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Company growth, free cash flow, tax avoidance, and earnings management: Examining the role of the audit committee

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ABSTRACT

Earnings management remains a key concern in financial reporting quality, particularly in emerging markets where regulatory enforcement may be weaker. The novelty of this study lies in the integration of several variables, namely firm growth, free cash flow, and tax avoidance, into a single model to examine their impact on earnings management. Furthermore, this study incorporates corporate governance, specifically the role of the audit committee as a moderating variable. This research investigates the influence of company growth, free cash flow, and tax avoidance on earnings management, while also examining the moderating role of the audit committee. The study uses a sample of 274 manufacturing firms listed on the Indonesia Stock Exchange (IDX) in 2023, selected through purposive sampling. Data from financial reports were analyzed using multiple linear regression and moderated regression analysis. The findings indicate that company growth enhances earnings management, whereas free cash flow exerts a negative influence. Furthermore, the audit committee mitigates the positive relationship between tax avoidance and earnings management. This research highlights the importance of having independent and skilled audit committees to enhance supervision and ensure adherence to regulations. Firms should also design performance-based compensation carefully to align managerial incentives with shareholder interests.

Contribution/ Originality: This study integrates company growth, free cash flow, and tax avoidance into a single model to examine earnings management, with the audit committee serving as a moderating variable. Utilizing data from 2023 enhances regulatory consistency, providing clearer insights into internal firm dynamics and governance effectiveness within a uniform reporting environment.

1. INTRODUCTION

In the business world, financial reporting is a very crucial key to achieving transparent and accountable reporting and delivering accurate information to stakeholders (Healy & Wahlen, 1999). Decisions taken by companies related to financial reporting are influenced by various factors that can impact financial performance and market perception of the company (Watts & Zimmerman, 1986). In this context, companies often face pressure to meet stakeholder expectations regarding stable and positive performance, thus encouraging companies to manage financial reports to appear more profitable (Schipper, 1989). This tension can increase the company's potential to implement earnings management.

Earnings management is the effort to manipulate or organize the figures in financial reports to achieve specific objectives, such as creating a positive perception among investors (Abubakar, Mansor, & Wan-Mohamad, 2021; Budiantoro, Fazriyani, Santosa, Zhusryn, & Lapae, 2022; Enakirerhi & Ighosewe, 2024). Earnings management can be performed in various ways, such as accelerating revenue recognition or delaying cost recognition, with the aim of generating higher or lower profits according to managerial and stakeholder needs (Cheng, Goh, & Kim, 2016). This practice, although legal, still risks reducing the credibility of financial statements if done excessively or non-transparently (Oyeyemi, Adeniyi, & Amuda, 2021).

The cases of earnings management that occurred in Indonesia are as follows: (1) PT. Garuda Indonesia Tbk in 2018, which accelerated the recognition of revenue from Mahata Aero Teknologi amounting to USD 239 million in an effort to improve its financial statements; (2) PT. Krakatau Steel Tbk in 2019, which overproduced to reduce production costs per unit and thereby increase gross profit; and (3) PT. Indofood Sukses Makmur Tbk in 2014, which delayed the recognition of promotional and advertising costs, resulting in the company's net profit appearing higher than its actual condition.

The cases mentioned above, along with various studies on earnings management, often focus on aspects such as corporate governance, ownership structure, or managerial incentives (Al-Haddad & Whittington, 2019; Attia, Ismail, & Mehafdi, 2022; Le, Tran, & Vo, 2021; Tran & Dang, 2021). However, they frequently overlook the detailed internal conditions of companies that can influence the tendency for earnings management. Key aspects such as company growth, free cash flow, and tax avoidance have not been thoroughly explored.

Additionally, Al-Absy, Ku Ismail, and Chandren (2019), Klein (2002), and Sulistyanto (2014) stated that the availability of an audit committee is worthy of being a moderator that has the potential to minimize earnings management practices through rigorous oversight of financial statements. There is a notable research gap on earnings management in emerging economies like Indonesia, as most studies primarily focus on developed countries (Adair & Adaskou, 2015; Güner, 2016; Lourenço & Oliveira, 2017; Rodrigues, Moura, Santos, & Sobreiro, 2017). While research conducted in Indonesia by Fakhroni, Ghozali, Harto, and Yuyetta (2018) and Itan, Ahmad, Setiana, and Karjantoro (2024) addresses the interaction between tax avoidance and earnings management, it often fails to consider other internal factors that may also play a significant role.

The importance of addressing the gaps in previous research; this study was conducted to analyze and interpret the factors believed to impact earnings management (EM) practices, namely company growth, free cash flow, and tax avoidance. The first factor is company growth; companies that grow rapidly often face challenges in maintaining good financial performance in the eyes of investors and regulators (Collins, Pungaliya, & Vijh, 2017; Enakirerhi & Ighosewe, 2024). With the pressure to show good results, companies may tend to do earnings management to maintain a positive perception in the market (Collins et al., 2017; Potharla & Shette, 2025). Meanwhile, high FCF provides greater flexibility for companies to make decisions that can increase reported profits, either through profitable investments or by managing profits to meet financial obligations or maintain good relationships with creditors (Jensen, 1986).

