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Information Asymmetry and Audit Tenure on Earnings Management

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ABSTRACT

This study aims to determine the effect of information asymmetry and audit tenure on earnings management. Manufacturing companies in the food and beverage sub-sector listed on the Indonesia Stock Exchange from 2019 to 2023 were selected as the population in this study, consisting of 30 companies, using purposive sampling, resulting in a sample of 16 companies. The data analysis method used in this study is multiple linear regression. The data sources are secondary data, and the data collection technique uses the documentation method. This study uses agency theory to explain information asymmetry and audit tenure on profit management. The results indicate that information asymmetry significantly influences profit management, while audit tenure does not influence profit management.

Keywords- Information Asymmetry, Audit Tenure, Earning Management

INTRODUCTION

Financial statements are the final result of the accounting process used as a basis for management accountability in decision-making related to investments. They are crucial because auditors are responsible to stakeholders for ensuring the accuracy of financial statements. This information is also useful for parties outside the company, such as investors, creditors, and other interested parties. The parameters used to measure management performance in financial statements are profit information contained in the income statement (Hastuti, Arfan, and Yosi, 2018).

Profit management arises due to agency problems that occur because of a misalignment between shareholders (principals) and management (agents). Principals aim to improve their welfare through increasing profitability, while agents are motivated to maximise their economic needs and strive to achieve performance targets for compensation, bonuses, and other specific interests (Scott, 2015). This misalignment gives rise to information asymmetry, a condition where there is an imbalance of information between the principal and the agent, with the agent possessing more information about the company's internal affairs than the principal, thereby facilitating the agent's ability to engage in earnings management (Wiryadi and Sebrina, 2013).

In accordance with agency theory, the existence of information asymmetry can encourage agents as information providers to engage in moral hazard (agents abuse trust) and adverse selection (selection of inappropriate agents due to incomplete information). High information asymmetry increases the likelihood of management manipulating financial information due to a lack of transparency and openness (Nyoman and Suputra, 2016).

Agency theory implies the existence of information asymmetry between managers as agents and owners (in this case, shareholders) as principals. This asymmetry arises when managers have more knowledge about internal information and the company's future prospects than shareholders and stakeholders (Sairin, 2022). This condition provides an opportunity for management to use the information they possess to manipulate the company's finances in order to maximise their own prosperity. The more information managers have about the company, the more opportunities they have to engage in earnings management (Mahawyathrti and Budiashi, 2016; Suwarno et al, 2020).

An auditor is a third party who is considered capable of mediating differences in interests between management and other parties with an interest in financial statements. Auditors are tasked with examining and providing opinions on financial statements produced by companies based on applicable standards. Financial statements that have been audited by a professional independent auditor will have a high level of trust and value in terms of the quality of the financial statements compared to financial statements that have not been audited beforehand. Audited financial statements will foster trust in their quality by external parties of the company such as investors, creditors, and other interested parties (Udayana, 2017).

The audit engagement period, or audit tenure, which involves a long-term relationship with the client company, promotes the development of good business knowledge, enabling auditors to design and implement the most appropriate and effective audit programmes, thereby producing high-quality audit reports. However, an audit tenure that is too long can affect an auditor's independence (Wicaksono and Purwanto, 2021). A long audit tenure can lead to excessive familiarity between the auditor and the client. The case of Enron Corporation, which went bankrupt despite receiving a favourable opinion from its auditors, demonstrates that an overly long engagement period can result in emotional closeness between the client and the auditor, ultimately leading to the loss of the auditor's independence (Himawan, 2017).

Indonesian Regulation No. 20 of 2015 refers to Government Regulation (PP) No. 20 of 2015 concerning Public Accountant Practices. The provision of general audit services on public company reports by Public Accounting Firms (KAP) regarding audit service restrictions limits an auditor to a maximum of 5 (five) consecutive years in providing audit services to a client and will be allowed to provide audit services again after 2 (two) consecutive financial years without providing such services. This limitation on the audit engagement period is considered crucial for both internal and external stakeholders to maintain the auditor's independence in performing their duties, ensuring that the auditor does not favour the client when issuing their opinion (Sari et al., 2019). The longer the audit engagement period, the more the auditor's independence diminishes due to their closeness to the client (Oyedokun, 2016).

