

# Audit committee, real earnings management, and firm value: Evidence from Indonesia

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## ABSTRACT

This study investigates how audit committee effectiveness and real earnings management influence firm value by examining the mediating role of profitability and the moderating role of the debt-to-equity ratio (DER). Although prior studies have documented the direct effects of corporate governance and earnings management on firm value, limited evidence explains the underlying mechanism through which these relationships operate under different capital structure conditions. Using secondary data from 330 firm-year observations of Indonesian manufacturing companies during 2022–2024, this study employs Partial Least Squares Structural Equation Modeling (PLS-SEM), which is appropriate for simultaneously estimating multiple direct, mediating, and moderating relationships within a complex structural model. The results indicate that the audit committee improves firm value indirectly through profitability, whereas real earnings management negatively affects firm value. Furthermore, DER moderates these relationships, indicating that leverage alters the effectiveness of governance and profitability in enhancing firm value. Theoretically, this study extends Contingency Theory by demonstrating that capital structure conditions shape governance effectiveness. Methodologically, it illustrates the usefulness of PLS-SEM for simultaneously evaluating mediation and moderation effects in corporate governance research. From an accounting perspective, the findings provide evidence that governance quality, earnings management, and capital structure jointly influence firm value through financial performance.

**Keywords:** Audit committee, Debt-to-equity ratio, Firm value, Profitability, Real earnings management

**JEL Classification:** G32, G34, M41

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## 1. Introduction

Financial reporting integrity and earnings quality are key pillars in maintaining information transparency in the capital market. One major challenge in accounting reporting is the practice of real earnings management (REM), which involves manipulating operational activities, such as overproducing or cutting discretionary costs, to achieve specific profit targets (Rakhmawati et al., 2024; Yuniarsih & Permatasari, 2022). Unlike accrual earnings management, REM has a more destructive impact because it directly compromises cash flow and long-term operational efficiency, thereby reducing the credibility of financial reports in investors' eyes (Simamora et al., 2022). Therefore, effective accounting oversight

through the audit committee is crucial as a monitoring mechanism to mitigate such opportunistic managerial behavior.

Based on agency theory, the audit committee functions to reduce information asymmetry and minimize conflicts between managers and shareholders (Arfamaini & Soewarno, 2022; Jensen & Meckling, 1976). Although many studies demonstrate the positive role of audit committee, the current literature still shows conflicting results. Some studies find that strong audit committee directly increases market value, but others show that the effectiveness of this oversight is often hampered or even irrelevant under certain financial stress conditions (Aggianti & Novita, 2024; Damayanti et al., 2023).

These inconsistent empirical findings (unresolved) suggest the existence of an incompletely explained “offers insights into the underlying mechanism” mechanism for how governance oversight is transmitted to a company’s market value.

This study aims to uncover this mechanism by proposing a causal pathway through profitability as a mediator and the debt-to-equity ratio (DER) as a moderator. In accordance with signaling theory, profitability is the primary channel for sending credible signals to the market about the quality of internal governance and corporate efficiency (Spence, 1973). Quality audit committee is expected to initially improve operational performance, which is then positively reflected in market value (Afsari et al., 2025). However, this transmission pathway is not universal. Using contingency theory, this study argues that the effectiveness of monitoring and the strength of profitability signals are highly dependent on contingent factors such as capital structure (Donaldson, 1996). High leverage can trigger agency risk and create debt covenants that limit managerial flexibility and audit committees’ oversight independence (Chandra et al., 2021; Jamaludin, 2025).

The novelty of this study lies in its integrative examination of the “threshold flip” phenomenon, which is the change in direction and strength of governance influence due to extreme debt pressure. Using manufacturing sector data from 2022- 2024, this study tests contingency theory to demonstrate that capital structure (DER) is a contingent factor determining the effectiveness of governance oversight. The focus of this research is the threshold-flip phenomenon, in which high debt pressure reverses the direction of the audit committee’s (AC) influence on firm value (Tobin’s Q).

This research contributes to understanding the dynamics of corporate governance and firm value on the IDX during the 2022-2024 period, hopefully answering the “offers insights into the underlying mechanism” of the relationship between the audit committee, real earnings management, and firm value. The author presents this research systematically, with the next section covering the literature review and methods, followed by the results section, a discussion of the research results, and concluding with conclusions, future research, and recommendations.

