment needs, and the cash flow is provided by the company to be distributed to its investors. At the same time, the rest of the funding of all projects that generate a positive Net Present Value (NPV) is called a surplus free cash flow.

Companies that have high free cash flow surpluses have more potential for earnings management. In these circumstances, company management can act opportunistically by choosing to invest in projects that benefit themselves to take economic benefits so that their welfare increases. When monitoring or disciplinary attitudes of outside stakeholders and agents are ineffective, some managers can choose less profitable investments (Chung et al., 2005). In this case, it will harm shareholders and investors because it reduces their wealth. Managers can manipulate or hide their lousy investment decisions so that the information provided to investors always looks good. Managers choose accounting methods that increase profits to disguise the impact of adverse investments. Opportunistic behavior by company management will affect the company's low growth.

The company's financial statements reflect the financial condition of a company. To avert misstatements and asymmetric information, an external auditor is required. External auditors play an important role in ensuring the reliability of financial statements made under the actual circumstances of a company, later can provide accurate information to investors as a reference in making the best decisions. An inspection carried out by the auditor will affect the results presented. The quality of the decisions taken can judge the quality of the auditor's audit results. Audit quality considered an external monitoring center and one of the determinants of earnings management. The higher the audit quality, the higher it detects earnings management. Bartov et al. (2001); Bliss et al. (2011); and Lai (2004) show that high-quality auditors will report all forms of errors and irregularities that occur. Audit quality insignificantly moderates the relationship between free cash flow surpluses and earnings management (Rusmin & Bambang, 2014).

This study uses several variables, namely surplus free cash flow, audit quality, and the relationship between free cash flow surplus and audit quality as an independent variable and earnings management as the dependent variable. This study will examine the effect of surplus free cash flow with earnings management, audit quality with earnings management, and the relationship between surplus free cash flow and audit quality with earnings management. The control variables in this study are absolute total assets, leverage, company size, and relative cash flow. Control variables are useful for reducing bias in research results.

Effect of Free Cash Flow Surplus on Earnings Management

Jensen (1986) states that agency costs of free cash flows refer to cash flows invested in negative Net Present Value (NPV). Companies with low growth opportunities tend to spend less in free cash flow or choose unfavorable projects. Chung et al. (2005) explain that managerial behavior is related to free cash flow surpluses and influences the choice of accounting techniques for earnings management. They propose that when monitoring or disciplinary attitudes of external stakeholders and agents are ineffective, some managers may choose to invest in negative NPV projects. They further state that managers can select projects that benefit themselves to take economic benefits or personal benefits such as seeking personal enjoyment. The reason for this kind of manager behavior is to detect agency costs from free cash flow, which very difficult.

In the absence of regulations requiring managers to notify investors of investment cash flow projections, including the assumptions behind them will lead to commercial confidentiality. This situation will trigger managers to hide the lousy investment decision. Chung et al. (2005) suspect that biased managers might not internally project cash flow for some investments because they have some personal needs that make them ignore cash

and profit projections. However, they believe that bad investments will reveal their company's earnings reports in the future and argue that investments that not maximized will reduce profits. On the other hand, managers can disguise the negative impact of NPV investments by utilizing accounting techniques. Managers can use accounting procedures that improve earnings reporting, which results in higher market valuations. Under other circumstances, there is no way for investors with free cash flow surpluses to uncover earnings management practices truly. Company managers practice earnings management through accounting techniques by processing DAC (discretionary accruals).

Therefore, the first hypothesis proposed:

H1: Surplus free cash flow has a positive effect on earnings management

Effect of Audit Quality on Earnings Management

The quality of the auditing process carried out by an external auditor will affect the earnings management practices of the company's management. This study will explain the relationship between audit quality and earnings management, responding to anxiety among investors, policymakers, and corporate governance reformers in terms of mechanisms to curb opportunistic behavior by corporate management excessively. Auditor quality is an external monitoring center which is the main determining factor of earnings management.