Therefore, it can be concluded that audit tenure is the auditor's commitment to the client for a specific period of time to audit the company's financial statements (client). The implementation of regulations regarding audit tenure restrictions requires public accounting firms to prepare their auditors to undertake assignments with new clients. This will have an impact on the amount of audit start-up costs used to study the company's conditions and plan and determine appropriate and precise audit procedures for new clients (Wicaksono and Purwanto, 2021; Sa'adah and Challen, 2022). To address this, some companies tend to provide initial information about the company's conditions to the auditors, with the expectation that this initial information will be used as a reference for the auditors to audit the client company. Therefore, this becomes a factor in the emergence of high information asymmetry at the beginning of the audit engagement.

A. Formulation of the problem

Based on the background of the problem, the problem in this research is formulated as follows:

1. Does information asymmetry affect earnings management?

2. Does audit tenure have an effect on earnings management?

B. Research purposes

Referring to the research problem formulation above, the objectives of this research are as follows:

1. To determine the effect of information asymmetry on earnings management.

2. To determine the effect of audit tenure on earnings management.

C. Benefits of research

1) Academic Benefits

1. This study contributes to the existing literature on the relationship between information asymmetry, audit tenure, and earnings management, particularly in the context of Indonesian companies.
2. Provides theoretical support for the development of agency theory, which explains the conflict of interest between managers and shareholders due to information differences.
3. The findings can serve as a reference for future research investigating other factors that influence earnings management, such as audit quality, corporate governance, or auditor characteristics.
4. Provides new insights into how the level of information asymmetry in financial reporting influences managerial opportunistic behavior.

2) Practical Benefits

1. For company management, the results can be used to evaluate and improve financial reporting transparency while minimizing earnings management practices.
2. For auditors and public accounting firms (PAFs), the study highlights the importance of maintaining auditor independence throughout the audit engagement period.
3. For investors and shareholders, the findings can serve as a reference for assessing the credibility of financial statements and the potential risks arising from information asymmetry.For academics and students, this study provides empirical learning material on the interaction between auditing factors, information asymmetry, and managerial behavior within the framework of good corporate governance.

LITERATURE REVIEW

A. Information Asymmetry

Information asymmetry refers to a condition in which one party in a transaction possesses more or better information than the other party. In the context of financial reporting, managers typically have greater access to internal information about the firm's operations than shareholders or external stakeholders. This imbalance may encourage managers to engage in earnings management to achieve certain objectives, such as meeting performance targets or maintaining the company's image. According to Scott (2015), information asymmetry consists of two types: adverse selection, which occurs before a transaction, and moral hazard, which occurs after an agreement is made. A higher level of information asymmetry increases the likelihood of earnings management, as external monitoring becomes less effective.

B. Audit Tenure

Audit tenure refers to the length of the auditor–client relationship, typically measured by the number of consecutive years an auditor has audited a particular client. The duration of this relationship may have two opposing effects. On one hand, a longer tenure enables auditors to better understand the client's business environment, potentially improving audit quality. On the other hand, extended tenure can threaten auditor independence, as the auditor may develop excessive familiarity with the client (Oyedokun, 2016).

In Indonesia, Minister of Finance Regulation No. 154/PMK.01/2017 governs the auditor rotation policy to maintain independence. An optimal audit tenure is expected to suppress earnings management practices by ensuring auditor objectivity and audit quality.

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C. Earnings Management

Scott (2015) earnings management is management's choice of accounting policies or concrete actions that influence profits in order to achieve several profit objectives that will be reported. And Sulistyanto (2018) defines earnings management as the behavior of managers to play with discretionary accrual components to determine the size of profits, because accounting standards provide various alternative methods and procedures that can be utilized.Managers may engage in this practice by selecting specific accounting methods, accelerating or deferring revenue recognition, or adjusting expenses to achieve desired profit levels.