## 2. Theoretical Framework and Hypotheses Development

### Theoretical Framework and Integrative Architecture

The research framework, as shown in Figure 1, integrates three main theories to comprehensively explain the dynamics of firm value. Agency theory (Jensen & Meckling, 1976) underpins the direct influence relationship, in which the audit committee serves as a monitoring mechanism to reduce agency costs and mitigate managers’ opportunistic actions, including real earnings management (REM). Furthermore, signaling theory (Spence, 1973) explains the mediating mechanism: profitability serves as a credible signal to the market regarding the effectiveness of internal governance and the quality of a company’s earnings. Finally, contingency theory (Donaldson, 1996) is used to explain the moderating role, arguing that monitoring effectiveness and the strength of profitability signals are not universal

but depend on contingent factors such as capital structure (DER). This integration addresses theoretical fragmentation by clearly mapping the flow of supervision that improves fundamentals (agency), which is then positively responded to by the market (signaling). However, its effectiveness is limited by the pressure of the debt burden (Contingency).

## Literature Synthesis and Research Gaps

A review of previous studies reveals unresolved issues regarding the role of oversight in mitigating REM. While studies by [Arfamaini & Soewarno \(2022\)](#) and [Damayanti et al. \(2023\)](#) found that strong audit committee increases firm value, there are contradictions in that such oversight often loses its effectiveness when firms face extreme financial stress or debt covenant constraints ([Aggianti & Novita, 2024](#); [Chandra et al., 2021](#)). The current literature largely summarizes the findings without explaining the “offers insights into the underlying mechanism” causal mechanisms. This study addresses this gap by using the theory, contradiction, and gap path to demonstrate that capital structure is a threshold-flip factor that shifts governance effectiveness from positive to negative.

## Hypothesis Development

### Audit committee, real earnings management profitability, and firm value

Firm value is the perception of investors and the capital market regarding a company's ability to create long-term economic wealth, reflecting its growth prospects, profitability, and overall operational risk. This concept is based on the total market value of financial claims (debt + equity), where management's primary objective is to maximize firm value to enhance shareholder wealth through high stock prices and stable dividends. In the Indonesian context, firm value is often measured using ratios such as Tobin's Q (market value + debt)/book value of assets) or price to book value (PBV = share price/book value per share), which indicate how much the market values a company's assets relative to their book value ([Lim & Mali, 2024](#)).

An audit committee is a committee formed by the board of commissioners of a public company in Indonesia, responsible for overseeing financial reporting, the effectiveness of internal controls, the independence of internal/external auditors, and the implementation of GCG in accordance with POJK 55/POJK.04/2015, with the following main characteristics: independence e"50 percent, a size of 3-5 members (the majority of commissioners are independent), financial expertise, and meetings at least 4 times/year. Agency theory explains the audit committee as an independent monitoring mechanism that minimizes manager-shareholder conflicts by reducing information asymmetry through reporting oversight and preventing earnings management, thereby increasing firm value. Effective characteristics (high independence, optimal size, accounting expertise) increase transparency and investor confidence. That is supported by research ([Arfamaini & Soewarno, 2022](#)) which found a significant impact on PBV, either directly or indirectly through increased profitability ([Al-Jalahma, 2022](#)).

Real earnings management refers to manipulating operational activities to influence profits, as measured by abnormal CFO (cash flow operations), abnormal production costs, and abnormal discretionary expenses. That differs from accounting manipulation, as it sacrifices long-term efficiency ([Rakhmawati et al., 2024](#); [Simamora et al., 2022](#)). Real earnings management negatively impacts firm value because overproduction leads to obsolescence, cuts in discretionary expenses (R&D/advertising) reduce future innovation, and abnormal CFO triggers stock volatility, affecting firm value in emerging markets. Research [Simamora et al. \(2022\)](#) shows that real earnings management increases agency costs and lowers valuations, and that the detection of debt covenants exacerbates this. Signaling theory

supports this, where investors punish real earnings management as an indication of managerial opportunism (Al-Shouha et al., 2024).