De Angelo (1981); Watts and Zimmerman (1986) argue that auditor quality relies on relevant auditor reports in examining contractual relationships and reporting violations. Becker et al. (1998); Frankel et al. (2002) argue that auditors with higher quality would prefer to report errors and deviations that occur and not accept questionable accounting practices. We believe that high-quality auditors tend to uncover earnings management practices.

Therefore, this study also proposes the following hypothesis:

H2: Audit quality has a negative effect on earnings management

The Effect of Audit Quality That Can Moderate the Relationship of Surplus Free Cash Flow and Earnings Management

The agent (company management) and the principal (shareholders and investors) have a contractual relationship with each other related to the company's financial statements. Because agents have access to be able to know the current condition of the company, they assigned to provide information about the company's profits, which later used by principals to make decisions. Therefore, managers must prioritize the interests of shareholders. When managers prioritize personal interests over the interests of shareholders, there will be a conflict of interest. The battle of interest will encourage management to practice earnings management. Companies with a high surplus free cash flow tend to practice earnings management. Managers can invest in the company's free cash flow surplus for projects that benefit themselves and maximize personal well-being.

Because the principal cannot monitor the agent's activities continuously, a third party, namely an external auditor, is needed to help the principal supervise the agent. Also, external auditors can help uncover earnings management practices by checking the company's financial statements to match the company's actual conditions. High-quality audits expected to detect earnings management better, and therefore audit quality can weaken the relationship between surplus free cash flow and earnings management.

Therefore, the proposed hypothesis is:

H3: Audit quality moderates the relationship between surplus free cash flow and earnings management

RESEARCH METHOD

This study uses the dependent variable, earnings management. Earnings management is a condition when managers manipulate earnings information to hide the company's real financial situation (Chung et al., 2005). Earnings management variables in this study are proxied by discretionary accruals (DAC). To measure this variable Hill and Jones (1992) model are used. The following are the steps for calculating the Jones modification model.

Total accruals (TAC) calculated by:

$$TAC_{jt} = (NI_{jt} - CFO_{jt})$$

Where TAC_{jt} is the total accrual of j company year's t; NI_{jt} is the j company net income for the year t; and CFO_{jt} is the cash flow from the company's operating activity year t.

Normal accruals (NAC) determined by:

$$\frac{TAC_{jk,t}}{TA_{jk,t-1}} = \alpha_{jt} \frac{1}{TA_{jk,t-1}} + \beta_{jt} \frac{\Delta REV_{jk,t} - \Delta REC_{jk,t}}{TA_{jk,t-1}} + \gamma_{jt} \frac{PPE_{jk,t}}{TA_{jk,t-1}} + \varepsilon_{jk,t}$$

$TAC_{jk,t}$ is the total accrual of the company j industry k years t; $TA_{jk,t-1}$ is the total assets of company j industry k years t-1; $\Delta REV_{jk,t}$ reflect the change in net sales of the company j industry k year t; $\Delta REC_{jk,t}$ is the change in net receivables of the company j industry k year t; $PPE_{jk,t}$ is the property, plant, and equipment of company j industry k year t; α_{jt} , β_{jt} , γ_{jt} are the estimated industrial specification coefficients; and ε is an error.

Discretionary accruals (DAC) estimated with:

$$DAC = TAC - NAC$$

Dimana DAC is discretionary accrual; TAC is total accrual; and NAC is normal accrual.

The independent variables in this study are surplus free cash flow and audit quality. In this study, surplus free cash flow are calculated by estimating the retained cash flow (RCF) and the company's growth prospects. When a company with low growth opportunities maintains high free cash flow, it will invest the cash flow in negative net present value (NPV) projects. The following are measurements for surplus free cash flow.

$$RCF_{jt} = \frac{NIBD_{jt} - INT_{jt} - TAX_{jt} - PSDIV_{jt} - CSDIV_{jt}}{TA_{jt-1}}$$

Where RCF is retained cash flow; NIBD is net operating income before depreciation expense; TAX is a total tax; INT is the interest expense; PSDIV is preferred stock dividends; CSDIV is a common stock dividend; and TA_{jt-1} is the total assets of company j in year t-1.