Earnings management is strongly associated with agency theory, where conflicts of interest between principals (shareholders) and agents (managers) motivate managers to manipulate earnings for personal gain. Therefore, information asymmetry and audit tenure are considered key variables that may affect the extent of earnings management within firms.

D. Theoretical Framework

This study is grounded in Agency Theory, proposed by Jensen and Meckling (1976), which explains the relationship between principals (owners) and agents (managers). The theory posits that due to differing objectives and unequal access to information, managers may act opportunistically, leading to information asymmetry and potential earnings manipulation. Auditing serves as an external monitoring mechanism to reduce agency conflicts. The audit tenure reflects how long an auditor has been assigned to a client, which can influence audit effectiveness. While a reasonable tenure enhances audit quality, an excessively long relationship may compromise auditor independence, thereby enabling earnings management.

Accordingly, this study assumes the following theoretical relationships:

1. Information Asymmetry has a positive effect on Earnings Management, as higher asymmetry increases managerial discretion.
2. Audit Tenure has a negative effect on Earnings Management, as longer auditor engagement improves audit quality and reduces the opportunity for manipulation — up to the point where independence begins to decline.

E. Analytical Model

The conceptual relationship among variables is illustrated as follows:

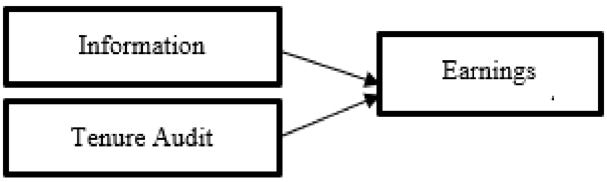

Fig 1. The research design

Description:

1. Independent Variable (X1): Information Asymmetry
2. Independent Variable (X2): Audit Tenure
3. Dependent Variable (Y): Earnings Management

This analytical model examines the direct effects of information asymmetry and audit tenure on earnings management, in line with the assumptions of agency theory.

RESEARCH METHOD

A. Research Approach and Framework Introduction

This study employs a quantitative approach with a causal associative research design, aiming to examine the influence of information asymmetry and audit tenure on earnings management. The research framework is based on Agency Theory, which explains that the conflict of interest between principals (shareholders) and agents (managers) leads to opportunistic behavior in the form of earnings management.

This framework positions information asymmetry and audit tenure as independent variables that are expected to influence earnings management as the dependent variable.

B. Type and Object of Research

This study is aquantitative research conducted on manufacturing companies in the food and beverage sub-sector listed on the Indonesia Stock Exchange (IDX) from 2019 to 2023, by downloading annual reports accessible through the official website www.idx.co.id.

The objects of this research are information asymmetry, audit tenure, and earnings management.

C. Types and Sources of Data

This study utilizes several types of data, namely:

1. Quantitative Data

Data that can be measured numerically, including financial statement figures, stock prices, bid-ask spreads, and audit tenure duration.

2. Qualitative Data

Non-numerical data derived from company disclosures and auditor reports, which explain contextual information such as audit engagement policies and regulatory settings.

3. Secondary Data

Data obtained from existing sources, including annual reports of manufacturing companies published on www.idx.co.id, and supporting literature from books, journals, and previous studies related to information asymmetry, audit tenure, and earnings management.

The data collection technique used in this research is the documentation method, by collecting and recording secondary data from the companies' financial statements and relevant literature.

D. Population and Sampling

The population in this study consists of manufacturing companies in the food and beverage sub-sector listed on the Indonesia Stock Exchange during the 2019–2023 period. The sampling method used is purposive sampling, which selects companies that meet specific criteria to represent the population (Sugiyono, 2018).

