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EARNING MANAGEMENT, AUDIT QUALITY AND FIRM VALUE IN INDONESIA MANUFACTURING COMPANIES

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Abstract

The contractual relationship between the principal and the agent based on accounting numbers can encourage management to conduct earnings management. This study examines the effect of earnings management, which is classified into accrual earnings management and earnings management with real activities on firm value which is moderated by audit quality. The populations in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2015-2017. Sampling was done by purposive sampling method and 114 observations were obtained. As hypothesized, the results of testing with moderated regression analysis show that real earnings management has a positive effect on firm value. Meanwhile, accrual earnings management has no effect on firm value. The audit quality variable serves to weaken the relationship between real earnings management and firm value, but does not moderate the effect of accrual earnings management on firm value.

Keywords:

Accrual earnings management, real earnings management, firm value, audit quality

Introduction

Firm value is one of the variables that is very important for future investors to assess the company as a whole (Cheung, Chung, & Fung, 2015). Firm value is reflected in the value of the company's shares, which shows the company's ability to achieve expected earnings, sales growth, and capital increase. The higher the share price the higher the firm value, which means the higher the welfare of shareholders. Therefore, creating high share values is the goal of modern publicly traded companies (Faozi & Ghoniyah, 2019).

In the agency relationship, management is involved in a contract with the company owner (shareholder). The contract is generally based on accounting figures, which can encourage management to behave opportunistically (Watts & Zimmerman, 1990). When the bonus plan received by managers is based on increasing firm value or even when the firm value is overvalued, it will cause opportunistic behavior of managers as manifested in earnings management actions (Healy, 1985). The results of Badertscher (2011) research indicate that the drive to maintain the value of equity that is overvalued will be used by managers to improve their welfare through stock options or bonuses related to company performance. This condition reflects that there is a conflict of interest between management and shareholders (Wibowo & Fuad, 2018).

An increase in firm value is reflected in the value of equity that is overvalued, that is when the company's stock price exceeds its fundamental value (overvalued) (Jensen, 2005). Over valued occurs when there is misinformation and manipulation contributed by investors, managers, securities analysts, auditors, commercial banks, and law firms. An increase in company value can also occur when there is information asymmetry between managers and investors, which encourages managers to practice earnings management. This condition can have very bad consequences because management tries to maintain high equity values by creating figures that can mislead the market through the illusion of growth. However, when the market is able to detect that growth is only an illusion, then the firm value will go down because of lost market confidence (Badertscher, 2011; Marciukaityte & Varma, 2008; Wibowo & Fuad, 2018).

In general, earnings management can be done through two main methods, namely accrual-based earnings management and earnings management with real activities. Accrual-based earnings management involves choosing specific accounting methods for certain transactions to manipulate reported earnings (El Diri, 2017) in Khanh and Khuong (2018). Accrual-based earnings management is done by changing the accounting method or estimation used when presenting transactions in the financial statements (Zang, 2012). Therefore, manipulation through accruals does not affect economic transactions and company cash flows. The aim is to mislead the market regarding the company's actual performance (Caylor, Christensen, Johnson, & Lopez, 2015). When the market cannot detect managers' opportunistic behavior, the market will assume that the earnings figures presented by managers are the result of good performance.

Gaio and Raposo (2011) examined the relationship between the quality of proxied earnings and accrual quality and firm value. The study was conducted on 7,000 companies in 38 countries (22 developed countries and 16 developing countries) in 1990-2003. The results of the study prove that there is a positive and significant relationship between the quality of accrual quality and firm value. Research by Susanto and Christiawan (2016) also proves that accrual earnings management has a positive effect on firm value.

The second form of earnings management is real earnings management, which is often referred to as real activity manipulation or real activity management (D. Cohen, Pandit, Wasley, & Zach, 2016). Real earnings management is carried out by actions that deviate from normal business practices, including a loose sales credit policy, reducing discretionary costs, or excess production to achieve revenue targets (Roychowdhury, 2006).

