COSTING:Journal of Economic, Business and Accounting
Volume 8 Nomor 3, Tahun 2025
e-ISSN : 2597-5234

THE INFLUENCE OF PRUDENCE AND INTELLECTUAL CAPITAL ON EARNINGS MANAGEMENT WITH THE AUDIT COMMITTEE AS A MODERATING VARIABLE

PENGARUH *PRUDENCE* DAN *INTELEKTUAL CAPITAL* TERHADAP MANAJEMEN LABA DENGAN VARIABEL KOMITE AUDIT SEBAGAI VARIABEL MODERASI

Halimahtussakdiah[1*], Sanusi Ariyanto[2], Alfi Nopriyanti[3]
Accounting Study Program, Faculty of Economics and Business, Universitas Islam Riau[1,2,3]
Email: halimah@eco.uir.ac.id

ABSTRACT
This study aims to analyze the influence of prudence and intellectual capital on earnings management, with the audit committee serving as a moderating variable. The research adopts a quantitative approach using regression analysis to examine data from companies listed on the Indonesia Stock Exchange. The results indicate that prudence has a positive and significant effect on earnings management practices, meaning that companies that are more cautious in managing profits tend to avoid earnings manipulation. On the other hand, intellectual capital does not have a significant impact on earnings management, suggesting that an increase in knowledge and innovation within the company does not necessarily reduce earnings management practices. Furthermore, the audit committee has been proven to strengthen the effect of prudence on earnings management but does not strengthen the effect of intellectual capital on earnings management. These findings highlight the important role of the audit committee in overseeing and enhancing the transparency of financial reporting while ensuring compliance with applicable accounting principles.
Keywords : *Earnings Management, Prudence, Intellectual Capital, Audit Committee*

INTRODUCTION

Earnings management has become an important issue in modern business as it affects the transparency and credibility of financial statements. The principle of prudence emphasizes the early recognition of expenses and liabilities, while the recognition of revenues and assets is deferred until there is certainty, in order to avoid overestimation of company performance. Intellectual capital includes intellectual resources such as employee competencies, internal structures, and external relationships, which can enhance company performance.

This research highlights the role of the audit committee as a moderating variable that aims to control or mitigate the influence of prudence and intellectual capital on earnings management practices. The audit committee is responsible for overseeing financial reporting and internal controls, which are essential to ensure the reliability of financial information.

The phenomenon in 2021 showed pressure on companies to maintain financial stability amid the

economic uncertainty caused by the COVID-19 pandemic. Additionally, awareness of the importance of intellectual capital in supporting the competitiveness and sustainability of companies increased in the digital era.

Previous research has produced diverse findings regarding the influence of prudence and intellectual capital on earnings management. Studies such as Li, Y., Abeysekera, I., & Ma, S. (2021), show the influence of prudence on earnings management, while Gholipour, H. F., Karimi, F., & Sharifi, M. (2020) state the opposite. Similarly, regarding intellectual capital, research by Chen, M. H., Cheng, S. J., & Hwang, Y. (2005) shows a significant effect, while Mavridis, D. G. (2012) did not find such a relationship.

Based on the phenomenon and differences in previous research results (research gap), this study adds a moderating variable, namely the audit committee, as well as control variables such as Return on Assets (ROA) and company size, to better understand the influence of prudence and intellectual capital on earnings management. This research is expected to contribute to the academic literature and business practices related to earnings management and internal oversight.

LITERATURE REVIEW

Agency Theory

Agency theory, as explained by Scott (2015), discusses contract design aimed at motivating agents to act in the best interests of principals, despite the presence of divergent interests. The relationship between principals (owners) and agents (managers) is often marked by information asymmetry, where agents possess more information about the management of the company than principals. Jensen and Meckling (1976) emphasized this contractual relationship, where principals entrust agents to manage the company with the expectation that they act in the principals' best interests. However, misunderstandings can arise due to conflicts of interest, leading to opportunistic behavior by the agent.

Signaling Theory

Signaling theory explains how parties in an interaction use signals to reduce information asymmetry. Akerlof (1970) in his study "The Market for Lemons" showed how product quality uncertainty can be addressed through signals such as warranties or reputations. In the financial context, Ross (1977) developed signaling theory to explain how a company's capital structure can be used as a signal of the company's prospects to investors. For example, companies with good prospects tend to use debt as a signal of confidence in their ability to meet obligations. In capital markets, dividend announcements are often seen as a positive signal about the company's financial stability and prospects.

Stakeholder Theory

Stakeholder theory emphasizes the importance of managing relationships with various groups that have an interest in the company. According to Post, Preston, and Sachs (2002), a company is a complex system involving key stakeholder groups. Evan and Freeman (1988) underline the importance of a normative approach in this theory, meaning that stakeholder interests should be prioritized for the sustainability and success of the company.