Profitability is a company's ability to generate profits from assets/equity. It can be proxied by ROA (net profit/total assets) or ROE (net profit/equity). It reflects operational efficiency and signals stability for investors (Ayu et al., 2025). Positive profitability drives firm value as a key signal of stable profit generation, reduces the cost of capital, and consequently improves the company's profitability. That is supported by signaling theory, which explains that high ROE provides investors with confidence in future cash flows, a phenomenon consistent across the property and manufacturing sectors. In the context of Indonesian companies, ROA can significantly mediate the relationship between governance and firm value (Kalbuana et al., 2022).

### Direct influence and monitoring mechanisms (Agency theory Perspective)

Based on agency theory, independent oversight by the audit committee ensures the integrity of financial reporting and the effectiveness of internal controls. This oversight directly limits the scope for operational manipulation by managers, thereby increasing investor confidence. Conversely, REM practices such as overproduction or R&D cost cuts create long-term inefficiencies that directly damage the economic value and credibility of financial reports.

H<sub>1</sub>: Audit committees have a positive effect on firm value.

H<sub>2</sub>: Real earnings management has a negative effect on firm value.

H<sub>3</sub>: Profitability has a positive effect on firm value.

### Audit committee, real earnings management and profitability

Audit committees influence company profitability through independent oversight that ensures the integrity of financial reporting, the effectiveness of internal controls, and the prevention of managerial fraud, in accordance with agency theory, which emphasizes monitoring to reduce agency costs and increase operational efficiency (Arfamaini & Soewarno, 2022; Pamungkas & Waspodo, 2024). In the digital era, audit committees are adapting by monitoring cyber risks, leveraging big data analytics for real-time anomaly detection, and using AI-driven fraud detection, thereby optimizing digital resource allocation and reducing opportunity costs. That is supported by agency theory, which views audit committees as independent monitors that minimize principal-agent conflicts by ensuring accurate reporting, risk management, and regulatory compliance. Therefore, the digital era amplifies the role of audit committees as strategic enablers of profit growth (Afsari et al., 2025).

Real earnings management impacts corporate profitability because managers manipulate real operating activities, overproduce to increase gross profit margins, or aggressively sell assets to meet short-term profit targets, even though this incurs long-term economic costs such as lost innovation and reduced real operating cash flow, which undermines sustainable profitability (Yuniarsih & Permatasari, 2022). In the digital era, the negative impact of REM is exacerbated because big data analytics, AI, and block chain technologies enable real-time anomaly detection by investors and auditors, accelerating market penalties in the form of increased capital costs and decreased stock valuations. Empirical studies such as Roychowdhury (2006)—often cited in Indonesian research—show that REM weakens the relevance of profitability to company valuation, with negative outcomes on earnings quality.

H<sub>4</sub>: Audit committees have a positive effect on profitability.

H<sub>5</sub>: Real earnings management has a negative effect on profitability.

### **Mediating role of profitability**

Profitability plays a key role in the transmission mechanism by which corporate governance influences firm value, as supported by the empirical findings of [Afsari et al. \(2025\)](#) who found that intermediary financial performance mediated the effects of internal company factors. Specifically, an audit committee with strong oversight improves financial reporting quality and regulatory compliance ([Siahaan et al., 2024](#)), thereby increasing profitability, which in turn boosts firm value through operational efficiency and investor confidence. Conversely, opportunistic real earnings management undermines the integrity of financial statements by manipulating cash flows or discretionary spending, sustainably reducing profitability and ultimately depressing firm value due to litigation risk and loss of legitimacy. Thus, profitability bridges this causal pathway, emphasizing the importance of governance oversight to maximize firm value.

### **Mediated transmission paths (Signal theory perspective)**

The causal pathway indicates that audit committee affects profitability before impacting market value. That occurs because audit committees focus on operational efficiency and real-time anomaly detection. Improved operational performance (profitability) then becomes a strong signal that the market responds to with rising stock prices. Conversely, REM first undermines a company's fundamental profitability, which the market then interprets as a negative signal (opportunism signal) that lowers valuations.

H<sub>6</sub>: Audit committees have a positive effect on firm value through profitability.

