# CHAPTER II
# LITERATURE REVIEW

## 2.1. Theoretical Review

### 2.1.1. Agency Theory

In this study, the relationship between audit committee expertise and the number of audit committee meetings with real earnings management and human capital as a mediating variable is based on agency theory (Jensen & Meckling, 1976). Agency theory discusses management as an agent and owners of capital as principals, and this research uses agency theory as a basis for understanding corporate governance. Jensen & Meckling (1976) was the first to put forward this theory stating that agent relationships, namely managers, are contracts between one or more principals, namely investors, who require agents to do some work related to their interests, including delegating some information or giving authority to an agent. In this case, the management as supervisor of the company must be responsible to the owner because the owner has given management authority to make the best decisions for the progress of the company they manage. However, the contractual relationship between investors and managers can result in managers carrying out activities that investors do not want, allowing agency costs to arise (Agustia, 2013; Kalbuana *et al*., 2020).

The existence of prominent differences in interests results in the emergence of information asymmetry. Agency conflicts occur between management obliged to fulfill shareholder welfare and personal welfare interests. Agency theory states that agents are usually opportunistic and do not like risk. This aligns with the debt-covenant hypothesis that companies that violate debt contract agreements tend to choose accounting methods that can transfer reported profits, namely earnings management. This is done because an increase in net profit can reduce the possibility of a company's technical failure (Scott, 2015; Sari & Astika, 2021). The existence of differences in interests between agents and principals, which is the focus of agency theory, ignores other resources that are important to companies, such as human capital (Istanti *et al*., 2021).

DeFond (1992) in Edyna (2014) argues that companies demand audit services because agency problems create potential conflicts of interest between owners and management. Auditors who provide audit services as a monitoring tool help companies reduce agency costs. The level of demand for audit quality has a positive relationship with the level of agency fees. A company's higher agency costs require higher audit quality (Francis & Wilson, 1988; Johnson & Lys, 1990; Edyna, 2015). Therefore, good corporate governance practices have been proposed as an essential strategy to control and minimize conflicts and prevent organizational resource misuse (Platt & Platt, 2012; Abusamak & Shahwan, 2018; Shahwan & Fathalla, 2020).

### 2.1.2. Stakeholder Theory

Stakeholders are individuals or groups with specific claims, interests, or interests in the company's business activities and operations, so they also monitor their performance (Bello & Abu, 2021). Donaldson & Preston (1995) define stakeholder theory as governance that recommends attitudes, structures, and practices, which can form a stakeholder management philosophy when applied together. Stakeholder theory states that a company is not an entity that only operates for its interests but must benefit its stakeholders, such as shareholders, creditors, and so on (Augustine & Dwianika, 2019). Therefore, according to Cordeiro & Tewari (2015) in Bello & Abu (2021), this theory explains that company managers have a broader scope to cover all groups, so business actions or activities can influence, hence not only shareholders. Castrillón's study (2021) shows that in the shareholder approach, it is considered that shareholders are the only ones who have the right to participate in the income created by the company. Therefore, in this case, the value created is measured by what they receive. This approach implies that corporate governance is oriented towards the relationship between shareholders and managers who control and manage value creation, and only the interests of shareholders are taken into account. Management's goal is to maximize shareholder value.

### 2.1.3. Resources Dependence Theory

To explain corporate governance, resource dependence theory is also used in several academic papers (Pfeffer & Salancik, 1978; Castrillón, 2021). This theory interprets organizations as interdependent with the context in which they operate. Organizations will depend, to ensure their survival, on the resources and information provided by companies and other institutions in the contexts in which they are involved. Under these circumstances, organizations compete with other entities that use the same scarce resources (Castrillón, 2021). Shahwan & Fathalla (2020) argue that resource dependency theory implies that good practice in corporate governance, i.e. a large and well-diversified board of directors, and a higher proportion of outside directors will maintain a firm's ability to attract more resources available, namely, physical, human, structural and relational capital resources. According to Saeed *et al*. (2015), the existence of this kind of IC will further support the creation of value and profitability of the company in the long term. Sari & Astika (2021) also stated that strategic resources are the root of obtaining a sustainable company competitive advantage, one of which is an intangible asset in the form of intellectual capital.

Nonetheless, Castrillón (2021) reveals that these theories are limited to the analysis of the relationship between partners, professional managers, regulatory boards, and the environment, establishing the most important aspects of corporate governance, but do not take into account other interest groups such as customers, workers, associations businesses, and/or suppliers, among others. Because of this, the stakeholder theory by Freeman (1984) emerged, which assumes that organizations should be accountable to a set of interest groups within the company and not only be selfish with shareholders because all these groups can affect the achievement of goals (organizational goals in achieving business success). However, the resource-based view emphasizes that human resources greatly influence competitive advantage (Lim, Chan, & Dallimore, 2010; Istanti *et al*., 2021). In this study, the human capital variable refers more to the Resource Based Value (RBV) theory

### 2.1.4. Human Capital Theory

Hendry & Situmeang (2017) explain the theory of human capital which was first developed by Becker (1964) states that it is very important to invest in training and improving human resources because it can increase workforce productivity which also improves company performance, Lubis (2013) increases company performance and also affect the main competence of the company. Increased human capital will enable companies to produce output in the form of services or goods according to what customers need with better quality than those offered by competitors. In other words, the company is very competitive (Hendry & Situmeang, 2017).

### 2.1.5. Intellectual Capital

One of the company's efforts to achieve its goals is through increasing intellectual capital. The company's focus on value creation has shifted from using physical assets to intangible assets. Rahmadani & Panggabean (2021) argue that intellectual capital is believed to be able to predict and adjust to all forms of uncertain situations that can threaten the existence of a company. So that these conditions can increase the value of the company through profit creation, technological innovation, and increased productivity.

Dumay (2016) in Astuti *et al*. (2020) argue that companies report their intellectual capital to provide adequate and appropriate information about intellectual assets to the market to improve decision-making by investors and assist management and disciplinary boards with positive economic consequences. Supported by Jaya (2021) says that the efficient use of intellectual capital resources can increase a country's economic growth. Intellectual capital resources also enable modern organizations to sustain their strategies in highly competitive markets. The concept of fixed intellectual capital covers a variety of complex issues related to conceptualization, determination, measurement, and modeling of its impact on company performance (Stahle, & Aho, 2011; Jaya, 2021). Mortensen (1999) in Astuti *et al*. (2020) define intellectual capital as the economic value of two categories of intangible assets from a company, namely organizational or structural capital and human capital. According to Statement of Financial Accounting Standards No. 19 issued by the Indonesian Association of Accountants (IAI), intangible assets are non-monetary assets that can be identified, do not have a physical form, and are used for use in producing or delivering goods or services, rented out to other parties, or for administrative purposes (IAI, 2002; Astuti *et al*., 2020).