High FCF in companies may create incentives to allocate funds efficiently; however, unused funds can lead to earnings management, especially if the company aims to meet specific financial ratios outlined in debt agreements or covenants (Nagata, 2013; Yang, Hsu, & Yang, 2016). The last factor is tax avoidance. Companies involved in tax avoidance strategies aim to decrease their tax liabilities, which can lead them to use earnings management techniques to avoid or mitigate the negative impact of uncovered tax avoidance (Yuliastuti & Nurhayati, 2023).This practice is increasingly a concern for companies operating in countries with strict tax regulations, such as Indonesia, where large companies often try to take advantage of legal loopholes to reduce their tax burdens (Abubakar et al., 2021). To reduce the potential for deviations in this EM, the contribution of the audit committee becomes very important. An effective audit committee (AC) can act as an oversight mechanism that ensures EM is implemented in accordance with applicable accounting principles and does not lead to practices that are detrimental to the company or other stakeholders (Al-Absy et al., 2019; Hidayat, Putri, & Aisyah, 2022; Isa & Farouk, 2018; Nengzih, 2019; Zadeh, Askarany, Shirzad, & Faghani, 2023).

This study focuses on the manufacturing sector due to its relevance in earnings management research. Compared to other sectors, manufacturing companies typically have complex operational activities and detailed financial reporting structures, including accounts such as inventory and fixed assets, which offer greater flexibility in applying accounting policies (Permatasari, 2017; Susanto & Pradipta, 2020). Moreover, the choice of a single sector enhances data comparability and minimizes variations that could distort the analysis (Siregar & Utama, 2008).

This study aims to analyze the determinants that influence earnings management practices in manufacturing companies in Indonesia, focusing on three main variables: company growth, free cash flow (FCF), and tax avoidance. It seeks to examine how company growth affects the tendency toward earnings management under pressure to maintain positive performance perceptions among investors and regulators. Additionally, the study explores the impact of FCF on managerial decisions related to earnings reporting and investigates the role of tax avoidance in encouraging earnings management strategies to offset the negative effects of tax policies. Furthermore, the research analyzes the moderating effect of the audit committee (AC) in reducing earnings management practices through effective financial reporting supervision. Addressing the existing literature gap, this research deepens understanding of internal dynamics that shape earnings management in developing countries such as Indonesia. The findings aim to provide useful insights for managers, stakeholders, and regulators, improve audit committee effectiveness, and evaluate regulatory frameworks.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Company Growth and Earnings Management

Corporate growth relates to the increase in a company's capacity, size, and performance over time (Penrose, 1995). In a financial context, corporate growth is often associated with a company's ability to generate greater revenues and increase its profitability as the business scales (Jensen & Meckling, 1976).

From the perspective of agency theory, corporate growth is often a source of opposing interests between principals and agents (shareholders and managers) (Jensen & Meckling, 1976). Managers might have incentives to favor personal interests, such as obtaining performance-based bonuses or enhancing their reputation, rather than focusing on shareholder value creation (Watts & Zimmerman, 1986). Besides that, managers of growing companies are often under pressure to meet market expectations and maintain positive investor perceptions (Edison & Nugroho, 2020). This pressure may encourage them to be employed in earnings management practices to present a more favorable financial performance (Levillain & Segrestin, 2019).

In growth companies, information asymmetry often occurs among managers and shareholders, posing a significant challenge, as shareholders may not always have sufficient information to monitor managerial actions directly, increasing the risk of opportunistic behavior (Dzulfikar & Firmansyah, 2022). This growth also often leads to increased scrutiny from stakeholders, including investors and regulators, which may pressure managers to present a more favorable financial position (Levillain & Segrestin, 2019). Consequently, managers may resort to earnings management techniques to align reported earnings with market expectations or to secure bonuses tied to performance metrics (Himeur, Alsalemi, Bensaali, Amira, & Al-Kababji, 2022).

Positive accounting theory explains that managerial behavior is driven by self-interest and contractual relationships within the company (Watts & Zimmerman, 1986). One of its key principles, the bonus plan hypothesis, indicates that managers tend to select accounting policies that increase reported profits to maximize their bonuses (Watts & Zimmerman, 1986). Consequently, managers may actively pursue company growth as a means to achieve higher profit targets, which in turn enhances their compensation (Naue, Anastasia, Harjanto, & Novyarni, 2023). Companies with high growth potential are expected to generate maximum returns on future investments, making them more attractive to investors (Budiman & Setiyono, 2012). As firms expand, the growing complexity of operations and increased market expectations further amplify the motivation for managers to employ in EM.