H<sub>7</sub>: Real earnings management has a negative effect on firm value through profitability.

### **Moderating role of debt-to-equity ratio**

The debt-to-equity ratio (DER) serves as an important moderating variable in altering the influence of governance and financial performance on firm value, consistent with [Widagdo et al. \(2020\)](#), who found that high leverage increases agency costs in Indonesian and Asian companies. Specifically, DER weakens the audit committee's positive effect on firm value because debt pressure reduces the committee's independence from oversight. Conversely, DER strengthens the positive relationship between profitability and firm value because high earnings with elevated leverage signal superior financial credibility. Finally, DER amplifies the negative effect of real earnings management on firm value by increasing detection and sanction risks in a high-leverage environment. Therefore, high debt can reverse the situation, where leverage (ext REM) amplifies agency risk and limits managerial flexibility due to debt covenants.

### **Leverage contingency factor (Contingency theory perspective)**

Debt distress (DER) affects governance effectiveness because debt covenants limit managerial flexibility and reduce the independence of audit committee oversight. At extreme levels of leverage, audit committee becomes less effective at mitigating REM because managers are encouraged to manipulate financial statements to avoid debt covenant violations. However, under high-leverage conditions, stable earnings actually signal greater financial credibility in the eyes of investors.

H<sub>8</sub>: Debt-to-equity ratio weakens the audit committee's influence on firm value.

H<sub>9</sub>: Debt-to-equity ratio strengthens the influence of profitability on firm value.

H<sub>10</sub>: Debt-to-equity ratio strengthens the influence of real earnings management on firm value.

Table 1. Variable measurements

| Variable                 | Proxy     | Formula                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Source                             | Expected Sign |
|--------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------|
| Firm value               | Tobin's Q | (Market Value + Total Debt) / Total Assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Santosa et al. (2022)              | (+)           |
| Profitability            | ROA       | Net Income/Total Assets                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Hutabarat (2024)                   | (+)           |
| Real earnings management | REM       | <p>Combined Abnormal CFO, Production, &amp; Discr.</p> <p>- <i>Abnormal cash flow operations</i> = Operating cash flow at company i in year t / Total assets at the end of the period at company i in year t-1 = <math>\alpha_0 + \alpha_1 (1 / \text{Total assets at the end of the period at company i in year t-1}) + \alpha_2 (\text{Net sales at company i in year t} / \text{Total assets at the end of the period at company i in year t-1}) + \alpha_3 (\text{Net sales at company i in year t minus net sales at company i in year t-1} / \text{Total assets at the end of the period at company i in year t-1}) + \varepsilon_{it}</math></p> <p>- <i>Abnormal discretionary expenses</i> = Discretionary expenses at company i in year t / Total assets at the end of the period of company i in year t-1 = <math>\alpha_0 + \alpha_1 (1 / \text{Total assets at the end of the period of company i in year t-1}) + \alpha_2 (\text{Net sales at company i in year t} / \text{Total assets at the end of the period of company i in year t-1}) + \varepsilon_{it}</math></p> <p>- <i>Abnormal production costs</i> = Sum of cost of goods sold and changes in inventory at company i in year t / Total assets at the end of the period of company i in year t-1 = <math>\alpha_0 + \alpha_1 (1 / \text{Total assets at the end of the period of company i in year t-1}) + \alpha_2 (\text{Net sales at company i in year t} / \text{Total assets at the end of the period of company i in year t-1}) + \alpha_3 (\text{Net sales of company i in year t minus net sales of company i in year t-1} / \text{Total assets at the end of the period of company i in year t-1}) + \alpha_4 (\text{Net sales of company i in year t-1 minus net sales of company i in year t-2} / \text{Total assets at the end of the period of company i in year t-1}) + \varepsilon_{it}</math></p> | Roychowdhury (2006)                | (-)           |
| Audit committee          | AC        | Number of Audit Committee Members                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Santosa et al. (2022)              | (+)           |
| Debt-to-equity ratio     | DER       | Total Debt / Total Equity                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Khalifaturofi'ah & Setiawan (2024) | (+/-)         |