According to Ghazzawi *et al*. (2020), intellectual capital emerges through synergistic action, which is conquered by human capital, structural capital, relational capital, and their mutual interactions. Likewise, Abdelrahman *et al*. (2014) stated that intellectual capital can be defined as a group of intangible resources, including human resources, organizations, and relationships that are not related to a certain level of administration but if managed effectively, several benefits can be achieved by companies, including strengthening competitive capabilities in the market. , wealth generation and development, and value-added creation. Related to that, Guthrie and Petty (2000) in Astuti *et al*. (2020) also divides intellectual capital into three components, namely internal structure (structural capital), external structure (customer capital), and employee competence (human capital). The three types of capital complement each other and work actively. This is the only possible way to talk about intellectual capital. As written in research by Ghazzawi *et al*. (2020), the three sections described by Petty and Guthrie in detail are as follows:

a. Internal Structure: It consists of items such as patents, concepts, research and development models, and computer systems and administration. These are usually made by employees or brought in. Decisions can be made to invest in or replace these intangible assets. Organizational culture and spirit are also considered part of the internal structure, such as organizational structure and legal parameters.
b. External Structure: It consists of relationships with customers and suppliers, brand names, trademarks, and reputations. Some of this can be considered proprietary, but only in a provisional sense, and even then, not with any

degree of credence. For example, a company has influence over the value of its customer relationships; however, reputations and relationships may change from time to time and the company may not be able to control the behavior of its customers or suppliers if they do not comply. The tenuous nature of the supplier-firm-customer relationship complicates the measurement process. Therefore, the economic value of this relationship is not currently defined by generally accepted definitions or measurement systems.

c. Employee competence: This refers to the education, skills, training, values, experience, and so on of an individual. Non-revenue generators are called support staff. Like customers and suppliers, these cannot be owned by organizations. However, seen from a values-based perspective, they must be measured and placed on a balance sheet, because an organization without employees is unthinkable. Employee competency requires the ability to create tangible and intangible assets in a variety of situations. In a knowledge organization, there are very few "engines" other than employees.

Ghazzawi *et al.* (2020) also explained the three components of intellectual capital namely:

a. human capital (employee competence, know-how, work-related knowledge, innovativeness, education)
b. structural capital (cultural, team spirit, copyrights, trademarks, patents, internal databases, management processes)
c. Relational capital (brand, reputation, strategic alliances, customers, licensing, agreements, distributions channels)

The framework of the components of intellectual capital explained by Guthrie *et al.* (2004) in Ghazzawi *et al.* (2020) is shown in the table below.

**Table 2.1**
**Framework IC Guthrie *et al.* (2004)**

| Internal Capital | External Capital | Human Capital |
|---|---|---|
| Intellectual property<br>Management Philosophy<br>Corporate culture<br>Management processes<br>Information/networking systems<br>Financial relations | Brands<br>Customers<br>Customers satisfaction<br>Company names<br>Distribution channels<br>Business collaborations<br>Licensing agreements | Employee<br>Education<br>Training<br>Work-related knowledge<br>Entrepreneur spirit |

Source: Guthrie *et al.*, 2004

Furthermore, based on the International Federation of Accountants or IFAC (1998) in (Ulum, 2009) defined intellectual components in three components figure out in the table below.

**Table 2.2**
**Framework IC IFAC (1998)**

| Structural Capital | Relational Capital | Human Capital |
|---|---|---|
| Intellectual property:<br>- Paten<br>- Copyrights<br>- Design rights<br>- Trade secrets<br>- Trademarks<br>- Service marks<br><br>Infrastructure assets:<br>- Management<br>- Philosophy<br>- Corporate culture<br>- Information system<br>- Networking system<br>- Financial relation | - Brand<br>- Costumers' loyalty<br>- Backlog orders<br>- Company names<br>- Distribution channel business collaborations<br>- Licensing agreements<br>- Favorable contracts<br>- Franchising agreements | - Know-how<br>- Education<br>- Vocational qualification<br>- Work-related competencies<br>- Entrepreneurial spirit, innovativeness, proactive and reactive abilities changeability<br>- Psychometric valuation |

Source: International Federation of Accountant or IFAC (1998) in (Ulum, 2009)

Intellectual capital consists of several components that can be used as a basis for a company in implementing its strategy (Dewi *et al*., 2014). Although there are no unanimous components, this study adopts the IC measurement framework from Sveiby (1997) which is categorized into three components, namely human capital, structural capital, and relational capital/customer capital. But in this study, the authors will examine the role of human capital. The authors of this study believe that the power of good human capital can minimize earnings management practices.

**1. Definition of Human Capital**

Hameed & Anwar (2018) who states that human capital is a combination of hereditary heritage, mindset, training, and individual involvement in life and business. Bontis *et al* (2000) in Dali *et al*. (2019) stated that human capital is a combination of knowledge, skills, the ability to innovate, and the ability to complete tasks, including corporate values, culture, and philosophy, which influence corporate creativity and acceptance of new ideas (Hayton, 2005; Ginesti *et al*., 2018). However, Ghazzawi *et al*. (2020) stated that human capital is the most difficult part of intellectual capital both in terms of definition and recognition. This is because human capital includes human resources in business, external and internal resources as well as customers and suppliers. Istanti (2009) defines human capital as a life source of intellectual capital. Resource of innovation and improvement, however, the components are difficult to measure. Manzari *et al*., (2012) defined a specified category for measuring human capital:

a. Attitude & Motivation;
b. Competence, skill, capabilities;
c. Creativity & Innovativeness;
d. Experience & expertise;
e. Individual personal characteristics;
f. Knowledge;
g. Efficiency.

Human resources refer to a specialist or representative talent, learning, and experience given to their association with a specific end goal to increase appreciation (Andreeva, 2016; Hameed & Anwar, 2018), and also Nazari & Herremans (2007) in Ginesti *et al*. (2018) claim that it is the main driver for developing structural capital. The existence of human capital resources will provide support for the creation of structural capital and relational capital which are the essence of intellectual capital (Widyaningrum, 2004), meaning that without good human capital, the company will not run successfully. Companies tend to have more human capital because it can lead to achieving company goals with effectiveness and efficiency. Apparently, Sarea & Alansari (2016) in Istanti *et al*. (2021) concluded that human capital is currently an important investment for companies, which includes developing employee skills in the form of experience or educational background. Human resources include salaries, compensation, bonuses, training costs, and employee skills and competencies. It also includes the company's values, culture, and philosophy. However, human capital cannot be owned by companies.

**2. Human Capital Measurement**

The first step is to calculate Value Added (VA). VA is the difference between output and input (Pulic, 1998). Here, the output is “the total revenue from all products and services sold in the market” (Pulic, 2000) and the input is “all the costs of everything that goes into the company” (Pulic, 1998) except labor costs. In this formula, because of the employee's active role in creating the VA, employees are treated as a resource, not an expense, which is the opposite of traditional accounting systems where employees are considered an expense of the company. Pulic (1998) defines this situation as a key point of his methodology. VA is defined as follows (Chang, 2007; Bayraktaroglu *et al*., 2019):

$$VA = OUT - IN$$

Explanation:
OUT : Gross Margin – Sales + General & Administrative Expenses
IN : Labor Expenses

The second step is to calculate the HCE. HCE is used to see how much value added (value added) the company generates for every rupiah invested in labor.

$$HCE = VA/HC$$

HCE : human capital efficiency coefficient of company
HC : total burden of salaries and allowances
VA : value added

### 2.1.6. Good Corporate Governance

Good Corporate Governance (GCG) is a set of regulations governing the relationship between management, creditors, government, employees, and other internal and external stakeholders with respect to their rights and obligations, or in other words the system that directs and controls the company (Forum Corporate Governance in Indonesia, 2001). The GCG concept became known in Indonesia after the 1997 economic crisis which occurred due to bad corporate governance in Indonesia, such as irresponsible managers, neglected regulations, and the existence of KKN (corruption, collusion, nepotism) (Haryani *et al*., 2020). Therefore, in 1998 the government introduced the concept of GCG to companies and formed a National Governance Policy (KNKG), then the government issued a policy of economic reform in Indonesia through the Decree of the Coordinating Minister of the Republic of Indonesia No.KEP49/M.EKON/11/2004 with the enactment of KNKG policy with the mission of encouraging and increasing the effectiveness of the implementation of good governance in Indonesia in order to build a culture that has good governance, both in the public and corporate sectors (Haryani *et al*., 2020). This strategy is also used to maintain consistency and public trust in a company. The presence of GCG for companies is absolutely necessary because GCG requires good management for a company (Herdyanto, 2019). According to The Indonesian Institute for Corporate Governance (IICG), Corporate Governance is a series of mechanisms that direct and control a company so that the company's operations run according to the expectations of stakeholders. GCG is a company mechanism in ensuring that the manager's decision is the best decision for the owner (Singh & Delios, 2017). In addition, the corporate governance structure defines the distribution of rights and responsibilities among the different participants in the corporation, such as the board, managers, shareholders, and other interested parties, and details the rules and procedures for making decisions on corporate matters (Hebble and Ramaswamy, 2005; Garzón Castrillón, 2021). Furthermore, other definitions of GC can be found in the existing literature. For example, GC is a system whose purpose is to provide control and direction to the organization as described by Cadbury (1992); They provide another definition: GC is the process by which an organization's financiers expect to get a return on their investment.