Later the company growth is estimated by using a price to book ratio. Surplus free cash flow is measured using a dummy variable. Companies with retained cash flows (RCF) that are above the sample mean value and the ratio of book values below the sample mean value will be given a score of 1, but if otherwise provided a value of 0.

Second independent variabel is audit quality. Audit quality is the quality of audits performed by the auditor. In this study, audit quality is proxied by the size of the public accounting firm in line with research conducted by Rusmin and Bambang (2014). Audit quality is measured using a dummy variable, where companies audited by Big 4 public accounting firms are given a score of 1. In contrast, companies audited by Non-Big 4 public accounting firms are given a score of 0.

The control variables in this study are absolute total assets (*AbsTAC*), leverage, firm size (*Fsize*), and relative cash flow (*RelCFO*). Absolute total assets (*AbsTAC*) aim to control the "potential to produce accruals" of a company (Becker et al., 1998). In line with research Rusmin and Bambang (2014) then the absolute variable total assets are measured by dividing the absolute value of the company's total accruals with the company's total assets for year t-1. Second control variable is leverage indicates. Companies that violate debt agreements are more likely to be involved in earnings management to increase income. The leverage variable is measured by the

ratio of total company debt for year t divided by total company assets for year t, consistent with research conducted by Rusmin and Bambang (2014).

This study included firm size control variables (*Fsize*) as in previous studies which showed that large client firm sizes would have a higher risk of litigation than smaller client company sizes (Heninger, 2001). The way to measure it is by the natural logarithm of the company's equity value of year t. And the last control variable is relative cash flow (*RelCFO*). It is used to control discretionary accruals against operating cash flow (Rusmin & Bambang, 2014). This variable is measured by dividing the cash flow difference from the company's operating activities for years t and t-1 with the total assets of the company year t-1.

The sample data used in this study is manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2015-2016. Manufacturing companies listed on the Indonesia Stock Exchange in 2015-2016 are 287 companies. The research sample used in this study is a company that meets predetermined criteria. The samples criteria are all manufacturing companies listed on the Indonesia Stock Exchange (IDX) and issue an annual report for 2015-2016 audited by a public accounting firm. The research criteria can be seen in the table below:

Table 1
Details of Sample Determination

Criteria	Total
Manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2015-2016	287
Manufacturing companies that do not publish an annual report 2015-2016 and have not been audited by a public accounting firm	(4)
Manufacturing companies that suffered losses in 2015-2016	(76)
Manufacturing companies that do not meet the required data	(151)
Total research sample	56
Samples that are outliers	(8)
The final sample used in the study	48

Source: Secondary data processed, 2017

Based on the table above, the number of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2015-2016 was 287 companies. Four companies did not publish the 2015-2016 annual report and have not been audited by a public accounting firm, and 76 companies suffered losses. Manufacturing companies that did not meet the required data were 151 companies, and 8 sample companies were outliers, the total final sample used in this study was 48 companies.

This study uses multiple regression analysis methods to test hypotheses that have several independent variables and one dependent variable. The regression equation model in this study is as follows:

$$DAC_{jt} = \alpha_0 + \alpha_1 SF_{CF_{jt}} + \alpha_2 AQ_{jt} + \alpha_3 SF_{CF_{AQ_{jt}}} + \alpha_4 AbsTAC_{jt} + \alpha_5 LEV_{jt} + \alpha_6 Fsize_{jt} + \alpha_7 RelCFO_{jt} + \epsilon_i$$

Where :

DAC_{jt} = Company discretionary accruals
 $SF_{CF_{jt}}$ = Surplus free cash flow
 AQ_{jt} = Audit Quality

SFCFAQ _{jt}	= Interaction between surplus free cash flow and audit quality
AbsTAC _{jt}	= Absolute total assets
Lev _{jt}	= Leverage
Fsize _{jt}	= Firm size
RelCFO _{jt}	= Relative Cash Flow
jt	= Company and year index
α	= Regression coefficient
ε_i	= Error