This study indicates that growing companies are more inclined to employ EM practices to inflate reported earnings (Kothari, Leone, & Wasley, 2005). Furthermore, earnings management can serve as a tool to align market expectations and stabilize stock prices (Enakirerhi & Ighosewe, 2024). Moreover, growing firms often have more opportunities to recognize revenue earlier, facilitating earnings management (Dechow, 1994). This practice can help mitigate uncertainties associated with rapid growth (Graham, Harvey, & Rajgopal, 2005). Additionally, the flexibility in choosing accounting methods allows managers to manage earnings more easily (Schipper, 1989). Ultimately, a growing company may foster an environment where management feels justified in taking risks with earnings management, potentially leading to inflated reported earnings (Beneish, 1999).

H_1: Company growth has a positive effect on earnings management.

2.2. Free Cash Flow and Earnings Management

Free Cash Flow (FCF) refers to the cash generated from operational activities after deducting capital expenditures, indicating the resources available for investment, debt repayment, or shareholder distributions (Jensen, 1986). FCF reflects a company's ability to generate net cash that can be used to pay dividends, retire debt, or invest in new programs (Dzulfikar & Firmansyah, 2022; Richardson, 2006).

According to agency theory, surplus FCF can create divergent interests among managers (agents) and shareholders (principals) because managers may attempt personal interests that are inconsistent with shareholder goals, such as overinvestment or the use of cash for opportunistic purposes (Bauweraerts, Vandernoot, & Buchet, 2020). In fact, when companies possess substantial free cash flow, managers are less inclined to engage in earnings management to achieve short-term performance targets, as they have the resources to pursue profitable investments that align with shareholder interests (Meryana & Setiany, 2021). This financial flexibility allows managers to allocate funds toward value-enhancing projects rather than resorting to accounting manipulations to inflate reported earnings (Chien, Chen, & Chang, 2020).

The perspective of pecking order theory suggests that investment-based financing is preferred by companies using internal resources before turning to debt and finally issuing equity, as information asymmetry imposes substantial costs on firms seeking external funding (Shyam-Sunder & Myers, 1999). When companies have high FCF, they have sufficient internal funding sources for operations and investments without needing to seek funding from external parties (Muflihah, 2017). Companies that do not have strong incentives to manage financial statements to meet external expectations or maintain certain financial ratios due to the lack of dependence on external creditors or investors (Lazzem & Jilani, 2018). However, firms with low FCF are more likely to rely on external financing, which is often accompanied by debt covenants or specific requirements that mandate them to maintain certain financial ratios. In such conditions, managers can use earnings management as a strategy to comply with these financial constraints and ensure sustainable funding (Yang et al., 2016). Therefore, from the perspective of pecking order theory, firms with high free cash flow have less pressure to engage in earnings management, so the relationship between free cash flow and earnings management (EM) is negative.

Previous findings support the notion that FCF has a negative impact on EM, indicating that high levels of FCF can reduce managers' incentives to practice EM (Meryana & Setiany, 2021). Ahmed and Sulong (2023) argue that firms with excess cash are less likely to engage in earnings management, as they can direct their resources to profitable investments instead of manipulating financial statements. This finding is further strengthened by Jelanti (2020), who found that companies with substantial FCF tend to avoid aggressive EM practices. In addition, Fatmala and Riharjo (2021) found that companies with substantial free cash flow tend not to engage in discretionary accruals. Furthermore, research by Chen, Elder, and Hsieh (2010) supports this view, stating that high FCF allows for less EM because they have the financial flexibility to pursue legitimate growth opportunities. In addition, a study by Kallapur and Trombley (2001) found that companies with strong cash flow levels were less likely to participate in EM because they do not experience the same pressure to achieve short-term performance targets. Research by Meryana and Setiany (2021) also shows that companies with excess cash flow are less likely to use accounting discretion to increase earnings because they can rely on activities that actually generate cash. Agustia (2013) stated that companies with large free cash flow tend not to be involved in earnings management, supporting the idea that greater financial flexibility reduces incentives for accounting manipulation.

H_2: Free Cash Flow negatively impacts earnings management.

2.3. Tax Avoidance and Earnings Management

Tax avoidance is defined as a legitimate action taken by individuals or companies through planning and acting to reduce their tax obligations while still complying with applicable laws and regulations (Abubakar et al., 2021). Aligned with agency theory, management has the initiative to carry out tax avoidance in order to maximize its personal goals (Amidu, Coffie, & Acquah, 2019). Managers use tax avoidance techniques to decrease the company's tax burden, which can increase profits so that they can provide greater compensation to managers in the form of performance-based bonuses (Shafai, Amran, & Ganesan, 2018). Meanwhile, shareholders seek tax avoidance for tax efficiency that can increase the company's value. However, managers may exploit this activity opportunistically for personal gain, which is not aligned with shareholders' goals. Additionally, non-transparent tax avoidance can damage the company's reputation and increase the risk of tax litigation, ultimately negatively affecting shareholders (Ratu, Komalasari, & Alvia, 2023).

Furthermore, positive accounting theory specifically addresses the political cost aspects. Firms that engage in aggressive tax avoidance may face pressure from governments and regulators for allegedly reducing their tax contributions. To mitigate this risk, managers may employ earnings management to disguise their tax avoidance strategies, for example, by increasing accounting profits to appear financially healthy and reduce harassment from tax authorities. Additionally, managers often have incentives to increase earnings because their benefits depend on reported financial performance (Taufiq, 2022). By engaging in tax avoidance, firms minimize their tax burden and increase after-tax earnings, which can then be further managed through earnings management practices to appear more stable or on target (Minnick & Noga, 2010).