### 3. Methodology

This research is a quantitative explanatory study that empirically tests mediation and moderation models. The role of intervening/mediating variables and interactions is examined to provide a more comprehensive picture of the structure of relationships between constructs within the developed research model. PLS-SEM was selected because the proposed research model simultaneously estimates multiple direct, indirect (mediation), and interaction (moderation) effects within a single structural framework. The method is prediction-oriented and is suitable for evaluating complex causal relationships while maximizing the explained variance of the endogenous constructs. To provide operational clarity in testing the structural equation modeling (SEM) model, the variables in this study are classified according to their respective roles: Firm Value (Tobin's Q) as the dependent variable (Y), Audit Committee (AC) and Real Earnings Management (REM) as the independent variables (X), Profitability (ROA) as the mediating variable (Z), and the Debt-to-Equity Ratio (DER) as the moderating variable (M).

This study uses secondary data, namely data related to variables from the financial statements of 110 manufacturing companies, using a purposive sampling approach, for three years (2022-2024). The criteria applied include the availability of information on firm value, profitability, debt-to-equity ratio, audit committee, and real earnings management, as well as being listed on the Indonesia Stock Exchange ([www.idx.co.id](http://www.idx.co.id)), using the Rupiah as the currency for their financial statements, consistently publishing financial statements during the study period, having a financial statement closing date of December 31, consistently earning profit after tax, and consistently earning positive equity. The number of observations (N) in this study is 330, reflecting the number of manufacturing companies and the three-year observation period that meet the inclusion criteria. Next, the measurement of each variable is as follows and shown in Table 1.

This study uses a quantitative approach based on structural modeling, specifically Structural equation modeling (SEM), with the Partial least squares (PLS) estimation technique, version 4. Inner model testing includes R<sup>2</sup> analysis (Hair et al., 2019) and Adjusted R<sup>2</sup> (adjusted for predictors), Q<sup>2</sup> predictive relevance via blindfolding, Goodness of Fit (GoF) overall suitability and one-tailed bootstrapping for the hypothesis (significant if  $t > 1.645$ ,  $p < 0.05$ ) (Hair et al., 2021). The empirical model of this study is expressed in two equations (Eq. 1 and Eq. 2).

$$ROA = \beta_1 AC - \beta_2 REM + \epsilon_1 \quad (\text{Eq. 1})$$

$$\text{Tobin's Q} = \beta_3 AC - \beta_4 REM + \beta_5 ROA - \beta_6 (DER \times AC) + \beta_7 (DER \times ROA) - \beta_8 (DER \times REM) + \epsilon_2 \quad (\text{Eq. 2})$$

### 4. Results

Table 2 presents the descriptive statistics of the study variables. The results indicate that most sample firms comply with the minimum regulatory requirements for the Audit Committee (AC). In addition, the substantial variation in Tobin's Q and Debt-to-Equity Ratio (DER) suggests considerable heterogeneity in firm value and capital structure among manufacturing companies during the observation period.

**Table 2.** Descriptive statistics

| Variable                 | N   | Min     | Max     | Mean   | Std. Dev. |
|--------------------------|-----|---------|---------|--------|-----------|
| Audit committee          | 330 | 2.000   | 5.000   | 3.027  | 0.285     |
| Real earnings management | 330 | -63.183 | 33.209  | 0.000  | 13.080    |
| Profitability            | 330 | 0.001   | 0.332   | 0.078  | 0.063     |
| Debt to equity ratio     | 330 | 0.034   | 104.416 | 0.838  | 101.910   |
| Firm Value               | 330 | 0.002   | 448.570 | 19.248 | 40.978    |

**Table 3.** R-square analysis and predictive relevance

| Variable      | R-square | R-square adjusted | Q <sup>2</sup> predict | RMSE  | MAE   |
|---------------|----------|-------------------|------------------------|-------|-------|
| Profitability | 0.479    | 0.475             | 0.470                  | 0.465 | 0.349 |
| Firm Value    | 0.819    | 0.815             | 0.637                  | 0.682 | 0.340 |

Based on Table 3, the R-square ( $R^2$ ) values indicate the explanatory power of the structural model for the endogenous constructs. The results suggest that the model explains a substantial proportion of the variance in Firm Value (Tobin's Q), while exhibiting a comparatively lower explanatory power for Profitability (ROA). Furthermore, the positive  $Q^2$  values for both endogenous variables indicate that the model possesses predictive relevance. The higher  $Q^2$  value for Tobin's Q suggests greater out-of-sample predictive capability for firm value than for profitability. Consistent with the PLS-Predict results, the relatively low RMSE and MAE values further indicate satisfactory predictive accuracy, supporting the model's capability to explain the relationships among the study variables.