Shleifer and Vishny (1997) in Hendra Titisari (2018) define corporate governance regarding how the supplier of funds and the company itself ensure returns on investment. Therefore, the essence of Corporate governance is to improve company performance through managing oversight and accountability to other stakeholders based on the regulatory and statutory framework. Millstein's (1998) report in Mohamad & Muhamad Sori (2012) shows that government support in corporate governance is very important in the following areas to instill investor confidence and attract foreign investment: ensuring the protection of shareholder rights, including the rights of minority and foreign shareholders, and ensuring the enforceability of contracts with resource providers (fairness);

a. requiring timely disclosure of adequate, clear, and comparable information concerning corporate financial performance, corporate governance, and corporate ownership (transparency);
b. clarifying governance roles and responsibilities, and supporting voluntary efforts to ensure the alignment of managerial and shareholder interests, as monitored by boards of directors (accountability); and
c. ensuring corporate compliance with the other laws and regulations that reflect the respective society's values (responsibility).

According to the National Committee on Governance Policy (2006), there are five principles of good corporate governance, namely as follows:

a. Transparency

   Transparency is openness in presenting material and relevant information and openness in carrying out the decision-making process. The company is required to provide sufficient, accurate, and timely information to all of its stakeholders. The information disclosed includes, among other things, the financial condition, financial performance, ownership, and management of the company. Disclosure is done so that shareholders and other people know the condition of the company so that shareholder value can increase.

b. Independence

Independence is a condition where the company is managed professionally without conflict of interest and influence/pressure from any party that is not in accordance with applicable laws and regulations and sound corporate principles. The company is managed professionally without conflict of interest and influence/pressure from parties or that is not in accordance with applicable laws and regulations and sound corporate principles.

c. Accountability

Accountability is the clarity of functions and the implementation of the responsibilities of the company's organs so that their management runs effectively. If the principle of accountability is applied effectively, the company will avoid agency problems (role conflicts of interest). Companies must be able to account for their performance in a transparent and fair manner, for that the company must be managed properly, measurably, and in accordance with the interests of the company while taking into account the interests of shareholders and other stakeholders.

d. Responsibility

Responsibility is conformity or compliance in the management of the company with the principles of a healthy company and the applicable laws and regulations. Applicable regulations include those relating to taxation, industrial relations, environmental protection, occupational health/safety, salary standards, and fair competition. Managers are required to provide accountability for all actions in managing the company to stakeholders as a form of trust given to them.

e. Fairness

Fairness is justice and equality in fulfilling the rights of stakeholders that arise based on agreements and applicable laws and regulations. Fairness is expected that all of the company's assets are managed properly and carefully so that there is fair (honest and fair) protection of the interests of shareholders. Companies must always pay attention to the interests of shareholders, other stakeholders, and everyone involved in them based on the principles of stakeholder equity and fairness.

The principles are developed with an understanding that corporate governance policies have an important role to play in achieving broader economic objectives with respect to investor confidence, capital formation, and allocation (OECD, 2015). If GCG principles are implemented properly, it will improve company performance, especially transparency, enabling the company to outperform competitors (Augustine, 2012; Napitupulu *et al*., 2020).

The function of implementing GCG Daniri (2005) is to reduce agency costs, reduce the cost of capital, increase the value of company shares while enhancing the company's image in the public eye for the long term, and support stakeholders within the company. The significant goals of corporate GCG are to uphold ethical activities, build stakeholder trust by ensuring transparency and create accountability policies regarding organizational managers to avoid major agent problems (Ashfaq & Saeed, 2017; Rahmadani & Panggabean, 2021). In line with the argument above, Sari & Astika (2021) argued in their research that GCG provides opportunities for principals to supervise and influence agencies in opportunistic actions in company management. GCG can be used as the key to developing a good corporate control and control system so as to reduce earnings management practices that can harm principals so that the higher the level of implementation of good corporate governance in a company, the lower the chance for management to practice earnings management.

According to Garzón Castrillón (2021), the corporate governance structure determines the distribution of rights and responsibilities among the various participants in the corporation, such as the board, managers, shareholders, and other interested parties, and details the rules and procedures for making decisions about the company. important (Hebble and Ramaswamy, 2005). This is supported by Manik's (2011) argument in Napitupulu *et al*. (2020) managers within the company consist of internal parties and external parties. Internal parties include the board of commissioners, directors, and employees, while external parties include investors, government, the community, and other interested parties or stakeholders. Putri and

Ulupui (2017) in Sari & Astika (2021) explain that good corporate governance is a mechanism for good company management based on regulations, laws, and ethics in order to increase accountability to stakeholders and provide added value to the company in the long term. running timeframe. The mechanism for implementing good corporate governance has four structures, namely institutional ownership, managerial ownership, independent commissioners, and audit committees. The mechanism of corporate governance is a clear procedure and relationship between the party making decisions and the party overseeing the decisions. Therefore, different internal and external mechanisms have been considered through corporate governance to prevent agency conflicts and avoid neglecting the interests of other parties in the company management (Napitupulu *et al*., 2020).

**1. Institutional Ownership**

Institutional ownership is sharing ownership by the government, financial institutions, legal entities, foreign institutions, trust funds, and other institutions at the end of the year (Winanda, 2009). Kusumawati & Setiawan (2019) argue that institutions also understand how efforts must be made so that company value increases because they are more experienced than non-institutional in predicting the future by looking at instruments that can increase and decrease company value. So that the institution can make decisions by providing input to company managers in order to increase company value. Understandably, Jensen & Meckling (1976) argue that institutional ownership has an important role in minimizing agency conflicts that occur between managers and shareholders.

Institutional investors have a role in managerial decisions. As institutional ownership increases, institutional investors become more actively involved in the company (Jiang & Anandarajan, 2009; Khafid & Arief, 2017). Institutional ownership generally acts as a supervisory party to the company, Kusumawati & Setiawan (2019) supervision carried out by institutional investors can reduce fraudulent acts committed internally by the company so as to increase the value of the company. The effectiveness and credibility of the entire framework of corporate governance and corporate oversight depend to a large extent on the willingness and ability of institutional investors to exercise their shareholder rights in an informed manner and effectively exercise their own functions in the companies in which they invest (OECD, 2015). Therefore, the existence of the role of institutional ownership is expected to encourage increased monitoring of management performance in a more optimal manner, because share ownership is a source of strength that can be used to support or reverse management performance. The measurement of institutional ownership uses the ratio of the number of shares owned by institutional parties to the company's total share capital as stated by Guna & Herawaty (2010).

$$INST = \frac{Number\ of\ shares\ owned\ by\ institutional\ parties}{Total\ capital\ stock\ of\ the\ company\ in\ circulation}$$

**2. Managerial Ownership**

Another element of governance that affects the monitoring activities of the board of managers is the board or managerial ownership. Khafid & Arief (2017) in their study explain that there are two different views in the literature on managerial ownership and earnings quality. Generally, large holdings create moral hazards and information asymmetry between internal and external investors. According to the managerial entrenchment hypothesis, managers may receive more incentives to manipulate financial statements and monitoring will be more difficult if there is managerial ownership in the firm (Niu, 2006). On the other hand, agency theory predicts that managers with lower shareholdings have greater incentives to manipulate accounting numbers to remove the barriers imposed on accounting-based compensation contracts (Jensen & Meckling, 1976). But there are other hypotheses such as interest alignment which believe that board ownership and management can effectively motivate managers' performance and create incentives for independent boards to monitor management.