Earnings Management

Earnings management is a practice where management uses accounting policies or operational transaction manipulations to achieve certain objectives, such as increasing earnings or meeting targets. Healy and Wahlen (1999) define earnings management as the process of manipulating financial statements that can provide a misleading view of the

company's performance. Meanwhile, Dechow, Sloan, and Sweeney (1995) emphasize that earnings management is often performed in ways that do not fully reflect the actual economic conditions.

Prudence Principle

The prudence principle in accounting emphasizes that companies should not overstate revenue and assets, nor understate expenses and liabilities. Basu (1997) explains that this principle aims to provide a realistic view of the company's performance and financial position by recognizing revenue only when there is high certainty, while costs and losses are recognized as soon as there is a possibility of occurrence. This principle ensures conservative and reliable financial information.

Intellectual Capital

Intellectual capital is intangible assets that include the knowledge, skills, and innovations owned by a company. Stewart (1997) defines it as knowledge that can be converted into profit. Bontis (1998) divides intellectual capital into three main components: human capital, structural capital, and relational capital. Edvinsson and Malone (1997) added that intellectual capital includes a combination of human competencies, internal structures, and external relationships that support each other in creating value.

Audit Committee

The audit committee is part of corporate governance responsible for overseeing financial reporting processes, audits, and compliance with regulations. According to Rezaee (2009), the audit committee helps ensure the integrity of financial statements and the effectiveness of internal controls. The Blue Ribbon Committee (1999) stated that the audit committee is responsible for monitoring financial reporting processes and overseeing external auditors. Under the Sarbanes-Oxley Act (2002), the audit committee must consist of independent members, with at least one member having expertise in finance. The committee plays a vital role in enhancing transparency, accountability, and stakeholder confidence in the company.

RESEARCH METHODS

This study uses a quantitative approach with descriptive and statistical methods to analyze companies in the Consumer Non-Cyclic (CNC) and Consumer Cyclic (CC) sectors listed on the Indonesia Stock Exchange (IDX) during the period from 2021 to 2023. The research population consists of all companies in the CNC and CC sectors listed on the IDX. The sample was determined using a purposive sampling method, which is a technique for selecting samples based on specific criteria relevant to the research objectives.

The criteria for sample selection include companies that were actively listed on the IDX during the 2021-2023 period, have not experienced suspension, have complete annual reports for all three years, and were not delisted during the research period. From the total of 251 companies listed on the IDX, 7 companies were excluded due to suspension, 35 companies did not meet the criteria due to incomplete annual reports or were newly listed after 2021, and 1 company was excluded due to delisting. Therefore, the number of companies eligible as research samples is 208.

The data used in this study comes from the financial statements and annual reports of the companies during the 2021-2023 period. Data analysis is conducted to identify patterns, relationships, and trends relevant to the research objectives. The statistical methods used in this study are tailored to the variables and hypotheses being

tested, so that the research results can provide in-depth insights into the performance of CNC and CC sector companies on the IDX.

RESULTS AND DISCUSSIONS

1. **Prudence Affects Earnings Management.**
   Based on the regression test results, which show that the prudence variable has a positive and significant effect on earnings management practices (H1), analysis can be conducted by relating it to several relevant theories. The agency theory explains that prudence can be used by managers as a strategy to reduce the monitoring risks from shareholders or principals. In the context of signaling theory, prudence acts as a signal to investors and creditors that the company has conservative and trustworthy financial management. This reflects the company's commitment to maintaining its credibility in the market. Meanwhile, stakeholder theory highlights that prudence can be seen as the company’s effort to maintain good relationships with various stakeholders, such as employees and suppliers, by demonstrating transparency and consistency in financial reporting. Previous research has provided diverse views on the relationship between prudence and earnings management. For example, Dechow and Skinner (2000) in their study highlighted that earnings management practices could be influenced by the tendency to use prudence in earnings management. On the other hand, research by Roychowdhury (2006) suggested that prudence can realistically be used to manage company activities for long-term goals. Analysis by Healy and Wahlen (1999) shows that there are significant implications of earnings management practices on accounting standards setting. In contrast, Schipper (1989) criticized earnings management practices that exploit prudence unethically. Burgstahler and Dichev (1997) also added a perspective by exploring how prudence is used to avoid earnings declines or losses. Therefore, this research provides a foundation for understanding the theoretical context and practical implications of using prudence in earnings management.
2. **Intellectual Capital Affects Earnings Management.**
   Based on the regression test results, the research findings show that the Intellectual Capital variable does not affect earnings management, thus H2 is rejected. If intellectual capital does not influence earnings management, it means that increasing knowledge, skills, and innovation within the company does not significantly reduce or increase earnings manipulation practices. In agency theory, this suggests that even with high intellectual capital, managers still have incentives to manipulate earnings for personal gain. Research by Salehi, Farhangdoust, and Omri (2022) supports this by finding that intellectual capital does not always reduce earnings management due to the incentives and pressures faced by managers. According to signaling theory, if

intellectual capital does not affect earnings management, the signals sent to the market regarding the quality of the company's financial reports are weak. Research by Janošević, Vukšić, and Peršić (2022) shows that although companies with high intellectual capital are considered more innovative, this does not always mean they have better accounting practices. In stakeholder theory, if intellectual capital does not influence earnings management, it indicates that the interests of various stakeholders are not always protected through ethical financial reporting. Research by Al-Sartawi, Al-Ghuwairi, and Samara (2022) supports this view by showing that high intellectual capital does not always lead to improved corporate social responsibility or more ethical reporting. This research is in line with previous studies by Bontis, N., Chua Chong Keow, W., & Richardson, S. (2000), Mavridis, D. G. (2011), Youndt, M. A., Subramaniam, M., & Snell, S. A. (2004), Chen, M. C., Cheng, S. J., & Hwang, Y. (2005), Wang, W. Y. (2008).