**Table 4.** Effect size

| Path                                     | f-square | Description |
|------------------------------------------|----------|-------------|
| Audit committee → Profitability          | 0.155    | Moderate    |
| Audit committee → Firm Value             | 0.172    | Moderate    |
| Real earnings management → Profitability | 0.362    | Strong      |
| Real earnings management → Firm Value    | 0.159    | Moderate    |
| Profitability → Firm Value               | 0.354    | Strong      |

Based on Table 4, the effect size analysis indicates that Real Earnings Management (REM) and Profitability (ROA) exhibit the strongest contributions to the structural model, as reflected by their large effect sizes. In contrast, the Audit Committee (AC) demonstrates a moderate effect on both profitability and firm value. These findings suggest that, although governance oversight through the audit committee contributes to corporate performance, variations in firm value are more strongly influenced by operational earnings management practices and the firm's underlying financial performance.

**Table 5.** Goodness of fit

|      | Saturated Model | Estimated Model |
|------|-----------------|-----------------|
| SRMR | 0.062           | 0.062           |
| NFI  | 0.907           | 0.907           |

The model fit assessment presented in Table 5 indicates that the SRMR values for both the saturated and estimated models are below the recommended threshold of 0.08, suggesting a good fit between the proposed model and the observed data. In addition, the NFI value indicates an acceptable overall model fit. Collectively, these fit indices suggest that the PLS-SEM model is adequately specified and appropriate for testing the proposed relationships among the Audit Committee (AC), Real Earnings Management (REM), Debt-to-Equity Ratio (DER), Profitability (ROA), and Firm Value (Tobin's Q).

Figure 2 presents the structural model illustrating the relationships among the Audit Committee (AC), Real Earnings Management (REM), Profitability (ROA), Debt-to-Equity Ratio (DER), and Firm Value (Tobin's Q). The model indicates that ROA serves as a mediating mechanism through which



the Audit Committee and REM influence firm value. Furthermore, the interaction effects involving DER suggest that capital structure moderates the relationships among the study variables, providing empirical support for the proposed threshold flip phenomenon in capital structure.

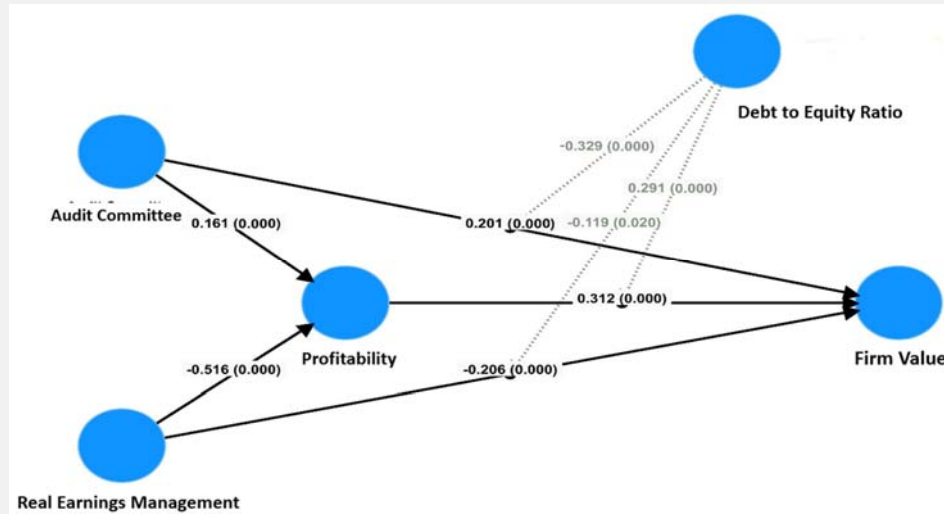


Figure 2. Inner model

$$ROA = 0.161AC + 0.516REM + \varepsilon_1 \quad (\text{Eq. 1})$$

$$\text{Tobin's } Q = 0.201.AC + 0.206.REM + 0.312.ROA + 0.329.(DER \times AC) + 0.291(DER \times ROA) - 0.119(DER \times REM) + \varepsilon_2$$