Company managers in managing company operations must be in accordance with what has been determined and planned in achieving company goals (Kusumawati & Setiawan, 2019). Mahariana & Ramantha (2014) in Kalbuana *et al*. (2020) stated that managerial ownership is thought to minimize earnings management practices because shareholders who are also company managers will be measured by other parties in the contract so that management is expected to be motivated to prepare quality financial reports. In line with that, Niu (2006) and Nitkin (2007) in Khafid & Arief (2017) found that managerial ownership can improve earnings quality the same as Alzoubi (2016) in Khafid & Arief (2017) managerial ownership is negatively related to earnings management and thereby providing a higher quality of financial reporting and a higher quality of earnings as well. Managerial ownership can limit the excessive actions of managers in the company. In addition, the amount of share ownership can also influence the actions of managers who are more active in managing the company so that the value of the company increases from time to time (Kusumawati & Setiawan, 2019). This is because, with the ownership of shares by management, there is a tendency to be careful in using it so that share ownership by management will reduce the amount of debt (Arilyn, 2016). As in the measurement by Guna & Herawaty (2010), This variable is measured using the ratio between the number of shares owned by management with the total capital of the company's share in circulation.

$$\boxed{MNGR = \frac{Number\ of\ shares\ owned\ by\ managerial\ parties}{Total\ capital\ stock\ of\ the\ company\ in\ circultion}}$$

**3. Audit Committee**

An audit is the evaluation and calculation of all physical and digital data to accounts and financial reports kept by the company. This is done by an accredited auditor who will examine the company's earnings and finances. The auditor then provides a report indicating whether the account is an accurate and fair record of the company's financial statements. Indonesia's audit landscape is unique in that global audit firms need to affiliate with local audit firms to conduct business. The audit was conducted in accordance with Indonesian Accounting Standards and Regulations (Financial Accounting Standards Board or DSAK). DSAK is regulated by the Financial Services Authority (OJK). The OJK, in turn, is advised by the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia or IAI). The

Indonesian Institute of Certified Public Accountants (Association of Indonesian Public Accountants or IAPI) is responsible for adopting the auditing standards set by the IAOI Auditing Standards Committee. All audit work by IAPI members is regulated by the Supreme Audit Agency (BPK) (3E Accounting, 2022).

The audit committee is a sub-group of a company's board of directors that is responsible for overseeing the financial reporting and disclosure process. To be successful, the audit committee must know the processes and internal controls in the organization (CFI, 2021). In line with that, Klein (2002) in Kusumaningtyas & Noor Farida (2016) also states that the Audit Committee is often referred to as one of the successes of corporate governance. The audit committee is part of the board of commissioners and is responsible for overseeing the company's financial reporting process. Also, Arens, *et al.* (2003) in Sirait *et al.* (2014) stated that the audit committee members were selected from members of the board of commissioners to help the company's auditors remain independent from management. Registration of Securities Number I-A: regarding the general provisions for listing equity securities on the stock exchange, it is stated that:

> An audit committee is a committee formed by the board of commissioners of a listed company whose members are appointed and dismissed by the board of commissioners of a listed company to assist the board of commissioners of a listed company in conducting audits or research that is deemed necessary for the implementation of the functions of the board of directors in the management of a listed company.

From the definition above it can be concluded that an audit committee is formed to assist the board of commissioners (in two-tier systems) to oversee the performance of financial reporting activities and the implementation of both internal and external audits within the company and therefore to maintain independence, the audit committee consists of independent commissioners, and parties outside the company who are independent of daily management activities and have the main responsibility to assist the board of commissioners in carrying out their responsibilities, especially with issues related to the company's accounting policies, internal control, and financial reporting system.

The audit committee is often referred to as one of the successes of corporate governance. The audit committee is an important element of the governance structure and operates under the delegated authority of the board. The committee's roles and responsibilities will be documented in its terms of reference which must be reviewed annually and proposed to the board for approval (ACCA, 2022). The audit committee is considered very important in reducing earnings management actions because the audit committee plays a role in the company's internal control in the process of preparing financial reports (Hapsari *et al*., 2022). Auditors with good human capital will be able to find errors in financial statements so that financial reports avoid material misstatements and provide quality audit results (Dali *et al*., 2019).

There are several benefits of forming an audit committee within a company. First, the audit committee oversees financial reports and conducts external audits. Second, the audit committee performs independent oversight of the company's management. Third, the audit committee performs independent oversight of good implementation processes in influencing the quality of financial reporting which will ultimately affect earnings management (Herianto, 2013; Hadnan & Setiyawati, 2021). The emergence of audit committees is caused by the increasing tendency of various fraud scandals and negligence of directors and commissioners of large companies, both in the USA and in Indonesia, which indicates an inadequate oversight function (Agoes & Ardana, 2014; Napitupulu *et al*., 2020).

### 2.1.7. Audit Committee Quality

The audit committee has a duty to assist the Board of Commissioners to monitor the financial reporting process by managers and boost the credibility of financial statements (Al-Abbas, 2009; Khafid & Arief, 2017). Thus, Istanti *et al.* (2021) the presence of the audit committee board is considered important in order to reduce agency conflicts that occur between managers and shareholders.

Audit committee quality includes the factors of authority, independence, competence, or expertise, and communication through regular meetings with the expected function and role of the audit committee is able to work effectively so as to identify the possibility of opportunistic profit management practices. The better the audit committee quality of a company, the more information and quality will be provided to give a good signal to the stakeholders (Astuti *et al.*, 2020).

**1. Audit Committee Expertise**

In Indonesia, the audit committee should at least has one independent party who has expertise in finance and accounting (Effendi, 2016; Florencea & Susanto, 2019). An audit committee that has knowledge of accounting and auditing will be able to do its duties more effectively (Ayemere & Elijah, 2015; Florencea & Susanto, 2019).

Earnings management increases when audit committee members do not have financial competence, whereas audit committees must ensure that financial statements provide a true picture of the company's financial condition, operating results, plans, and long-term commitments (Mintara, 2008; Sirait *et al*., 2014) ). Audit committee members will be better off if they don't work for many companies which can lead to a lack of focus on the performance of the audit committee members themselves. The effectiveness of the audit committee will decrease when its members work in many companies, whereas the experience of audit committee members working in companies can increase the effectiveness of audit committee members. This situation can be reversed when audit committee members work at many other companies (more than three companies) at the same time (Bryan *et al*., 2004; Sirait *et al*., 2014). Therefore, audit committee expertise can be measured using the ratio of audit committee expertise to the number of audit committees.

**2. Audit Committee Meetings**

According to the Forum for Corporate Governance in Indonesia (FCGI), the audit committee is required to meet three to four times a year. The existence of internal control through routine and structured audit committee meetings can detect problems that occur in the company early. The more intense the number of audit meetings that discuss existing problems, it is hoped that the quality of financial reports will also be more transparent thereby reducing real earnings management actions. Abbot *et al*. (2004) in Sirait *et al*. (2014) argue that if the number of audit committee meetings is less than the minimum number that has been set, there is a high chance of repeated earnings management. The audit committee in carrying out its duties requires coordination with various parties, so the audit committee holds regular meetings to evaluate management performance. The meeting is expected to reduce agency conflicts and pressure managers to take earnings manipulation (Ali & Kamardin, 2018; Istanti *et al*., 2021). Therefore, to measure the number of audit committee meetings is to count the number of meetings held in one year.