Research indicates that tax avoidance may lead companies to manage earnings, with Hanlon and Heitzman (2010) demonstrating that firms use tax expense manipulation as a tool for earnings management, particularly to meet analysts' forecasts. Fernández-Rodríguez, González, and Pérez (2021) declare that companies with high levels of tax avoidance also exhibit higher discretionary accruals, indicating a correlation between tax avoidance and EM implementations. Meanwhile, Taufiq (2022) highlighted that aggressive tax planning is often accompanied by EM techniques oriented towards presenting profitable financial results. Gaaya, Lakhal, and Lakhal (2017) prove that strong corporate governance has an effect on the interaction between tax avoidance and earnings management, as companies with better governance may employ both practices to enhance shareholder value. Amidu et al. (2019) explored how managerial incentives can create a positive correlation between tax avoidance and earnings management, as managers aim to maximize their compensation. Kim, Li, and Li (2016) also state that firms with political connections tend to engage in tax avoidance and earnings management, indicating that external factors can influence these practices. Goh, Lee, Lim, and Shevlin (2013) showed that firms with aggressive tax strategies often report better financial performance, which can be attributed to EM.

H_3: Tax avoidance has a positive effect on earnings management.

2.4. The Moderating role of Audit Committee in the Relationship between Firm Growth and Earnings Management

The Audit Committee (AC) is a part of the company formed by the board of commissioners, responsible for maintaining the reliability of financial reporting and ensuring compliance with applicable laws and standards (DeFond & Zhang, 2014). Typically, this committee is composed of independent individuals who possess strong expertise in accounting, auditing, and internal controls (Cohen, Gaynor, & Krishnamoorthy, 2004). Among its main responsibilities are reviewing financial statements, monitoring the performance of external auditors, reviewing the sufficiency of internal control structures, and ensuring alignment with legal and regulatory requirements (Klein, 2002). In addition, the committee plays a role in identifying and mitigating risks associated with financial reporting and corporate governance (Abbott, Parker, & Peters, 2004).

Supported by agency theory, the audit committee serves as a central governance mechanism designed to minimize agency costs those that stem from conflicting interests between management (as agents) and shareholders (as principals). These conflicts are often exacerbated by information asymmetry, where managers possess greater access to internal corporate information than external shareholders. Such an imbalance can lead to opportunistic behavior, including earnings manipulation or decisions that serve managerial self-interest (Watts & Zimmerman, 1986). Through its independent supervisory role, the audit committee fosters accountability and transparency in financial disclosures, thus helping to alleviate agency conflicts (Toumeh, Yahya, & Amran, 2023). The presence of an active and effective audit committee contributes significantly to stronger corporate governance practices and helps reduce agency-related expenses resulting from managerial shareholder conflicts (Balouei, Rostamy, Sharif, & Saeedi, 2018).

According to agency theory, the audit committee plays an important role in monitoring managerial behavior and ensuring that corporate decisions are aligned with shareholder interests (Al-Absy et al., 2019). Several studies have also highlighted the moderating role of the audit committee in the relationship between corporate growth and earnings management. Rapid corporate growth can increase managerial pressure to meet performance benchmarks, thereby increasing the risk of earnings manipulation. An independent audit committee can mitigate this risk by enforcing compliance with accounting standards and promoting transparency in financial reporting (Taufiq, 2022).

According to Zadeh et al. (2023), firms with robust audit committees are less likely to engage in earnings management, as their monitoring discourages manipulative practices by executives. This view is further supported by Zgarni, Hlioui, and Zehri (2016), who found that audit committees enhance the quality of financial disclosures, thereby limiting the motivations for earnings manipulation. Itan et al. (2024) also argue that the existence of a competent audit committee improves the trustworthiness of financial reporting, reducing management's reliance on earnings management to meet market expectations. Isa and Farouk (2018) echo this by showing that firms with active audit committees are less prone to aggressive financial reporting tactics, reinforcing the committee's role as a stabilizing force amid firm expansion. Miko and Kamardin (2015) also highlight that an effective audit committee enhances the accountability of financial statements, ultimately reducing managerial incentives to manipulate earnings. Together, these studies provide a compelling case for the hypothesis under examination.

H_4: The audit committee weakens the positive relationship between firm growth and earnings management.

2.5. The Moderating Role of Audit Committee in the Relationship between Free Cash Flow and Earnings Management

An effective audit committee can strengthen the negative relationship between free cash flow (FCF) and earnings management (EM). Based on agency theory, excess FCF may give rise to agency conflicts, as managers have greater discretion to engage in EM to justify expenditures or meet performance targets (Jensen, 1986). However, a well-functioning audit committee mitigates these conflicts by providing independent oversight and promoting transparent financial reporting. This study supports the findings that strong and proactive audit committees play a crucial role in monitoring how FCF is allocated, thus reducing the likelihood of earnings manipulation.