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Compared to accrual earnings management, real earnings management is more difficult to find out because of its nature which can be hidden in normal business activities (Anagnostopoulou & Tsekrekos, 2016; Khanh & Khuong, 2018). Several previous studies also stated that real earnings management is more difficult to track and study by outside parties such as auditors or regulators (D. A. Cohen & Zarowin, 2008, 2010; Gunny, 2010; Zang, 2012). This happens because real earnings management is easily covered up in the form of everyday business transactions. Meanwhile, accrual earnings management involves choosing accounting methods that are easier to detect and monitor by outsiders (Roychowdhury, 2006).

Agency theory suggests that monitoring mechanisms can be used to align interests between shareholders and management. This monitoring function can be carried out by an external auditor as an external mechanism of corporate governance. Quality auditors are assumed to function as a monitoring mechanism that will help in minimizing management in manipulating earnings, so as to reduce information asymmetry between the two parties (Alzoubi, 2017). Quality auditors (Big 4) have a strong drive to maintain high audit quality because of several reasons, 1) has a greater number of clients; 2) has significant resources to support the audit process (recruitment, training and technology); and 3) the possibility of obtaining a greater loss if it does not report violations found, for example termination of the client, loss of reputation (Chung, Firth, & Kim, 2005; Rusmin, 2010). The reliability and fairness of financial statements that have been verified by qualified external auditors will improve the quality of financial information and reduce earnings management. However, the role of audit quality at the level of earnings management is still an open question that needs to be further discussed because the results of previous research are still being debated (Khanh & Khuong, 2018).

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This study examines the effect of earnings management, which is classified into accrual earnings management and earnings management with real activities on firm value which is moderated by audit quality. This research was motivated by several things which also contributed to this research. First, until now earnings management is a central topic in theoretical and empirical research in accounting (Beyer, Guttman, & Marinovic, 2019). Some previous studies have focused more on accrual-based earnings management. This focus is incomplete and is not the best in overvalued research because it does not pay attention to earnings management with real activities (Kothari, Mizik, & Roychowdhury, 2012). This research contributes to the current literature with the focus of the investigation both on accrual earnings management and real earnings management.

Second, because the results of the current literature are still being debated, this study will clarify the relationship between the level of accrual and real earnings management to firm value by including audit quality variables 14 as moderating variables in the relationship between earnings management and firm value. Third, empirical evidence about the relationship between earnings management (accrual and real) and firm value has been found in many developed countries. In an effort to increase accounting harmonization, understanding of the contexts of different countries including Indonesia as a developing country must be taken into account in all issues investigated (Alzoubi, 2017). Therefore, 14 this study contributes to the current literature by providing evidence about the effect of audit quality in the relationship of accrual and real earnings management to firm value, particularly in emerging markets such as Indonesia.

Literature Review and Hypothesis

Agency Theory

The theory underlying the relationship between earnings management, audit quality and firm value is agency theory. This theory explains the agency relationship between management and shareholders. In this relationship, management acts as an agent for shareholders, who get commensurate authority for productive purposes (Chen & Chu, 2005). Management as an agent has an obligation to maximize earnings and shareholder value (Campbell, 2007). However, with the separation of ownership and control between management and shareholders, it is questionable whether management will take the best course of action in the interests of the owners. This happens because as a rational person, managers are motivated to achieve personal goals that may conflict with the goals of shareholders (Eisenhardt, 1989; Mohd, 2005). Based on these assumptions, management may not always behave in ways that can maximize shareholder value (Eisenhardt, 1989).

