



**RELATIONSHIP BETWEEN AUDIT COMMITTEE
AND EARNINGS MANAGEMENT**

THESIS

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ABSTRACT

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This study investigates the relationship between audit committee and earnings management among the banking firm listed in Indonesia. To analyze the relationship of audit committee and earnings management among banking firms, secondary data is used, which are gathered from the analysis of companies' financial statement and annual report taken from a sample of 28 banks listed on the Indonesia Stock Exchange (ISX) in each year, for two consecutive years, 2007-2008 were randomly selected.

The results found that there is no association between audit committee and earnings management. The findings of this study suggest that the audit committee's number of meetings could not enhance the audit committee effectiveness in decreasing the opportunity of management in doing earnings management.

Keywords: Audit committee effectiveness, audit committee's number of meetings, earnings management.

CHAPTER I

INTRODUCTION

1.1 Problem Background

As the increasing of needs for trust and worthiness, competition in business field cannot be seen as just the business itself as the entity. In order to stand with this tough condition, the performance of a business must be stable all the time in all the ways. The stability for the performance can be achieved through many ways. One of them is by including the third parties for monitoring the performance itself, related with trust and worthiness mentioned above. Because of the performance will be valued by outsiders as the main target, the monitoring function of the third parties will strengthen.

One of the main tool for seeing the performance of a company is through their financial statements. These financial statements are usually crosschecked by the public accountant before it is published to the outsiders. The financial statements are used for knowing the result of the business running and the condition of the financial itself besides as the means of responsibility of the management of that company.

Public accountant as the third parties checked the financial statements which is authorized by management is still monitored by the commissioners as the supervisory board. Even this function is clearly stated, it ever been questioned followed by the scandals of several big companies such as Enron and Worldcom in USA. That is why, the issuance of Sarbanes-Oxley act of 2002 has significant influence related with these all issues. The 2002 Sarbanes-Oxley act requires the

establishment of independent body that is called audit committee which the members are independent, financially literate, and at least one of the members has accounting or financial management expertise. Following the passage of this act, the NYSE and NASDAQ adopted listing requirements with respect to the independence, required that the audit committee has at least three independent directors and set the criteria that a director must meet to be regarded as an independent director.

As the position of audit committee is one of key factor for trust and worthies, in Indonesia, the existence has been regulated of BAPEPAM in SE BAPEPAM No. 03 *Tahun* 2000 about the arrangement of audit committee and also the *Kep. Direksi* BEJ No. 339 *Tahun* 2001 about the rule of reporting exchange in BEJ which is included independent commissioners, audit committee, the secretary of company; transparency; and financial reporting standard per sector (Sari, 2008).

The urgency of this audit committee is also related with the monitoring function of board of commissioners which is not optimal yet in many countries as the victims of last financial crisis (KNGCG 2002). Especially for Indonesia, this condition cause multiple effects because of the main character of our business entity is centralization with controlling of ownership are handled by some limited parties (Lukviarman 2004). Therefore, the existence of audit committee is expected to increase the quality of internal control of company, and optimize mechanism of check and balances, and the final purpose is giving the optimum guarantee for shareholders and other stakeholders.

CHAPTER V

CONCLUSION AND LIMITATIONS

The previous chapter has described the empirical results and this chapter presents conclusions drawn from the findings and discussions presented in the previous chapter, followed by an assessment of the potential limitations present in this study and possible future direction for research.

5.1 Conclusion

This research is purposed to investigate the effectiveness of audit committee in performing its function in decreasing the opportunity of management in doing earnings management. This research is examining the association between Audit Committee effectiveness which proxy by the audit committee's number of meeting (within the year) with earning management which proxy by DTAC (Discretionary Total Accrual).

The result of this study suggest that there is no association between the Audit Committee's number of meeting for all samples. The findings of this study thus suggest that the Audit Committee's number of meeting during the year could not enhance the Audit Committee's effectiveness in decreasing the opportunity of management in doing earnings management. The result of this study match with the result of research of Klein (2002), Bedard (2004), Yang and Krishnan (2005), Kelin (2006), and Sari (2008). While the contradictory result is found in the finding of Hsieh and Tsai (2004), Carcello (2006), and Smith (2006).

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