For example, Fatmala and Riharjo (2021) suggest that firms with well-functioning audit committees are less prone to manipulating earnings, particularly in the presence of high levels of FCF. Miko and Kamardin (2015) also discovered that greater participation of independent audit committee members is associated with a reduction in discretionary accruals, implying a mitigating effect on the relationship between FCF and EM. Chen, Chen, Lobo, and Wang (2022) support this view by demonstrating that audit committees possessing financial expertise are more capable of curbing earnings management, especially in firms with abundant free cash resources.

Zadeh et al. (2023) also found that underscore that effective audit committees enhance the reliability of financial reporting, which discourages managerial manipulation of earnings when cash reserves are substantial. Carcello, Hollingsworth, and Mast (2011) highlight the critical oversight role audit committees play in overseeing managerial discretion in the allocation of cash flows, ultimately reducing the opportunities for earnings management. Studies by Krishnan (2005) and Cohen et al. (2004) indicate that the strongest AC are related to improved accuracy of financial reports, which can further reduce management's motivation to manipulate earnings when free cash flow is available. Based on this phenomenon, this study proposes the following hypothesis.

H_5: The audit committee strengthens the negative relationship between free cash flow and earnings management.

2.6. The Moderating role of Audit Committee in the Relationship between Tax Avoidance and Earnings Management

Although tax avoidance may initially create opportunities for earnings management (EM), the presence of an effective audit committee (AC) has been found to reduce the strength of this association. Based on agency theory, managers might utilize tax avoidance strategies as a tool for manipulating earnings, which can lead to conflicts of interest between management and shareholders (Yuliastuti & Nurhayati, 2023). However, an active and independent audit committee plays a crucial role in overseeing managerial behavior, thus potentially limiting earnings manipulation linked to tax strategies (Ratu et al., 2023).

Desai and Dharmapala (2006) reported that firms with robust audit committees tend to avoid aggressive tax planning, which otherwise could facilitate EM practices. By the same token, Budiantoro et al. (2022) found that the effectiveness of audit committees substantially diminishes the positive effect of tax avoidance and EM, suggesting that proper oversight discourages opportunistic behavior. Ratu et al. (2023) further showed that firms with proactive audit committees are generally less involved in EM, particularly when engaging in tax-related activities.

Carcello et al. (2011) also emphasized the important role of audit committees in upholding ethical governance, which can further moderate the relationship between tax avoidance and EM. Liu, Chi, and Chu (2023) also provided evidence that companies with effective audit committee oversight tend to engage less in earnings manipulation through tax avoidance practices. These studies indicate that while tax avoidance may create opportunities for earnings management, a well-functioning audit committee can serve as an effective deterrent, thereby supporting transparent and reliable financial reporting.

H_6: The positive effect of tax avoidance on earnings management is weakened by the audit committee.

3. DATA, METHODOLOGY, AND ANALYSIS

The population in this study consists of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2023. The manufacturing sector was selected because it provides comprehensive and structured financial disclosures that are important for identifying earnings management practices. The complexity of accounting and the high transaction volume in this sector make it suitable for testing the research model (Permatasari, 2017; Susanto & Pradipta, 2020). Focusing on one sector also supports the consistency of data characteristics across companies (Siregar & Utama, 2008). In addition, this study uses data from 2023 to ensure comparability within the same regulatory and economic environment. According to Hidayat et al. (2022). The use of the latest data also allows the findings to reflect current reporting practices and governance conditions.

The sampling method utilized in this study is purposive sampling, with criteria encompassing manufacturing firms listed on the IDX in 2023 and those with complete data necessary for the analysis. The study employs multiple linear regression analysis to evaluate the influence of each independent variable on the dependent variable. Additionally, moderated regression analysis is applied to assess how moderating variables influence the interaction among independent and dependent variables.

3.1. Framework

Based on the theoretical background and previous empirical findings, the conceptual framework of this study is developed to illustrate the relationship between company growth, free cash flow, and tax avoidance on earnings management, with the audit committee acting as a moderating variable. The framework is presented in the following Figure 1.

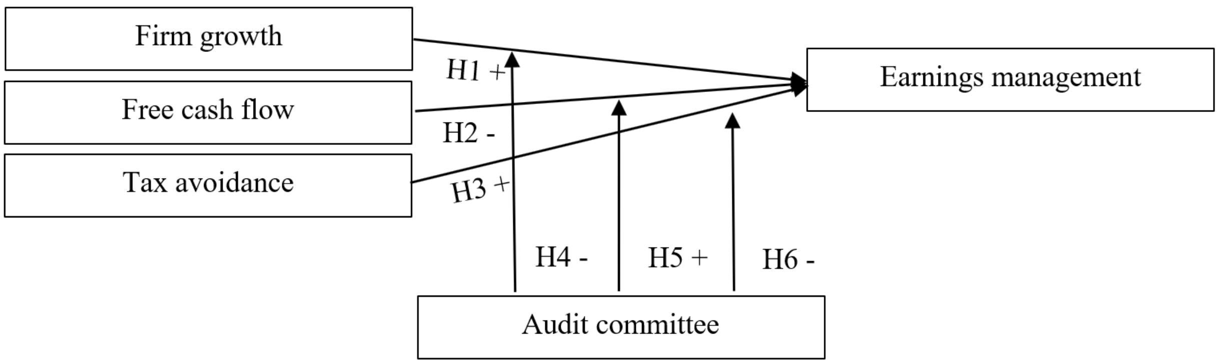

Figure 1. Research model.