The source of agency problems is the involvement of managers in earnings management with the aim of producing the desired earnings performance in maintaining the company's value as indicated by the share price which is overvalued (Jensen, 2005). This research is based on an assumption based on agency theory, which is an over-assessment of the equity hypothesis, that earnings management leads to an increase in firm value. Badertscher (2011) prove that if the company's value is in an overvalued condition, managers are encouraged to maintain this condition by meeting market expectations and tend to be involved in earnings management. In addition, earnings management is a way to create values practiced by opportunistic managers to create the impression that earnings performance is very good (Badertscher, 2011; Jensen, 2005; Marciukaityte & Varma, 2008). Thus, earnings management is a manifestation of value creation to achieve better corporate value conditions, and is triggered by the opportunistic behavior of managers for compensation to be given, such as bonuses or stock options. This argument is supported by the hypothesis proposed by Jensen (2005) that managers tend to be involved in earnings management, both with accruals and real activities to meet unrealistic performance expectations, which are reflected in stock prices that are higher than fundamental values.

Earning Management

Earnings management is an action taken by managers to obtain the desired profits, one of which is to mislead the market regarding the company's actual performance (Caylor et al., 2015). When the market cannot detect the opportunistic behavior of management, the market will assume the earnings figures presented by managers are the result of good performance (Darmawan, T, & Mardiati, 2019).

In general earnings management can be done through two main methods, namely accrual-based earnings management and earnings management with real activities. Accrual-based earnings management involves choosing specific accounting methods for certain transactions to manipulate reported earnings (El Diri, 2017) in Khanh and Khuong (2018). Accrual-based earnings management is done by changing the accounting method or estimation used when presenting transactions in the financial statements (Zang, 2012).

The second form of earnings management is real earnings management, which is often referred to as real activity manipulation or real activity management (Cohen, et al., 2016). Real earnings management is carried out by actions that deviate from normal business practices, including a loose sales credit policy, reducing discretionary costs, or excess production to achieve revenue targets (Roychowdhury, 2006).

Real earnings management has been a concern since the research of Graham, Harveya, and Rajgopal (2005) dan Roychowdhury (2006). Today, more and more research is proving that real earnings management is carried out to increase reported earnings (Darmawan et al., 2019; Gunny, 2010; Wibowo & Fuad, 2018; Zang, 2012). This evidence shows that managers prefer earnings management by manipulating the company's real activities rather than through accrual earnings management.

There are at least three reasons why managers prefer to manipulate real activities(Alhadab & Clacher, 2018), namely 1) Unlike laboratory management, accrual earnings management is in the scope of the audit. Therefore manipulation of real activities is more likely to be undetected by auditors and regulators(Graham et al., 2005).2) real earnings management is carried out throughout the year, while accrual earnings management only occurs at the end of the quarter or fiscal year. When management has a profit target, then using accrual earnings management alone will run the risk of not achieving the profit target. In addition, management cannot possibly use real earnings management to cover shortages because there is not enough time to effectively manipulate real activities (Roychowdhury, 2006).3) the balance sheet accumulates all changes in previous accounting methods(Barton & Simko, 2002), which results in companies that use higher accrual earnings management in previous years tend to manipulate real activities in the current period if they have a continuous motivation to manipulate earnings (Gunny, 2010).

Accrual Earning Management and Firm Value

Accrual earnings management is an approach in manipulating earnings using available accruals. Accrual-based earnings management is practiced by changing the accounting method or estimation used when presenting transactions in the financial statements(Zang, 2012). The adverse effects of earnings management practices shown by Marciukaityte and Varma (2008), who found that opportunistic managers in accrual earnings management practices could cause damage to the relevance of the value of accounting information as reflected in an increase in stock prices.This finding is consistent with the argument byJensen (2005), which states that accrual earnings management practices are value creation to deceive the market and provide the illusion of growth to the market. This is in line with the findings (Teoh, Welch, & Wong, 1998), which shows that the increase in accruals is associated with poor company performance. Similar findings are shown by Gaio and Raposo (2011), with a sample of 7,000 companies from 38 countries in 1990-2003, which provides evidence that there is a positive and significant relationship between the quality of the proxied earnings and the quality of the accruals and the value of the company. Based on the logic and empirical evidence described above, a hypothesis is formulated:

H1. Accrual earnings management has a positive effect on firm value

Real EarningManagement and Firm Value

Gunny (2010)explains that real earnings management occurs when a manager performs an activity that can change the time or structuring of operations, investments and / or financing transactions to influence the output of the accounting system. In addition, Zang (2012)states that accrual earnings management is a measure that aims to modify earnings, with less than optimal business consequences. Thus, the practice of real earnings management is actually a change in the company's operational activities to earn revenue. Roychowdhury (2006) states that real earnings management methods can be implemented through sales manipulation, overproduction, and discretionary payment delays. Gunny (2010) proposes several reasons why companies prefer real earnings management over accrual earnings management. One reason is that real earnings management is under the control of managers through decisions in business operations, whereas accounting or accrual earnings management options are limited by auditor supervision.

Graham et al. (2005) show strong evidence that managers prefer real economic action to maintain earnings performance. Their research shows that in an effort to meet revenue targets, 80% of survey respondents reduce and / or delay research, development, advertising, and maintenance costs. In addition, more than half (55.3%) of respondents postponed the start of a new project to meet revenue targets regardless of the consequences big enough for the value sacrificed.

In line with these findings, D. A. Cohen and Zarowin (2010)explain that earnings management using the real earnings management method is more common than the accrual method. This is due to the tendency that accrual earnings management attracts more attention from auditors or regulator supervision than real earnings management.Likewise, Kothari et al. (2012)show that managers are more likely to be involved in real earnings management than accrual earnings management during a seasond equity offering (SEO) even though real earnings management is considered more expensive in the long run. In addition, they show that real earnings management practices encourage an overvalued company, but ultimately adversely affect market performance.The same results were also shown by Wibowo and Fuad (2018), who found that managers do earnings management with abnormal production costs to increase firm value.

Badertscher (2011) found that managers use accrual earnings management in the initial stages of overvaluation and turn to real earnings management to maintain high company value (overvalued). Thus, managers use real earnings management to increase company value. Based on the description and findings, the hypothesis is formulated as follows:

H2. Real earnings management has a positive effect on firm value

Audit Quality Moderates the Effect of Earnings Management on Company Value

Agency theory suggests that monitoring mechanisms can be used to align interests between shareholders and management. This monitoring function can be carried out by an external auditor as an external mechanism of corporate governance. Quality auditors are assumed to function as a monitoring mechanism that will help in minimizing management in manipulating earnings, so as to reduce information asymmetry between the two parties.(Alzoubi, 2017). Quality auditors (Big four) have a strong drive to maintain high audit quality because of several reasons, 1) has a greater number of clients; 2) has significant resources to support the audit process (recruitment, training and technology); and 3) the possibility of obtaining a greater loss if it does not report violations found, for example termination of the client, loss of reputation

(Chung et al., 2005; Rusmin, 2010).The reliability and fairness of financial statements that have been verified by qualified external auditors will improve the quality of financial information and reduce earnings management. Based on the logic of thought above, the following hypothesis is formulated:

H3a: Audit quality moderates the effect of accrual earnings management on firm value

H3b: Audit quality moderates the effect of accrual earnings management on firm value

Research Methods

Population and Sampling

The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange in 2015-2017. The selection of samples using the purposive sampling method produced a total of 114 observations.

Operational Definitions and Variable Measurement

The independent variable in this research is earnings management, which is divided into accrual earnings management and real earnings management. Firm value variable as the dependent variable and audit quality as a moderating variable. The following are operational definitions and measurements of the variables.