### 2.1.8. Earnings Management

Earnings management is defined as an effort to intervene or influence the information on financial statements in order to trick the stakeholders who want to know the performance and condition of the firm (Sulistyanto, 2014; Augustine & Dwianika, 2019). In managing earnings, managers initially choose accounting methods or policies to increase profits or reduce profits. Managers can increase profits by shifting future period profits to the current period. Thus, managers can reduce profits by shifting current period profits to the next period (Augustine & Dwianika, 2019). Increases or decreases in accounting numbers occur because managers have the ability to assess and provide information held through stock options and accounting estimates. This management flexibility provides an opportunity for managers to manage earnings through the freedom to choose or change accounting methods (Wiyadi *et al*., 2015; Susanto *et al*., 2021). Earnings management is a management intervention in determining profits for personal gain (Susanto *et al*., 2021). However, Kusumawardhani (2012) in Susanto *et al*. (2021) explained that earnings management is not always detrimental if it is carried out within the corridor of opportunity. Earnings management also does not manipulate financial statements because there are choices to use several methods that do not violate the provisions.

In this research, earnings management measurement uses the Modified Jones Model that has been used extensively in previous research, inter alia, Jones (1991), DeFond & Jiambalvo (1994), Butler *et al.* (2004), Lin, Hutchinson, & Percy

(2009) in Kusumaningtyas & Noor Farida (2016) used the Modified Jones Model as a proxy for earnings management.

To get the Discretionary accruals, it was conducted by calculating the following steps:

**First step**: Calculate Total Accrual (TA)

$$\boxed{\boldsymbol{TA_{it} = NI_{it} - CFO_{it}}}$$

Explanation:

$TA_{it}$ : Total Accrual company i year t

$NI_{it}$ : Net Income (net income before tax year t)

$CFO_{i}$ : Cash Flow Operation t

**Second step**: Estimating Total Accrual ($TA_{it}$) with Ordinary Least Square (OLS) to obtain the regression coefficient value

$$\boxed{\boldsymbol{\frac{TA_{it}}{A_{it-1}} = \beta_1\left(\frac{1}{A_{it-1}}\right) + \beta_2\left(\frac{\Delta REV_{it}}{A_{it-1}}\right) + \beta_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon}}$$

Explanation:

$A_{it-1}$ : Total assets of company i in year period t-1

$\Delta Rev_{it}$ : Revenue in year t minus revenue in year t-1

$PPE_{it}$ : Fixed assets year t

$\beta_{1, 2, 3}$ : Coefficient

$\varepsilon$ : Error

**Third step**: Find Nondiscretionary Accruals ($NDA_{it}$) with the following formula.

$$\boxed{\boldsymbol{NDA_{it} = \beta_1\left(\frac{1}{A_{it-1}}\right) + \beta_2\left(\frac{\Delta Rev_{it} - \Delta Rec_{it}}{A_{it-1}}\right) + \beta_3\left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon}}$$

Explanation:

$NDA_{it}$ : Nondiscretionary Accruals of the company I year t

$\Delta Rec_{it}$ : Accounts receivable in year t minus accounts receivable in year t-1

$PPE_{it}$ : Fixed assets year t

**Fourth step**: Calculate Discretionary Accruals (DA) with the following formula.

$$\boxed{DA_{it} = (TA_{it}/A_{it-1}) - NDA_{it}}$$

Explanation:

$DA_{it}$ : Discretionary Accruals of the company i year t

$TA_{it}$ : Total Accrual of the company i year t

## 2.2. Empirical Studies

The previous research used as the basis for this research is shown in the following table.

**Table 2.3**
**Empirical Studies**

| No. | Title/Author/Year | Variable | Research Method | Result |
|---|---|---|---|---|
| 1. | The Effect of Audit Committee Characteristics on Intellectual Capital Disclosure / Jing Li, Musa Mangena, Richard Pike / 2012 | Independent Variable:<br>- Size of Audit Committee<br>- Frequency of Audit Committee Meetings<br>- Audit Committee Independence<br>- Audit Committee Directors' Shareholding<br>- Audit Committee Financial Expertise<br>Dependent Variable: IC Disclosure | Secondary Data, Stratified Sampling, Multiple Regression Analysis, Descriptive Analysis, Sensitivity Analysis | 1) The results show that AC size (SAC) is significantly and positively associated with the overall IC disclosure<br>2) The frequency of AC meetings (MAC) is positively associated with overall IC disclosure. The frequency of AC meetings has also been found to be associated with more management earnings forecasts (Karamanou & Vafeas, 2005), fewer earnings management (Cornett *et al.*, 2009), and earnings restatement (McMullen & Raghunandan, 1996).<br>3) AC independence is not significantly associated with any of the IC disclosure<br>4) The relationship between human and relational capital disclosure indices and AC directors' shareholding is not significant.<br>5) The relationship between AC financial expertise and IC |

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| | | | | disclosure is negative and significant. |
| 2. | Audit Committee & Earnings Management: A Case Study of Manufacturing Companies in Indonesia / Herty Rita Sirait, Samuel PD Anantadjaya, Florentinus Nugro Hardianto / 2014 | Independent Variable:<br>- Audit Committee Independence<br>- Audit Committee Competence<br>- Effectiveness of Audit Committee Meetings<br>Dependent Variable: Earnings Management | Secondary Data, Discretionary Accruals, Linear Regression Method, Descriptive Statistics, SPSS | 1) The independence of the audit committee has a significant effect on earnings management<br>2) The audit committee has a significant effect on earnings management<br>1) The effectiveness of the audit committee meeting has a significant effect on earnings management |
| 3. | The Role 0f Audit Committee Attributes In Intellectual Capital Disclosures Evidence From Malaysia / Abdifatah Ahmed Haji / 2015 | Independent Variable:<br>- Audit Committee Size<br>- Financial Expertise of Audit Committee<br>- Audit Committee Experience<br>- Intellectual Capital Disclosure<br>Dependent Variable: Firm Value | Secondary Data, Purposive Sampling, SPSS 25, Ordinary Least Square (OLS) Approach | a. The size of the Audit Committee has a significant positive effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>b. The Audit Committee's Financial Expertise has a significant positive effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>c. Audit Committee Experience has no effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>3) Intellectual Capital Disclosure (ICD) has a significant positive effect on Firm Value in the banking industry on the Indonesia Stock Exchange. |

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| 4. | Board Indicators, Managerial Ownership, Intellectual Capital and Earnings Quality in Consumer Goods of Indonesia and Malaysia / Saarce Elsye Hatane, Natalia Ivana Halim, and Josua Tarigan / 2019 | Independent Variable:<br>- Board of Directors<br>- Managerial Ownerships<br>- Intellectual Capital<br>Dependent Variable:<br>- Earnings Quality | Secondary Data, Purposive sampling, WarpPLS version 5.0 software, Descriptive Statistics, Goodness-of-fit test | 1) In Indonesia, the board of directors has a significant positive impact on absolute discretionary accruals, which is a negative impact on earnings quality. Meanwhile, in Malaysia, the board of directors has no impact on earnings quality.<br>2) In Indonesia, when the board of directors improves, the intellectual capital increases as well. In Malaysia, the relationship shows a negative value which means higher BOD results in a lower VAIC which is the opposite of what is observed in Indonesia.<br>3) In Indonesia, intellectual capital has a positive impact on earnings quality. In Malaysia, the relationship shows that higher VAIC leads to higher ABSDA, which is a lower earnings quality (EQ). This infers a negative impact of VAIC on earnings quality.<br>d. In both Indonesia and Malaysia, the firm characteristic is positively correlated with IC |
| 5. | The Effect of Corporate Governance on Company Value and Earnings | Independent Variable:<br>- Managerial Ownership | Secondary Data, Purposive Sampling, SmartPLS, | 1) institutional ownership has a significant effect on earnings management |