Table 1: Sample Selection Criteria

Description	**Number**
Manufacturing companies in the food and beverage sub-sector listed on the Indonesia Stock Exchange	30

Manufacturing companies in the food and beverage sub-sector that did not publish annual reports consecutively on the Indonesia Stock Exchange (IDX) during the 2019-2023 period.	(8)
Manufacturing companies in the food and beverage sub-sector that did not submit financial statements in Rupiah during the 2019-2023 period	(5)
Manufacturing companies in the food and beverage sub-sector listed on the IDX that did not disclose complete financial statements for the 2019-2023 period	(1)
Number of companies to be studied	1
Number of Years Observed	5
Total Sample	80

Source: Processed data, 2025

E. Conceptual Framework

The conceptual framework of this study illustrates the relationship between the independent variables—information asymmetry (X_1) and audit tenure (X_2)—and the dependent variable—earnings management (Y).

According to Agency Theory, higher information asymmetry tends to increase the possibility of earnings management due to managers' superior access to internal information. Conversely, audit tenure may either improve audit quality (through a better understanding of the client's business) or reduce independence if the relationship becomes too long.

F. Hypothesis Testing

Based on the conceptual framework and theoretical review, the following hypotheses are proposed:

H_1: Information asymmetry has a significant effect on earnings management.

H_2: Audit tenure has a significant effect on earnings management.

H_3: Information asymmetry and audit tenure simultaneously have a significant effect on earnings management.

The hypotheses are tested using a multiple linear regression model as follows:

$$Y = \mathrm{a} + \mathrm{b1\,X1} + \mathrm{b2\,X2} + \mathrm{e}$$

Where:

Y = Earnings Management

A = Constant

b1, b2 = Regression Coefficients of the Independent Variables

X1 = Information asymmetry

X2 = Audit Tenure

E = Error

Variable Definition and Measurement

1. Dependent Variable – Earnings Management (Y)

Measured using the conditional revenue model proposed by Stubben (2010), which uses accrual receivables as a function of revenue changes:

$\Delta ARit = \alpha + \beta 1\ \Delta Rit + \beta 2\ \Delta Rit \times SIZEit + \beta 3\ \Delta Rit \times AGEit + \beta 4\ \Delta Rit \times AGE\_SQit + \beta 5\ \Delta Rit \times GRMit + \beta 6\ \Delta Rit \times GRM\_SQit + e$

Explanation:

ΔAR = End-of-year accounts receivable

R = Revenue

SIZE = Natural log of total assets at year-end

AGE = Natural log of company age (years)

GRM = Gross margin

_SQ = Square of the variable

E = Error

2. Independent Variable

1) Information Asymmetry (X_1)

$$Spread = \frac{\text{ask price} - \text{bid price}}{(\text{ask price} + \text{bid price})/2} x100$$

Source (Agusti and Pramesti, 2008)

Explanation

Spread = Difference between the ask price (selling price) and the bid price (buying price) company shares

Ask price = the highest ask (sell) price of a company's shares

Bid Price = the lowest bid price of a company's shares

2) Audit Tenure (X_2)

Calculated by counting the number of years an auditor has consecutively audited the company’s financial statements during the observation period (Ulina et al., 2018).

G. Data Analysis Technique

The analytical tool used in this study is multiple linear regression analysis. Prior to regression testing, classical assumption tests (normality, multicollinearity, heteroscedasticity, and autocorrelation) are conducted to ensure the reliability of the regression model.

The regression results are interpreted through t-tests, F-tests, and R^2 analysis to assess partial, simultaneous, and explanatory power of the variables.