Firm Value is measured using Tobin's Q which is the sum of total market value with total debt divided by total company assets as used by Faozi and Ghoniyah (2019)andGamayuni (2015)with the formula:

Tobin's Q = (Total market value + Total debt)/Total assets…………………(1)

The measurement of accrual earnings management in this study uses the formula developed byDechow, Sloan, and Sweeney (1995), the Modified Jones Model (1991), with the following steps:

1) Calculate total accruals

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$$TA_{it} = NI_{it} - CFO_{it} \quad \text{...} \quad (2)$$

Where:

TA_{it} = Total accruals of company i in period t

NI_{it} = Net income of company i in period t

CFO_{it} = Cash flow from operating activities of the company i in period t

2) Determine of the regression coefficient

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$$TA_{it}/A_{it-1} = \beta_1(1/A_{it-1}) + \beta_2(\Delta REV_{it}/A_{it-1} - \Delta REC_{it}/A_{it-1}) + \beta_3 (PPE_{it}/A_{it-1}) + \varepsilon_{it} (3)$$

Where:

TA_{it} = Total company accrual i in period t

A_{it-1} = Total assets 8 f company i in period t-1

ΔREV_{it} = Changes in company income i in period t

ΔREC_{it} = Changes in company receivables i in period t

PPE_{it} = The company's fixed assets i in period t

ε_{it} = company term error i in period t

$\beta_{1,2,3}$= regression coefficient

3) CalculateNon Discretionary Accruals (NDA) of the regression coefficients.

$$NDA = \beta 1(1/A_{it-1}) + \beta 2(\Delta REV_{it}/A_{it-1} - \Delta RECit/A_{it-1}) + \beta 3 (PPE_{it}/A_{it-1}) + \varepsilon it\text{.......} (4)$$

Where:

NDA_{it} = Non discretionary accruals i in period t

A_{it-1} = Total com 8 ny assets i in period t-1

ΔREV_{it} = Change in company income i in period t

ΔREC_{it} = Changes in company receivables i in period t

PPE_{it} = Company fixed assets i in period t

ε_{it} = company term error i in period t

$\beta_{1,2,3}$ = regression coefficient

4) Calculate Discretionary Accruals (DA)

$$DA_{it}= (TA_{it}/A_{it-1}) - NDA_{it} \quad \text{...} \quad (5)$$

Where:

DA_{it} = Company discretionary accruals i in period t

TA_{it} = Total company accruals i in period t

A_{it-1} = Total company assets i in period t-1

NDA_{it} = Non discretionary accruals of the company i in the period t

Detection of whether or not accrual earnings management practices occur can be done by looking at the value of discretionary accruals (DA).

Real earnings management variables are measured by a model developed byRoychowdhury (2006), which is proxied by abnormal production costs (RMP) and abnormal discretionary expenses (RMD). Several researchers have previously used the formula and proved that the proxy can capture real earnings management behavior accurately(Braam, Nandy, Weitzel, & Lodh, 2015; Wibowo & Fuad, 2018; Zang, 2012).Abnormal production costs are estimated using the following regression formula.

$$PRODt/A_{t-1} = \propto_0+\propto_1(1/A_{t-1}) + \propto_2(St/At\text{-}1) + \propto_3(\Delta St/At\text{-}1) + \propto_4(\Delta S_{t-1}/A_{t-1}) + \varepsilon_t \ldots\ldots\ldots\ldots (6)$$

Where:

$PROD_t$ =the cost of goods sold (COGS) in year t and the inventory change from t-1 to t
A_{t-1} = the asset total in year t-1
S_t = the net sales in year t and
ΔS_t = the change of net sales from year t-1 to t.

Abnormal production cost was measured using the residual estimation of that equation. The higher the residual, the higher the amount of oversupply and the bigger the earnings increase by reducing the cost of good sold (COGS).Then, the abnormal discretionary expenses were estimated with cross-section regression Roychowdhury (2006):

$$DISX_t/A_{t-1}= \propto_{0\,+}\propto 1(1/A_{t-1}) +\propto_1(1/A_{t-1}) + \propto_2(S_{t-1}/A_{t-1}) + \varepsilon_t$$

Where

$DISX_t$ = the discretionary expenses i.e., the amount of research & development (R&D), advertising and sales, general & administrative (SG&A expenses) in year t.
A_{t-1} = the asset total in year t-1.
S_t = the net sales in year t-1.