Table 7. Hypothesis test

| Path                                                         | Original sample | Sample mean | T statistics | P values |
|--------------------------------------------------------------|-----------------|-------------|--------------|----------|
| <i>Direct effect</i>                                         |                 |             |              |          |
| Audit committee → Profitability                              | 0.161           | -0.162      | 2.355        | 0.000    |
| Audit committee → Firm Value                                 | 0.201           | 0.205       | 4.059        | 0.000    |
| Real earnings management → Profitability                     | -0.516          | -0.513      | 10.044       | 0.000    |
| Real earnings management → Firm Value                        | -0.206          | -0.219      | 4.096        | 0.000    |
| Profitability → Firm Value                                   | 0.312           | 0.317       | 4.605        | 0.000    |
| <i>Indirect effect</i>                                       |                 |             |              |          |
| Audit committee → Profitability → Firm Value                 | 0.119           | 0.120       | 4.216        | 0.000    |
| Real earnings management → Profitability → Firm Value        | -0.161          | -0.161      | 5.136        | 0.000    |
| <i>Moderating effect</i>                                     |                 |             |              |          |
| Debt to equity ratio * Audit committee → Firm Value          | -0.329          | -0.313      | 4.520        | 0.000    |
| Debt to equity ratio * Profitability → Firm Value            | 0.291           | 0.250       | 3.063        | 0.000    |
| Debt to equity ratio * Real earnings management → Firm Value | -0.119          | -0.110      | 2.020        | 0.020    |

The hypothesis test results in Table 7 confirm that all direct influence paths are in the direction consistent with the proposed theory and are statistically significant. Audit committee (AC) oversight has been shown to improve a company's financial performance and market value effectively. Conversely, real earnings management (REM) practices are a value-destroying factor, both directly and through reduced profitability. Furthermore, the results of the moderation test support the threshold-flip phenomenon, whereby debt pressure (DER) significantly weakens the audit committee's effectiveness but increases the importance of profitability signals to investors.

## **5. Discussion**

This study provides empirical evidence on the transmission mechanism explaining how governance and managerial practices translate into market value in manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2022- 2024. The test results indicate that the audit committee (AC) has a significant positive effect on firm value (as measured by Tobin's Q). Theoretical interpretation through the lens of agency theory suggests that the AC serves as an effective monitoring mechanism to reduce agency costs and ensure transparency in financial reporting, thereby increasing investor confidence. This finding aligns with research by [Arfamaini & Soewarno \(2022\)](#), which found a significant impact of the AC on firm value, and supports [Al-Jalahma \(2022\)](#) argument that audit committee characteristics strengthen firm performance.

Furthermore, the audit committee was found to have a positive effect on profitability (ROA). That suggests that independent oversight ensures reporting integrity and the effectiveness of internal controls in daily operations, thus optimizing financial performance. These results support the findings of [Pamungkas & Waspodo \(2024\)](#) who stated that audit committee effectiveness plays a vital role in increasing profitability by reducing the opportunity for managerial fraud. Simultaneously, profitability was shown to have a significant positive effect on firm value. Economically, stable earnings serve as a strong signal to the market about a company's operational efficiency, consistent with [Ayu et al. \(2025\)](#) who find that profitability provides investors with confidence in future cash flows.

Conversely, real earnings management (REM) has been shown to have a significant negative impact on firm value and profitability. Operational manipulation practices, such as overproduction or discretionary cost-cutting, create long-term inefficiencies that undermine economic value and the credibility of financial statements. This finding supports the research of [Simamora et al. \(2022\)](#), which states that the market punishes managerial opportunism because REM increases operational risk and lowers valuations. This finding also aligns with the study by [Al-Shouha et al. \(2024\)](#) which shows that investors tend to penalize companies found to be engaging in earnings management.