Figure 1 illustrates the relationship between each independent variable (firm growth, free cash flow, and tax avoidance) and the dependent variable (earnings management), with the audit committee serving as a moderating variable.

3.2. Measurements

Earnings Management (DAC): As the dependent variable, it is defined as an accounting practice performed by managers through altering figures in financial statements with the aim of attracting investors and enhancing the company's reputation (Healy & Wahlen, 1999). The measurement of earnings management in this study uses discretionary accruals by subtracting operating cash flows from revenue. Earnings management is measured using the modified Jones model to estimate discretionary accruals, dividing total accruals into two components: non-discretionary accruals and discretionary accruals (Dechow, Sloan, & Sweeney, 1995).

Firm Growth (GRO): Firm growth refers to the improvement in financial performance or the size of a company, typically measured by year-on-year growth in sales or total assets.

Free Cash Flow (FCF): refers to the cash available to a company after making payments for operational expenses and investments in fixed assets. It reflects the company's capacity to fund its operational activities and investments without relying on external financing sources (Deloof, 2022).

Tax avoidance (TAX): refers to the use of strategies by companies to minimize their tax burden through legitimate tax planning, while potentially reducing tax liabilities significantly (Hanlon, Heitzman, & Shroff, 2020). In this study, tax avoidance is measured using the effective tax rate, which indicates the proportion of taxes paid relative to pre-tax income (Tijjani & Sani, 2016).

Audit Committee (KAI): A committee established by and accountable to the board of commissioners to assist in overseeing the financial reporting process, risk management, audit implementation, and corporate governance practices within the company. In this study, the audit committee variable is measured by the total number of meetings held in a year, divided by four. This aligns with the audit committee charter, which mandates that the committee must hold at least four meetings per year, or one meeting every three months.

Control Variables: This study includes three control variables. Profitability: The company's ability to generate profits, measured by ROE (Return on Equity). Leverage: The extent of debt used in corporate financing, measured by DER (Debt Equity Ratio). Firm Size: The size of a company is determined by the total value of its assets, measured by Ln=Total Assets.

4. RESULTS AND DISCUSSION

This study employs multiple linear regression and moderated regression analysis. Multiple linear regression is used to examine the direct effects of the independent variables on the dependent variable, while moderated regression analysis tests the interaction between the independent variables and the moderator.

Table 1 presents the descriptive statistical analysis, which illustrates the basic characteristics of the data set, providing informative details such as the minimum value, maximum value, mean, and standard deviation.

Table 1. Descriptive statistics.

Variables	N	Min.	Max.	Mean	SD
DAC	274	-0.580	0.760	-0.021	0.233
GRO	274	-0.900	3.090	0.019	0.380
FCF	274	-0.920	0.380	-0.007	0.128
TAX	274	-2.140	0.270	0.006	0.257
KAI	274	-1.340	12.410	-0.038	1.143
GRO_KAI	274	-2.800	1.590	-0.033	0.277
FCF_KAI	274	-0.300	0.670	0.014	0.082
TAX_KAI	274	-1.130	1.070	-0.001	0.168
ROE	274	-9.810	2.170	-0.009	0.652
DER	274	-0.930	116.210	0.134	7.229
SZE	274	-3.530	5.770	-0.158	1.840

Based on the outcome of the descriptive statistical test above, the average discretionary accrual is -0.0216, indicating it is relatively low. This suggests that company managers tend to delay revenue recognition or accelerate cost recognition, leading to lower and less aggressive earnings management. Such practices are often employed to prevent reporting excessively high profits or to ensure the long-term stability of the company's financial performance. The company's growth in Indonesia is also relatively low, at only 0.0198. This small growth indicates that the company did not experience significant expansion or improvement during the period. Meanwhile, free cash flow is only -0.0074, which means that the company tends to rely on debt to fund its operations. Fortunately, only a few manufacturing companies in Indonesia engage in tax avoidance, at a rate of 0.0062. However, the presence of an audit committee, which is recognized for increasing transparency in financial reports, does not have a significant effect. This suggests that the presence of an audit committee does not effectively reduce the occurrence of earnings management practices.

The regression model meets key statistical assumptions. The normality test with 274 samples produces a p-value of 0.055 ($p > 0.05$), indicating that the residuals are normally distributed. The multicollinearity test shows that all independent variables have tolerance values above 0.1 and VIF values below 10, confirming the absence of significant multicollinearity. The heteroscedasticity test results indicate significance values above 0.05 for all independent variables, ensuring that the assumption of homoscedasticity is met. Additionally, the DW value of 1.803 falls within the range of 1.5 to 2.5, suggesting no significant positive or negative autocorrelation. The F-test results ($F = 13.155$, $p = 0.000$) confirm that the regression model is statistically significant, demonstrating that the independent variables collectively influence the dependent variable. Thus, the regression model is valid for further analysis.