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|---|---|---|---|---|
| | Management as Intervening Variables in Go Public Manufacturing Companies in Indonesia / Monika Wulanda and Nurna Aziza / 2019 | - BOD Meetings Frequency<br>- Institutional Ownership<br>Dependent Variable:<br>- Earnings Management<br>- Firm Value | Descriptive Statistics, Structural Model Testing (Inner Model) | 2) managerial ownership has a significant effect on earnings management<br>3) the frequency of board of commissioners' meetings does not have a significant effect on earnings management<br>4) indicates that the frequency of audit committee meetings has no significant effect on earnings management<br>2) etc. |
| 6. | The Influence of Intellectual Capital, Corporate Governance and Audit Quality on Earnings Management / Nawang Kalbuana, Nita Yulistian, and A. Nugroho Budi R / 2020 | Independent Variable:<br>- Intellectual Capital<br>- Corporate Governance<br>- Audit Quality<br>Dependent Variable:<br>- Earnings Management | Purposive Sampling Method, Multiple Linear Regression and The Application of SPSS 23. | 1) Intellectual capital has a positive effect on earnings management<br>2) Institutional ownership has no effect on earnings management<br>3) Managerial ownership has no effect on earnings management<br>4) Audit quality has no effect on earnings management |
| 7. | Does Audit Committee Quality Mediate Determinants of Intellectual Capital Disclosure? / Resa Nur Astuti, Fachrurrozie, Muhammad Ihlashul Amal, Siti Fatimah Zahra / 2020 | Independent Variable:<br>- Institutional Ownership<br>- Managerial Ownership<br>- Profitability<br>Mediating Variable:<br>- Audit Committee Quality<br>Dependent Variable:<br>Intellectual Capital (IC) Disclosure | Quantitative Research, Purposive Sampling Technique, Content Analysis Method, Descriptive Analysis, Inferential Analysis, And Path Analysis by SPSS 25 IMB software, The T Test and Multiple Tests | 1) Managerial ownership has a positive effect on IC disclosure.<br>2) Institutional ownership has a negative effect on IC disclosure.<br>3) Profitability has a positive effect on IC disclosure.<br>4) The audit committee quality has a positive effect on IC disclosure.<br>5) The audit committee quality is not able to mediate the effect of managerial ownership on IC disclosure. |

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| 8. | Institutional and Managerial Ownership on Earnings Management: Corporate Governance / Yulius Kurnia Susanto, Arya Pradipta, and Irwanto Handojo / 2021 | Independent Variable:<br>- Institutional Ownership<br>- Managerial Ownership<br>- Independent Commissioners<br>- Commissioners Meeting<br>- Board of Commissioners<br>- Audit Committee<br>Dependent Variable:<br>- Earnings Management | Purposive Sampling, Multiple Regression, Secondary Data, Discretionary Accruals, Modified Jones Model, Descriptive Statistics, T-Test | 6) The effect of institutional ownership on earnings management is significant and negative.<br>7) The effect of managerial ownership on earnings management is not significant.<br>8) The effect of independent commissioners on earnings management is not significant.<br>9) The effect of commissioners' meetings on earnings management is not significant.<br>10) The effect of the board of commissioners on earnings management is not significant.<br>11) The effect of the audit committee on earnings management is not significant. |
| 9. | The Role of Intellectual Capital as A Mediation of Relationship Between Audit Committee and Real Earnings Management / Sri Layla Wahyu Istanti, Anis Chariri and Agung Juliarto / 2021 | Independent Variable:<br>- Audit Committee<br>- Number of audit committee meetings<br>- The expertise of the audit committee<br>Mediating Variable:<br>- Human Capital<br>Dependent Variable:<br>- Earnings Management | Secondary Data, Purposive Sampling, Path Analysis SPSS | 1) the expertise of the audit committee has a significant positive effect on human capital<br>2) The number of meetings shows that the number of meetings has no significant effect on human capital<br>3) Audit committee expertise does not significantly influence REM practice<br>4) The more often the members of the audit committee hold |

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| | | | | meetings, the less influence they have on REM practice<br>5) Human capital has a negative and insignificant effect on REM practice, thus high human capital performance does not directly affect the decline in real earnings management<br>6) The expertise of the audit committee and the number of audit meetings through human performance do not have a significant effect on REM. |
| 10. | Audit Committee Characteristics, Intellectual Capital Disclosure, and Firm Value / Ferra Ermawatie Hizriyani, Rudi Zulfikar, and Agus Sholikhan Yulianto / 2022 | Independent Variable:<br>- Audit Committee Size<br>- Financial Expertise of Audit Committee<br>- Audit Committee Experience<br>- Intellectual Capital Disclosure<br>Dependent Variable:<br>- Firm Value | Secondary Data, Purposive Sampling, Ordinary Least Square (OLS) approach, SPSS 25.0 | 1) The size of the Audit Committee has a significant positive effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>2) The audit Committee's Financial Expertise has a significant positive effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>3) Audit Committee Experience has no effect on Intellectual Capital Disclosure (ICD) in the banking industry on the Indonesia Stock Exchange.<br>4) Intellectual Capital Disclosure (ICD) has a |

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| | | | | significant positive effect on Firm Value in the banking industry on the Indonesia Stock Exchange |

Has been displayed from the previous research that the independent variables (institutional ownership, managerial ownership, number of audit committee meetings, and expertise of audit committee) in this research are mostly related to the practice of earnings management as the dependent variable. Although some of the previous research proves that the relation, they have is not significant, it makes this research interpolate human capital as a mediation between variables. It is believed that human capital can mediate the relationship between independent and dependent variables, as has been done by previous research they did not add human capital as a mediation, this is what makes this research different from previous research.

This research is conducted to continue the work by Istanti *et al.* (2021), although the results show an insignificant relationship between human capital performance and earnings management due to the existence of product innovation that indicates the performance of human capital, was declined by the market so the level of sales is still low resulting managers to manipulate sales results to cover targets. Therefore, to test the mediating effect of human capital on earnings management this research uses institutional ownership, managerial ownership, the number of audit committee meetings, and the expertise of the audit committee as its independent variable.

## 2.3. Conceptual Framework and Research Hypothesis

### 2.3.1. Conceptual Framework

Figure 2.1 shows the relationship of the hypothesis built in this research, which are: H1: Institutional ownership has a negative effect on earnings management*;* H2: Managerial ownership has a negative effect on earnings management*;* H3: The audit committee expertise has a negative effect on earnings management*;* H4: The number of audit committee meetings has a negative effect on earnings management*;* H5: The institutional ownership has a positive effect on human capital; H6: The managerial ownership has a positive effect on human capital; H7: The audit committee expertise has a positive effect on human capital performance; H8: The number of audit committee meetings has a positive effect on human capital performance; H9: Human capital performance has a negative effect on earnings management; H10: Human capital mediates managerial ownership on earnings management; H11: Human capital mediates the expertise of the audit committee on earnings management; and H12: Human Capital mediates the number of audit committee meetings on Real Earnings Management.