Abnormal discretionary expenses were measured using the residual estimation value from the regression. High residual value (low) shows high abnormal discretionary expenses (low).

Audit quality is proxied by the KAP size of the company i year t. This variable is a dummy variable, if the company is audited by KAP affiliated with the Big Four KAP which consists of Pricewaterhouse Coopers, Deloitte Touche Tohmatsu, KPMG, and Ernest and Young then it is worth 1, but if the company is audited by the Non Big Four KAP, it is worth 0. Here is the Big Four accountant office with affiliates in Indonesia: (1) KAP Purwantono, Sarwoko, Sandjaja is affiliated with Ernst & Young, (2) KAP Osman Bing Satrio is affiliated with Deloitte, (3) KAP Sidharta, Sidharta, Widjaja is affiliated with KPMG, (2) KAP Osman Bing Satrio is affiliated with Deloitte, (3) KAP Sidharta, Sidharta, Widjaja is affiliated with KPMG, (4) KAP HaryantoSahari is affiliated with PwC.

The data analysis technique used in this study is moderated regression analysis (MRA) with the following equation.

$$FV = \alpha + \beta_1 AEM + \beta_2 REM + \beta_3 AEM*AQ + \beta_4 REM*AQ + \varepsilon$$

Where:

FV : Firm value of firms
AEM : Accrual earning management
REM : Real earning management
AQ : Audit Quality
ε : error term

Results and Discussion

Test results for normality and classic assumptions

The normality test results showed a Z skewness value of 1.791, smaller than the critical number of 1.976. These results indicate that the residual value in the regression model is normally distributed.

Tabel 1
HasilPengujianMultikolinearitas

Variabel	Colinearity Statistics	
	Tolerance	VIF
AEM	0.147	6.815
REM	0.143	7.013
AEM*AQ	0.152	6.599
AEM*AQ	0.140	7.141

Based on the multicollinearity test results presented in Table 1, it can be seen that there is no variable that has a tolerance value above 0.1 and a variance inflation vactor value above 10. It can be concluded that in the regression model there is no multicollinearity problem between the independent variables. The results of autocorrelation testing with the run test method showed insignificant results, which means no autocorrelation problems occurred. Meanwhile the heteroscedasticity test results presented in Table 2 show that all variables are not significant at the 5% level, so it can be concluded that there is no heteroscedasticity problem in the regression model.

Tabel 3
HasilPengujianHeteroskedastisitas

Model	Unstandardized Coefficients		Standardized Coefficient	t	Sig.
	B	Std. Error	B		
(Constant)	0.190	0.021		9.083	0.000
AEM	0.089	0.181	0.123	0.490	0.625
REM	-0.130	0.228	-0.145	-0.572	0.568
AEM*AQ	-0.084	0.107	-0.193	-0.786	0.433
AEM*AQ	-0.074	0.161	0.117	0.458	0.648

Dependent variable: AbsRes

The Results of Moderated Regression Analysis Test

Table 3 presents the test results using moderated regression analysis. Based on Table 3 it can be seen that the adjusted R square value is 0.529, which means 52.9% of the variation in firm value can be explained by accrual earnings management, real earnings management, accrual earnings management interactions with audit quality and real earnings management interactions with audit quality. The remaining 47.1% is explained by other variables outside this research model. F test results show a figure of 30,380 with a significance level of 0,000, it can be concluded that the research model is fit and feasible to use to test the effect of accrual earnings management, real earnings management on firm value which is moderated by audit quality variables.