Regarding the mediation mechanism, the results of this study indicate that profitability partially mediates the effect. Profitability is shown to significantly mediate the positive effect of the audit committee on firm value and the negative effect of REM on firm value. That suggests that ROA is not simply a result, but rather a vital transmission channel; Investors do not respond to governance structures in the abstract, but rather to tangible outcomes in the form of earnings quality generated by such oversight. This mediation finding reinforces research by [Afsari et al. \(2025\)](#) and [Kalbuana et al. \(2022\)](#), which finds that financial performance is a crucial intermediary linking internal company factors to market value.

A crucial point is the identification of the threshold flip phenomenon through the moderating role of the debt-to-equity ratio (DER). The study found that DER significantly weakens the positive influence of the audit committee on firm value. Pressure from debt covenants at high debt levels tends to limit managerial flexibility and reduce the audit committee's oversight independence, thus reducing governance effectiveness. This finding aligns with the study by [Widagdo et al. \(2020\)](#) which found that high leverage increases agency costs and hinders the role of governance in Asian manufacturing

companies. Conversely, DER actually strengthens the positive influence of profitability on firm value. Under high-debt conditions, a company's ability to maintain profitability signals much stronger financial credibility in the eyes of investors than companies with low debt. This phenomenon offers a new perspective that supports [Chandra et al. \(2021\)](#) argument that capital structure dynamics are a contingency factor.

Finally, DER was shown to amplify REM's negative impact on firm value. The risk of market detection and sanctions for earnings manipulation becomes significantly greater in a highly leveraged environment, further depressing firm valuations. This finding offers a different perspective from traditional studies and aligns with research by [Aggianti & Novita \(2024\)](#) which shows that internal monitoring is not always able to stem the destructive impact of REM when contingency factors such as debt burden begin to dominate. Overall, these results confirm Contingency Theory, which suggests that monitoring effectiveness is dynamic and highly dependent on a firm's capital structure.

## **6. Conclusion**

Based on an analysis of 110 manufacturing companies during the 2022- 2024 period, this research concludes that audit committee and profitability (ROA) have a significant positive influence on firm value. On the other hand, real earnings management has been shown to have a significant negative impact on the company's market value. The research results also show that ROA serves as a successful mediating channel for transmitting the influence of supervision and earnings manipulation practices on firm value. The key findings in this study confirm that capital structure (DER) is a vital contingency factor; DER moderates all the main relationships in the model by weakening the effectiveness of audit committee supervision, while at the same time strengthening the ROA signal and exacerbating the damaging impact of REM on firm value. This research provides additional empirical evidence for the development of contingency theory by demonstrating that governance effectiveness is not universal, but rather depends on a company's capital structure. Furthermore, this study offers insights into the audit committee's oversight mechanism for firm value through the ROA transmission channel in emerging markets. Using an integrative structural modelling (PLS-SEM) approach, this research attempts to map the complex interactions between mediation and moderation simultaneously. This approach provides a complementary perspective to traditional regression models in identifying the threshold flip phenomenon. These findings indicate to regulators the importance of integrating debt threshold risk analysis (DER) into issuer supervision. For manufacturing company management, these results emphasize that avoiding REM practices is key to maintaining investor confidence, especially under high leverage conditions.

The authors acknowledge that this study has several methodological limitations that should be considered when interpreting its results: (1) This study is limited to the manufacturing sector on the Indonesia Stock Exchange with a relatively short observation period (2022-2024), so generalizing the results to other industrial sectors should be done with caution; (2) Using a single proxy for governance variables (number of AC members) and firm value may not fully capture the dimensions of supervisory quality and market perception; (3) This model does not fully explore endogeneity issues or include other external control variables (such as firm size or age) that may influence the model's dynamics.

Future research is encouraged to incorporate more comprehensive corporate governance proxies, such as the financial expertise, meeting frequency, and independence of audit committee members, to provide a deeper understanding of governance effectiveness. Additionally, extending the analysis beyond the manufacturing sector would help assess whether the threshold flip phenomenon is consistent across different industries. Finally, future studies should employ longer longitudinal datasets to better capture the dynamic changes and potential threshold effects of the debt-to-equity ratio over time.

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