RESULTS

Table 2 shows the results of the descriptive statistical analysis performed on earnings management variables having a minimum value of 0,000, a maximum amount of 0,203, and a mean or average of 0,053 with a standard deviation of 0,049. The surplus free cash flow variable (SFCF) has a minimum value of 0 and a maximum value of 1. The mean or average value for SFCF is 0,208, and the standard deviation is 0,410. The audit quality variable has a minimum amount of 0 and a maximum value of 1. This audit quality variable has a mean or an average of 0,438 with a standard deviation of 0,501. The interaction variable between SFCF and Audit Quality which is symbolized by SFCFAQ in table 2 has a minimum value of 0 and a maximum value of 1. This variable has a mean or an average value of 0,063 with a standard deviation of 0,245.

The control variables used in this study are an absolute total asset (AbsTAC), leverage (LEV), company size (Fsize), and relative cash flow (RelCFO) variables. The absolute variable total assets have minimum and maximum values of 0,002 and 0,204. While the mean or average and standard deviation of absolute total assets are 0,056 and 0,049. The leverage variable has a minimum value of 0,071 and a maximum value of 0,820. The mean or average value of the leverage shown in the table is 0,409, with a standard deviation of 0,173. The company size variables have minimum and maximum values of 25,20 and 31,41, respectively. While the mean and standard deviations are 28,57 and 1,597, respectively. The variable relative cash flow has a minimum value of -0,148, a maximum value of 0,349, and a mean and standard deviation of 0,037 and 0,107.

Table 2
Descriptive Statistics Results

	N	Minimum	Maximum	Mean	Std. Deviation
DAC	48	0,000	0,203	0,053	0,049
SFCF	48	0,000	1,00	0,208	0,410
AQ	48	0,000	1,00	0,438	0,501
ABSTAC	48	0,002	0,204	0,056	0,049
LEV	48	0,071	0,820	0,409	0,173
FSIZE	48	25,20	31,41	28,57	1,597
RELCFO	48	-0,148	0,349	0,037	0,107
SFCFAQ	48	0,00	1,00	0,063	0,245

Source: Output analysis of descriptive data from SPSS, 2017

The statistical t-test is used to test whether independent variables such as free current surpluses and audit quality influence the dependent variable, earnings management. The results of the statistical t-test will be explained in detail in table 3.

Table 3
 Statistical t-test Results

Variabel	B	t	Sig
Constant	-0,086	-1,354	0,183
SFCF	0,017	2,053	0,047
AQ	-0,015	-2,127	0,040
SFCFAQ	-0,016	-1,169	0,249
ABSTAC	1,000	16,789	0,000
LEV	-0,020	-1,131	0,265
FSIZE	0,003	1,565	0,126
RELCFO	-0,088	-3,279	0,002

Source: Multiple regressions output from SPSS, 2017

Based on table 3, the results of the statistical t-test show that the surplus free cash flow variable (SFCF) has a positive effect on earnings management. It is said to have a positive impact because SFCF has a p-value of 0,047 and a beta coefficient value of 0,017. Because of the p-value <0,10, and the positive coefficient value shows that the surplus free cash flow is positively and significantly influential on earnings management. Based on the results of these tests, it can be concluded that these results support H1.

Audit quality variables (AQ) based on these results negatively affect earnings management. This evidenced by the results showing a p-value of 0,040 less than 0,10 and a beta coefficient of -0,015. A negative value on the value of the beta coefficient means a negative effect on earnings management variables. Based on the results of these tests, it can be concluded that these results support H2.

The interaction between free cash flow surplus and audit quality (SFCFAQ) on earnings management in this test shows a p-value of 0,249 and a beta coefficient of -0,16. Because the p-value > 0,10 and the beta coefficient are negative, it can be said that the interaction of SFCFAQ negatively and insignificantly moderate the relationship between surplus free cash flow (SFCF) and earnings management. Based on the results of these tests, these results do not support H3.