Table 2 presents the results of the t-test, which is used to examine the significance of the effect of each independent variable on the dependent variable in the regression model. Additionally, it is used to test the impact of the moderating variable in the interaction between the independent variables and the dependent variable.

Table 2. t-Test.

Model	t	Sig.
GRO	2.579	0.010
FCF	-7.118	0.000
TAX	-1.060	0.290
KAI	0.731	0.465
GRO_KAI	-1.855	0.065
FCF_KAI	2.179	0.239
TAX_KAI	-2.684	0.008

Note: Sig. <0.05.

The resulting regression model is:

$$DAC = -0.035 + 0.086\,GRO - 0.803\,FCF - 0.050\,TAX - 0.089 GRO\_KAI + 0.216\,FCF\_KAI - 0.196\,TAX\_KAI - 0.039\,ROE + 0.001\,DER - 0.006\,SZE + e$$

First, the test outcome indicates that the coefficient for the firm's growth variable (GRO) is 0.086, with a significance value of 0.010 ($p < 0.05$). This positive coefficient suggests that as company growth increases, earnings management tends to increase significantly. In line with agency theory, this behavior reflects managers' responses to the pressures experienced by growing companies in their efforts to maintain profitable performance in the eyes of shareholders. In such conditions, managers have the potential to take advantage of information asymmetry to carry out earnings management, with the aim of strengthening the company's positive image in the investor perspective, which is crucial to maintaining market confidence and stock price stability (Healy & Wahlen, 1999; Jensen & Meckling, 1976).On the other hand, positive accounting theory provides additional perspectives on this phenomenon, especially in terms of performance-based compensation structures. The existence of incentives in the form of bonuses linked to reported profits often encourages managers to choose accounting policies that can increase profit figures (Watts & Zimmerman, 1986). When companies grow rapidly, the opportunity to carry out earnings management also increases, along with managers' efforts to meet shareholder expectations while optimizing their bonuses (Edison & Nugroho, 2020). This result aligns with previous studies indicating that high growth firms tend to be more prone to earnings management to achieve certain financial targets (Levillain & Segrestin, 2019). Recent studies have reinforced these findings; Himeur et al. (2022) found that the level of company growth is positively correlated with the tendency to manage earnings, especially when managerial compensation is directly related to performance indicators. Another study by Dzulfikar and Firmansyah (2022) also showed that the relationship between company growth and earnings management practices is stronger in companies with aggressive growth strategies. Additionally, Naue et al. (2023) highlight that the presence of performance-based incentives exacerbates the tendency for earnings manipulation in growing firms.

Second, the coefficient for the FCF is -0.803, with a t-value of -7.118 and a significance level of 0.000 ($p < 0.05$). This significant negative coefficient indicates that free cash flow negatively affects earnings management, thereby supporting H2. Agency theory suggests that a potential divergence of interests exists among managers and shareholders. Managers, having substantial control over the company, may be motivated to engage in earnings management to achieve personal goals, such as securing bonuses or meeting profit targets (Astami, Rusmin, Hartadi, & Evans, 2017). However, with high FCF, the company has sufficient liquidity for operations and investments without needing to rely on external funding sources, so supervision of internal cash usage becomes tighter (Chen, 2004). Therefore, FCF should minimize the room for managers to manipulate earnings because they do not need to show better performance to obtain funds or meet profit targets (Meryana & Setiany, 2021). In this case, the negative effects of FCF and EM can be understood as outcomes of reduced agency conflict. In pecking order theory, significant negative results can also be explained. Pecking order theory states that companies prioritize utilizing internal funds (such as FCF) for financing before seeking external debt or equity, due to the high costs associated with information asymmetry in external financing (Shyam-Sunder & Myers, 1999). When companies have high FCF, they do not need to rely on external financing, which can trigger greater scrutiny and increase pressure to demonstrate solid financial performance. Accordingly, large FCF are more inclined to avoid EM practices to maintain transparent and reliable financial statements, given the reliance on internal funding sources and the risk aversion associated with external financing (Agustia, 2013; Jelanti, 2020; Muflihah, 2017). This also reduces the possibility of companies managing earnings aimed at maintaining good relations with investors or creditors.

Third, the test results show that the coefficient for tax avoidance (TAX) is -0.050, with a t-value of -1.060 and a significance level of 0.290 ($p > 0.05$). This outcome is contrary to the formulated hypothesis, so H3 is rejected. Consistent with agency theory, tax avoidance negatively impacts earnings management due to strong corporate governance (CG), which limits managerial opportunism and discourages earnings management practices. Additionally, managers may avoid tax avoidance practices that could lead to litigation risks. From the perspective of positive accounting theory, the average free cash flow and profit of the sample companies are low or even negative, resulting in low political costs because the company does not attract significant attention from the public or regulators. With low political costs, incentives to engage in tax avoidance tend to diminish. Managers may use accounting policies to enhance the perception of financial performance, such as accelerating revenue recognition, postponing expense recognition, or employing other strategies that improve the company's reputation from stakeholders' perspectives.