The first hypothesis testing results show the value of the beta coefficient on the accrual earnings management variable (AEM) of -0.387 with a significance level of 0.242, which means that the first hypothesis stating that accrual earnings management has a positive effect on firm value is rejected. The beta coefficient value on the variable real earnings management (REM) shows a figure of 3,106, significant at the 0,000 level. It can be concluded that the second hypothesis stating that real earnings management has a positive effect on firm value is accepted. The interaction between accrual earnings management (AEM) and audit quality shows a beta coefficient of 0.200 with a significance level of .306, so the third hypothesis stating audit quality moderate the effect of accrual earnings management on firm value is rejected. Meanwhile the interaction between real earnings management variables and audit quality shows a beta coefficient of -1.142, significant at the 1% level. Thus the fourth hypothesis which states that audit quality moderates the effect of real earnings management on firm value is accepted.

Tabel 3
HasilPengujian
Moderated Regression analysis

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients B	t	Sig.
(Constant)	.836	.038		21.988	.000
AEM	-.387	.329	-.203	-1.176	.242
REM	3.106	.414	1.313	7.510	.000
AEM*AQ	.200	.194	.174	1.029	.306
AEM*AQ	-1.142	.292	-.689	-3.906	.000

Dependent Variable: FV
Adjusted R Square : 0.529
FHitung : 30.380
Sig. : .000

Discussion

Based on the test results, accrual earnings management has no effect on firm value. These results indicate that accrual earnings management has no effect on firm value. This finding is in line with the results of the study by (Darmawan et al., 2019), but it contradicts the findings of Gaio and Raposo (2011) and Susanto and Christiawan (2016). The argument that can be given is that the market can assume that earnings management is less dangerous, so the market does not give any positive or negative response to accrual earnings management by management..

The results show that real earnings management has a positive effect on firm value. This finding supports the results of research conducted by Badertscher (2011), which proves that real earnings management can increase firm value. This finding is also in line with the results of research by Wibowo and Fuad (2018) which proves that real earnings management by excessively increasing production results in a decrease in cost of goods sold and an increase in corporate profits. This increase in profit will lead to an increase in market expectations of the reported earnings performance, which is reflected in an increase in the value of the company.

This phenomenon shows that the market responds positively to earnings performance because it is not aware that accounting numbers have been manipulated through real earnings management. Market optimism about the growth of the resulting earnings performance can meet market expectations and cause an increase in the value of the company, which is actually only an illusion of growth. The findings of this study also prove that managers tend to choose earnings management by manipulating real activities (D. A. Cohen & Zarowin, 2010; Kothari et al., 2012) to increase firm value (Badertscher, 2011).

The results of tests on audit quality indicate that audit quality is only able to moderate the real earnings management variable to firm value, but not to accrual earnings management. This finding proves that the practice of accrual earnings management by management is easily detected by auditors (Alhadab & Clacher, 2018; Graham et al., 2005), so that management prefers earnings management with real activities. This evidence shows that the market strongly believes in the credibility of auditors, so that when managers create earnings value through accrual earnings management, the market knows about these illusions and price errors in equity can be avoided. The existence of a qualified auditor is also able to minimize management's actions to carry out management with real activities.

Conclusion

This study examines the effect of earnings management, which is classified into accrual earnings management and earnings management with real activities on firm value which is moderated by audit quality. The populations in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2015-2017. Sampling was done by purposive sampling method and 114 observations were obtained. As hypothesized, the results of testing with moderated regression analysis show that real earnings management has a positive effect on firm value. Meanwhile, accrual earnings management has no effect on firm value. The audit quality variable serves to weaken the relationship between real earnings management and firm value, but does not moderate the effect of accrual earnings management on firm value.

This study has several limitations, among others, this research is only able to prove two hypotheses from the four hypotheses proposed. The number of observations that meet the sampling criteria with a purposive sampling method is also relatively small, namely 114. Based on these limitations, the next researcher should use a number of audit quality proxies including audit tenure, audit size, audit specialization, and audit fees (Alzoubi, 2017). Future studies also need to consider extending the observation period so that the number of observations that is more representative of the population is obtained.

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