Furthermore, the absolute total control variable (AbsTAC) in table 4.12 is stated to have a positive effect on earnings management because it has a p-value of 0.000 less than 0,10 and a beta coefficient of 1.000. Because the beta coefficient value shows a positive value, it can be concluded that the absolute total assets have a positive influence on earnings management. Other control variables, namely leverage (LEV) based on the test results, have a p-value of 0,265 and a coefficient value of beta -0,020. Because the p-value > 0,10 and the coefficient value are negative, it can be concluded that the negative leverage is no significant effect on earnings management. The firm size control variable (Fsize) has a p-value of 0,126 and a beta coefficient value of 0,003. Because the p-value > 0.10 and the positive beta coefficient, it can be concluded that company size does not have a significant positive effect on earnings management. Then the last control variable is relative cash flow (RelCFO). This variable has a p-value, and the beta coefficient values are 0,002 and -0,088, respectively. The corresponding cash flow variable is stated to have a negative effect on earnings management because it has a p-value <0,10 and a beta coefficient that shows a negative number.

DISCUSSION

This study shows the same results as the research conducted by Bukit and Iskandar (2009); Chung et al. (2005) which state that companies that have high free cash flow surplus will tend to do earnings management, while companies with low free cash flow surplus tend not to do earnings management. Companies with low growth and high free cash flow use discretionary accruals to balance low or negative income (Chung et al., 2005). Managers will use free cash flow surpluses and accounting techniques by managing discretionary accruals in managing earnings. This study also addresses the same results as the study conducted by Becker et al. (1998); Frankel et al. (2002); Lin and Hwang (2010) which state that high quality auditors are considered more likely to detect earnings management practices and determine the magnitude of earnings management practices. Big 4 and non-Big 4 KAPs are used as a measure of audit quality in line with research conducted by Heninger (2001); Mayhew and Wilkins (2003); Rusmin and Bambang (2014). Therefore, companies that use KAP Big 4

audit services will most likely detect and disclose earnings management practices because KAP Big 4 is considered to have higher competence in auditing financial statements and is able to reduce earnings management. This study proves that audit quality negatively does not significantly moderate the relationship between free cash flow surpluses and earnings management. This can happen because the practice of earnings management is done because the company wants its performance to look good in the eyes of investors, but ignores the existence of Big4 auditors (Luhglatno, 2010). This result is in line with research conducted by Rusmin and Bambang (2014) which shows that companies audited by KAP Big 4 which are seen as high quality auditors do not show a significant influence in moderating the relationship between free cash flow surpluses and earnings management.

CONCLUSIONS AND SUGGESTIONS

The purpose of this study is to determine the effect of free cash flow surplus, audit quality, as well as the interaction between free cash flow surplus and audit quality on earnings management. The research sample used is manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2015-2016. After data collection, data processing through a series of tests, and analysis of test results, it can be concluded that the free cash flow surplus has a positive effect on earnings management. The higher the free cash flow surplus of a company, the higher the potential for earnings management. Audit quality has a negative impact on earnings management. It can be concluded that high audit quality will detect and reduce earnings management practices. The interaction between free cash flow surplus and audit quality has a negative effect and does not significantly moderate the relationship between free cash flow surplus and earnings management. Then it can be concluded that companies that have high free cash flow surpluses and are audited by the Big Four public accounting firm have not been able to reduce the level of earnings management practices.

Limitations and weaknesses in this study are the research samples used are only manufacturing companies listed on the Indonesia Stock Exchange so that the results of this study cannot be applied to non-manufacturing companies. The research period is only limited to two years, so this period is not able to reveal a situation that requires an extended observation period. This study only uses two independent variables, namely free cash flow surplus and audit quality, and have not added other variables that might affect earnings management. This study uses the size of the Big Four and Non-Big Four public accounting firms as a measurement of audit quality so that it is only determined by the size of the public accounting firm.

Based on the conclusions and limitations above, the suggestion for further research is to increase the sample of the study that is used not only by manufacturing companies and combining more countries studied. The research period is expanded to several years. Further research is recommended to use or add other independent variables that can affect earnings management, such as the existence of an audit committee variable. Additional suggestions are expected to use measurements other than the size of the public accounting firm for audit quality variables. Audit quality measurement can be replaced using audit tenure.

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