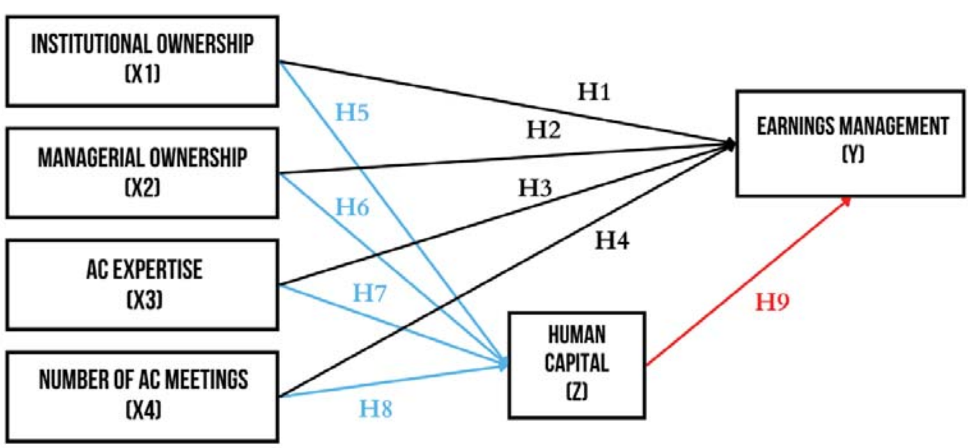


Figure 2.1 Conceptual Framework: Direct Relationship of X1, X2, X3, X4, and Z Toward Y

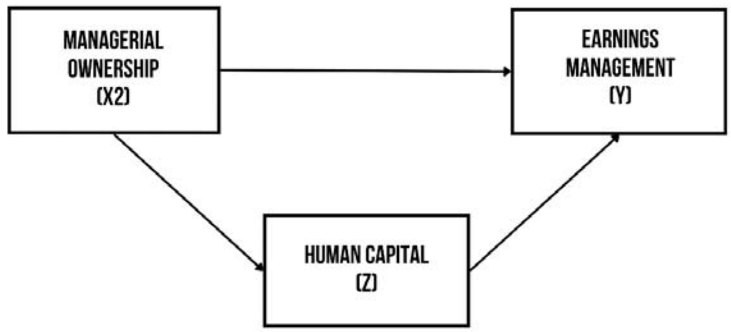


Figure 2.2 Conceptual Framework: Indirect Relationship of X2 Towards Y, Through Z (H10)

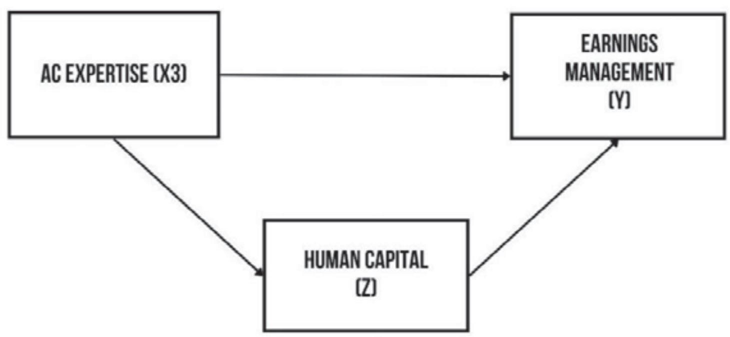


Figure 2.3 Conceptual Framework: Indirect Relationship of X3 Towards Y, Through Z (H11)

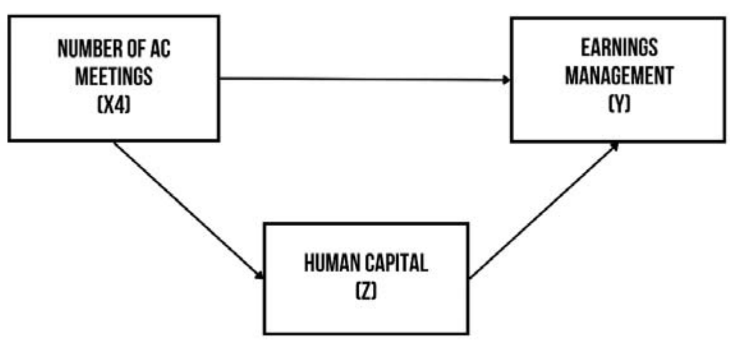


Figure 2.4 Conceptual Framework: Indirect Relationship of X4 Towards Y, Through Z (H12)

### 2.3.2. Research Hypothesis

**1. Institutional Ownership Has a Negative Effect on Earnings Management**

Institutional ownership is one way of monitoring the performance of company management in managing the company (Mahiswari & Nugroho, 2014; Susanto *et al.*, 2021). Institutional investors are considered more experienced and can perform better analysis so management finds it difficult to manipulate them. Therefore, managers tend to avoid earnings management practices and higher-quality earnings (Asward & Lina, 2015; Susanto *et al.*, 2021).

This was under previous research by Kusumaningtyas & Farida (2016) found evidence that the influence of institutional ownership on earnings management showed a negative and significant result, thus it can be concluded that institutional ownership could reduce earnings management actions undertaken by managers within a company. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Institutional Ownership and Earnings Management. The hypothesis can be put forward:

***H1: Institutional ownership has a negative effect on earnings management***

**2. Managerial Ownership Has a Negative Effect on Earnings Management**

Managerial ownership is one of the methods used to reduce earnings management actions. This condition makes a manager have multiple positions, besides being a manager, but also being an investor in the company he manages, so this will encourage managers to be careful in making decisions (Lestari, 2017; Hapsari *et al.*, 2022). Mahariana & Ramantha (2014) in Kalbuana *et al.* (2020) stated managerial ownership is thought to be able to minimize earnings management practices because shareholders who are also managers of the company will be measured by other parties in the contract so that management is expected to be motivated to prepare quality financial reports.

Wulanda & Aziza (2019) and Sutarmin (2017) research showed that managerial ownership significantly had a negative direction toward earnings management. This study proves that managerial ownership can reduce earnings management actions because when managers are also owners of the company, the interests of management and shareholders are aligned and the managers will improve their performance. This study is under agency theory which shows that managers will not deviate from the goal of maximizing shareholder wealth by earning profits when they also have share ownership in the company. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Institutional Ownership and Earnings Management. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Managerial Ownership and Earnings Management. The hypothesis can be put forward:

***H2: Managerial ownership has a negative effect on earnings management***

### 3. The Audit Committee Expertise Has a Negative Effect on Earnings Management

Expertise is considered the main characteristic of the audit committee on which effective and efficient operation depends. It has been argued that the audit committee should be capable enough and possess suitable expertise in accounting, auditing, and finance to assess and control the manipulation of accounts, which is reflected in financial reports (Kent *et al.*, 2016; Dali *et al.*, 2019). Audit committee members who have expertise in accounting and finance will greatly affect the effective and efficient performance of the audit committee, where each member can independently assess the information and issues, they receive, recognize and understand problems and find appropriate solutions to these problems (Purwati, 2006; Sirait *et al.*, 2014). So that any problems or risks that greatly affect the survival of the company can be properly resolved and detected early to prevent the possibility of the same thing happening in the future.

The results from previous research by Zgarni *et al.* (2016) indicate that firms with greater audit committee financial expertise are less likely to engage in earnings management. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Audit Committee Expertise and Earnings Management. The hypothesis can be put forward:

***H3: The audit committee's expertise has a negative effect on earnings management***

**4. The Number of Audit Committee Meetings Has a Negative Effect on Earnings Management**

The characteristics of the audit committee such as the frequency of meetings, expertise in finance, and time commitment in holding meetings are very supportive of the effectiveness of the audit committee that affects the success of the company for the sustainability of a company and the financial reporting process (Bryan *et al*, 2004; Sirait *et al.*, 2014). Abbott and Parker (2000) in Zgarni *et al.* (2016) examined the relationship between the frequency of meetings of the audit committee and the industry specialization of auditors. Indeed, they found that the number of audit committee meetings is associated with increases in the choice of a better-quality audit firm. Thus, the audit committees that meet more often are more likely to perceive industry specialization as an important skill in external auditors and accordingly appoint industry specialist auditors (Zgarni *et al.*, 2016).