Fourth, the test results show that the interaction coefficient between company growth and the audit committee (GRO_KAI) is -0.089, with a t-value of -1.855 and a significance level of 0.065 ($p > 0.05$). This suggests that the audit committee does not have a significant effect in mitigating the impact of company growth on earnings management, leading to the rejection of H4. Consistent with agency theory, the audit committee functions as a governance mechanism to mitigate divergence of interests among managers and shareholders (Itan et al., 2024). When a company experiences growth, the pressure to demonstrate good performance often drives management to manage earnings to meet market expectations or maintain stock prices. The audit committee has not proven effective in mitigating the positive effect of company growth on earnings management. This is because rapid growth often entails aggressive expansion and strategic changes, requiring quick managerial decisions that may involve earnings management to achieve short-term performance targets or market expectations. Although the audit committee is tasked with ensuring transparency and the accurate recording of financial statements, they may not have direct control over the operational or strategic decisions underlying the growth. Additionally, the audit committee does not always participate in decision-making processes related to the company's growth strategy, allowing managers to engage in earnings management to achieve corporate goals. While the audit committee plays a vital supervisory role, it cannot always intervene in decisions driven by the company's growth requirements.

Fifth, the test results show that the interaction coefficient between free cash flow and the audit committee (FCF_KAI) is 0.151, with a t-value of 1.381 and a significance of 0.168 ($p > 0.05$). This indicates that the audit committee does not significantly influence the relationship between free cash flow and earnings management, leading to the rejection of H5. According to agency theory, free cash flow negatively influences earnings management because firms with high liquidity can fund operations and investments without external financing. However, tighter shareholder and creditor supervision in high-FCF firms reduces managerial discretion in managing earnings. Despite this, the audit committee's role in reinforcing this negative effect is not significant. Several factors may explain this finding. First, audit committees may lack the authority to influence strategic financial decisions. Second, some audit committees may serve a symbolic function without actively preventing earnings management. Third, firms with high FCF are generally financially stable and transparent, making additional oversight less impactful. Although in theory, audit committees should strengthen governance, their actual influence on the FCF-earnings management relationship is not significant. The results are in line with previous research conducted by Fatmala and Riharjo (2021), Toumeh et al. (2023), and Choiriah (2022).

Last, these results show that the audit committee can reduce earnings management caused by tax avoidance. With a significance value of 0.008, its influence on this relationship is strong. The audit committee acts as an effective monitoring mechanism, ensuring that tax avoidance strategies employed by the company are not exploited by managers to manipulate financial statements for opportunistic profit gains (Ratu et al., 2023). Tax avoidance is carried out to increase company profits because this strategy aims to decrease the tax burden that must be paid to the government (Shafai et al., 2018). By reducing tax expenses, companies can retain more funds as net income, ultimately enhancing their value in the eyes of shareholders. This is achieved by managers with bonus-based motivation, where higher net income can provide additional incentives for them (Taufiq, 2022). From an agency theory perspective, this creates a conflict of interest because managers tend to prioritize personal goals rather than the long-term interests of shareholders. The audit committee, as part of corporate governance, helps mitigate divergence of interests among managers and shareholders (Budiantoro et al., 2022). In the context of tax avoidance and earnings management, the audit committee serves as a crucial monitoring mechanism by (1) ensuring that financial reports reflect actual conditions, (2) setting limits on the application of tax avoidance, and (3) ensuring that managers are held accountable for every decision made.

5. CONCLUSION

The study reveals that company growth encourages earnings management, while higher free cash flow enhances financial transparency. Tax avoidance shows no significant effect, likely due to strong corporate governance (CG). The audit committee is crucial in restricting earnings management, especially concerning tax issues. The results highlight the critical role of a competent and independent audit committee in enhancing governance effectiveness and promoting adherence to regulatory standards. Companies should also design performance-based compensation with caution to align managerial incentives with shareholders' goals. Policymakers can improve transparent regulations, especially for emerging companies.

Although this study provides valuable insights, it does have some limitations. Relying on a narrowly defined sample may reduce the external validity of the study's conclusions, and reliance on quantitative data may not fully reflect the complexity of managerial decisions. The cross-sectional approach may overlook changes over time. Future research could explore several ways to build on these findings. Longitudinal studies could provide deeper insights into how the relationships among firm growth, free cash flow, tax avoidance, and earnings management evolve over time. Qualitative research could also help uncover the motivations underlying managers' decision-making processes regarding earnings management and tax avoidance. Furthermore, examining the impact of different industry characteristics on these relationships could yield valuable insights into how context influences managerial behavior. Finally, future research could explore the effectiveness of various corporate governance mechanisms beyond the audit committee, such as board diversity and shareholder activism, in mitigating earnings management practices.

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