3. **Audit Committee Strengthens the Influence of Prudence on Earnings Management.** Based on the regression test results, which indicate that the audit committee can strengthen the influence of prudence on earnings management (H3 accepted), we can link this to several relevant theories. According to agency theory, an effective audit committee acts as a supervisor that reduces earnings management practices by enhancing financial reporting transparency. In the context of signaling theory, a strong audit committee sends a positive signal to investors that the company has good internal controls and is trustworthy. Stakeholder theory asserts that an effective audit committee considers the interests of various parties, ensuring fair and reliable financial information. Previous research supports these findings. Li and Wang (2020) found that the independence and expertise of the audit committee are negatively related to earnings management. Xie, Davidson, and DaDalt (2003) showed that an effective audit committee reduces earnings management practices. Alves (2014) demonstrated that the independence of the audit committee improves earnings quality. Klein (2002) and Bedard, Chtourou, and Courteau (2004) also support that the expertise and independence of the audit committee reduce earnings management practices.

4. **Audit Committee Strengthens the Influence of Intellectual Capital on Earnings Management.**

   Based on the regression test results, the research findings show that the audit committee does not strengthen the influence of intellectual capital on earnings management, thus H4 is rejected. If the audit committee cannot strengthen the influence of intellectual capital on earnings management, it indicates that the role of the audit committee in managing the company's intellectual capital is ineffective in reducing earnings manipulation practices.

In agency theory, the failure of the audit committee to properly supervise may leave room for managers to continue manipulating earnings for personal gain, regardless of the level of the company's intellectual capital. Research suggests that a weak audit committee may reduce the impact of managing intellectual capital on conservative accounting practices (Salehi, Farhangdoust, & Omri, 2022).
From the perspective of signaling theory, if the audit committee does not strengthen the influence of intellectual capital on earnings management, the signals sent to the market regarding the quality of the financial reports and the management of the company's intellectual capital may be weak. This could increase investor uncertainty regarding the company's value and their investment decisions (Janošević, Vukšić, & Peršić, 2022).
In stakeholder theory, the failure of the audit committee to strengthen the influence of intellectual capital on earnings management could also harm various stakeholders of the company, such as employees, creditors, and the general public, due to the lack of transparency and accountability in the use of intellectual capital (Al-Sartawi, Al-Ghuwairi, & Samara, 2022). This research is in line with the studies of Gul, F. A., & Leung, S. (2004), Zaman, M., Hossain, M., & Rahman, M. M. (2011), Bedard, J. C., & Gendron, Y. (2010), Chtourou, S. M., & Al-Najjar, B. (2012), Hossain, M., & Reaz, M. (2007).

CONCLUSION

Based on the research findings, it can be concluded that there are several key findings related to the influence of prudence, intellectual capital, and the role of the audit committee on earnings management practices. First, this study found that prudence has a positive and significant effect on earnings management. This is consistent with agency theory, which explains that prudence can be used by managers to reduce the risk of tight monitoring from shareholders. Additionally, in the context of signaling theory, prudence serves as a positive signal to investors and creditors regarding the company's credibility, and in stakeholder theory, prudence is considered a way for companies to maintain good relationships with stakeholders through transparency in financial reporting.

Second, the study also found that intellectual capital does not significantly affect earnings management, meaning that even though a company has high intellectual capital, it does not guarantee that earnings manipulation practices can be minimized. In agency theory, this finding suggests that managers still have incentives to manipulate earnings for personal gain despite the presence of substantial intellectual capital.

Third, the research findings show that the audit committee plays an important role in strengthening the influence of prudence on earnings management. An effective audit committee can improve transparency and reduce earnings management practices by ensuring better financial reporting. Agency theory supports this finding by stating that an independent and skilled audit committee can mitigate the negative impact of earnings management practices.

Finally, this study found that the audit committee does not strengthen the influence of intellectual capital on earnings management. This indicates that the audit committee's role in managing the company's intellectual capital is not sufficiently effective in reducing earnings manipulation practices. In agency theory, this finding suggests that a weak audit committee provides opportunities for managers to continue manipulating earnings. Overall, this research provides new insights into how elements such as prudence, intellectual capital, and the role of the audit committee interact in the context of earnings management, and emphasizes the importance of effective oversight, the use of ethical strategies, and transparency in corporate accounting practices to ensure sustainability and good accountability.

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