Previous research conducted by Sae-Lim & Jermsittiparsert (2019) has found that the success of audit committee performance is strongly influenced by the effectiveness of audit committee meetings. This finding is consistent with Zgarni *et al.* (2016) which shows the relation of audit committee meetings to earnings management, if the number of meetings of the audit committee increases, the practice of earnings management will be reduced. Hence, the researcher wants to explore and analyze the possibilities of the relationship between The Number of Audit Committee Meetings and Earnings Management. The hypothesis can be put forward:

***H4: The number of audit committee meetings has a negative effect on earnings management***

**5. Institutional Ownership Has a Positive Effect on Human Capital**

Agency theory states that the owner of the company can use voluntary disclosure as a way to monitor the management of the company (Jensen & Meckling, 1976; Fama & Jensen, 1983; Firer & Williams, 2018). Institutional owners usually tend to demand better information than individual owners because it is usually able to pay more for the information obtained. The owner is usually in the form of institutional investors who are smart and able to process information better than other investors (Siregar & Utama, 2008; Firer & Williams, 2018). The possibility of positive influence toward intellectual capital, perhaps because institutional investors provide rules that require companies to make more disclosures concerning the application of CG companies. Moreover, the result of the research conducted by Hendry & Situmeang (2017) and Mukti & Istianingsih (2018) proves that institutional ownership has a significant positive influence on intellectual capital. Also, research by Setiany *et al*. (2020) show positive and significant relation between institutional ownership on intellectual capital. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Institutional Ownership and Human Capital. The hypothesis can be put forward that:

***H5: Institutional ownership has a positive effect on human capital***

**6. The Managerial Ownership Has a Positive Effect on Human Capital**

Teguh & Hatane (2017) assume that corporate governance is one of the main factors for intellectual capital disclosure in the annual financial statements, in line with Iturriaga dan Sanz (2001) in Tungabdi & Hatane (2017) increasing managerial ownership in the company can reduce agency problems between managers and shareholders, and can help in aligning the different interests between shareholders and managers. According to Li and Qi (2008) in Widyatama & Hatate (2017) high managerial ownership can reduce agency costs and increase voluntary disclosure. Therefore, involvement as a shareholder will increase the motivation of managers to focus on the long-term life of the company, including the maintenance of intellectual capital (Tungabdi & Hatane, 2017).

This is in line with research conducted by Li & Qi (2008) in Widyatama & Hatate (2017), Mubaraq & Haji (2014), and Hendry & Situmeang (2017) which found a positive influence from managerial ownership and intellectual capital disclosure. This means that the higher managerial share ownership can harmonize the differences in interests between managers and company owners while making managers feel they own the company because managers own shares in the company. Managers as shareholders tend to make decisions that can create value, such as empowering and managing human capital so that the value of human capital increases. Hence, the researcher wants to explore and analyze the possibilities of the relationship between Managerial Ownership and Human Capital. The hypothesis can be put forward:

***H6: Managerial ownership has a positive effect on human capital***

**7. The Audit Committee Expertise Has a Positive Effect on Human Capital**

Expertise in accounting in analyzing financial statements is needed in companies because the main function of the audit committee is to oversee the financial reporting process of a company (Rustiarini, 2013). If the audit committee members have expertise in accounting and have good human capital performance, earnings management practices can be reduced. This is in line with the research conducted by Istanti *et al*. (2021) which shows a significant positive effect on human capital. They stated that good committee expertise is reflected in the level of understanding and a good level of accounting education so that it can compile quality financial reports and can improve capital performance. Increasing human capital can help improve the competitive advantage of the company. Also results from the previous research by Hizriyani *et al.* (2022) showed that the financial expertise of the audit committee had a positive and significant effect on ICD which include the performance of human capital. Hence, the researcher wants to explore and analyze the possibilities of the relationship between the expertise of the audit committee and human capital. The hypothesis can be put forward:

***H7: The audit committee's expertise has a positive effect on human capital***

**8. The Number of Audit Committee Meetings Has a Positive Effect on Human Capital**

The Forum for Corporate Governance in Indonesia (FCGI) requires the audit committee to meet three to four times a year. The existence of internal control through routine and structured audit committee meetings can early detect problems that occur in the company. The more intense the number of audit meetings discussing existing problems, it is hoped that the quality of financial reports will also be more transparent, thereby reducing real earnings management actions. Previous research conducted by Istanti *et al.* (2021) found the frequency of audit committee meetings has a significant positive relationship with the overall IC disclosures, including human capital performance. Hence, the researcher wants to explore and analyze the possibilities of the relationship between the number of audit committee meetings and human capital. The hypothesis can be put forward:

***H8: The number of audit committee meetings has a positive effect on human capital***

**9. Human Capital Has a Negative Effect on Earnings Management**

Marr *et al.*, (2004) state that human capital is a group of assets in the form of knowledge possessed by employees and contributes significantly to increasing the competitive value of the company. Increased knowledge creates investment costs from intangible assets. The increased performance of human capital is marked by value creation in the form of product innovation, to increase competitive advantage. Previous research conducted by Istanti *et al.* (2021) found human capital has a negative and insignificant effect on earnings management practice, thus high human capital performance does not directly affect the decline in real earnings management. It is hoped that the improvement of human capital performance can reduce real earnings management practices. Hence, the researcher wants to explore and analyze the possibilities of the relationship between human capital and earnings management. The hypothesis can be put forward:

***H9: Human capital performance has a negative effect on earnings management***

**10. Human Capital Mediates Managerial Ownership on Earnings Management**

Hedry & Situmeang (2017) in their research showed that Human Capital is able to mediate managerial ownership which with the ownership of shares by the manager will bring up self-controlling in the manager who is also a shareholder. This will make the utilization more efficient and empower human capital as a vital asset of the company so as to improve the performance of human capital. Hence, the researcher wants to explore and analyze the possibilities of the mediating role of the human capital in the relationship between managerial ownership on earnings management. The hypothesis can be put forward:

***H10: Human capital mediates managerial ownership on earnings management***

### 11. Human Capital Mediates Expertise of Audit Committee on Earnings Management

Expertise in accounting in analyzing financial statements is needed in companies because the main function of the audit committee is to oversee the financial reporting process of a company (Rustiarini, 2013; Istanti *et al.*, 2021). If the audit committee members have expertise in accounting and have good human capital performance, earnings management practices can be reduced. Hence, the researcher wants to explore and analyze the possibilities of the mediating role of human capital between the relationship of expertise of the audit committee on earnings management. The hypothesis can be put forward:

***H11: Human capital mediates the expertise of the audit committee on earnings management***

### 12. Human Capital Mediates Number of Audit Committee Meetings on Earnings Management

The increasing frequency of audit committee meetings will increase the supervision of the management in carrying out the company's operational activities. The number of intense meetings can also increase the performance of human capital, thereby reducing the practice of real earning management. This is because committee members may not be independent in evaluating financial statements. Hence, the researcher wants to explore and analyze the possibilities of the mediating role of human capital between the relationship of the number of audit committee meetings on earnings management. The hypothesis can be put forward:

***H12: Human Capital mediates the number of audit committee meetings on Real Earnings Management***