RESULTS AND DISCUSSION

The population in this study consisted of 150 manufacturing companies in the food and beverage sub-sector from 2019 to 2023, using purposive sampling so that the sample consisted of 80 companies. The results of the descriptive statistical test in this study are as follows:

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
X1	80	2.44812389	178.50674175	50.4646953311	34.5992094295
X2	80	1.00	5.00	2.6750	1.40321
Y	80	-51.72	55.59	2.1355	11.64466
Valid N (listwise)	80				

Source: Data processed, 2025

From the statistical test data in Table 2 above, it can be seen that after data processing, there are 80 data points in this study, from the sample data asymmetry (X1), the minimum value is 2.448, the maximum value is 178.506, the mean value for the 2019-2023 period is 50.464, and the standard deviation is 34.599. Audit tenure (X2) from 80 samples showed that the minimum value was 1.00, the maximum value was 5.00, the mean value for the 2019-2023 period was 2.675, and the standard deviation was 1.403. Profit management (Y) from 80 samples showed a minimum value of -51.72, a maximum value of 55.59, a mean value for the 2019-2023 period of 2.135, and a standard deviation of 11.644.

Based on calculations using SPSS 24, the results of the multiple linear regression analysis are presented in the following table:

Table 3: Results Of Multiple Linear Regression Analysis

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	8.953	3.557		2.517	.014
	X1	-.102	.037	-.304	-2.752	.007
	X2	-.621	.915	-.075	-.679	.499

a. Dependent Variable: Y

Source: Data processed, 2025

Based on Table 3, the multiple linear regression equation can be formed as follows:

$Y = 8.953 - 0.102\ X1 - 0.621\ X2 + e$

The results of the multiple linear regression equation above can be interpreted as follows:

1. The constant value (a) is 8.953. This indicates that if all independent variables, including information asymmetry (X1) and audit tenure (X2), are constant (unchanged), then profit management is 8.953.
2. The regression coefficient value for the information asymmetry variable (X1) is -1.02, which means that if other comprehensive income increases by 1%, there will be an increase of -1.02. A positive coefficient value indicates a positive relationship between other comprehensive income and profit management.
3. The regression coefficient value for the audit tenure variable (X2) is -0.621, which means that if audit tenure increases by 1%, there will be a decrease of -0.621. A negative coefficient value indicates a negative relationship between audit tenure and profit management.

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Table 4: T-Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.953	3.557		2.517	.014
	X1	-.102	.037	-.304	-2.752	.007
	X2	-.621	.915	-.075	-.679	.499

a. Dependent Variable: Y

Source: Data processed, 2025

The t-test results indicate that:

1. Information asymmetry (X1) has a significance value of 0.032 < 0.05 and a t-value of -2.186. This means that information asymmetry has a significant effect on profit management. This supports agency theory, which explains that the greater the information imbalance between management (the agent) and shareholders (the principal), the greater the likelihood of management engaging in opportunistic behaviour, such as profit management practices. This finding is consistent with the research of Wiryadi and Sebrina (2013), Mahawyahrti and Budiartha (2016), and Suwarno et al. (2020).

2. Audit Tenure (X2) has a significance value of 0.158 > 0.05 and a t-value of -1.429. This indicates that audit tenure does not significantly influence earnings management. This implies that the length of the auditor's engagement with the client does not always influence the company's tendency to engage in profit management practices. Although theory suggests that an overly long audit period may reduce auditor independence (Himawan, 2017), in practice, other factors such as auditor rotation regulations and capital market authority oversight can mitigate such risks.

Table 5: F-Test

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	964.383	2	482.191	3.809	.026[b]
	Residual	9747.859	77	126.596		
	Total	10712.242	79			

a. Dependent Variable: Y

b. Predictors: (Constant), X2, X1

Source: Data processed, 2025

The F-test results show an F-value of 3.759 with a significance level of 0.026 < 0.05. This indicates that information asymmetry and audit tenure simultaneously have a significant effect on earnings management. In other words, although audit tenure does not have a partial effect, when combined with the information asymmetry variable, both play a role in influencing the level of profit management practices.

This finding suggests that earnings management is a multifactorial phenomenon, where the combination of several variables can produce significant effects even though individualy they are not all dominant.

Table 6: R Square

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.300[a]	.090	.066	11.25147

a. Predictors: (Constant), X2, X1

b. Dependent Variable: Y

Source: Data processed, 2025

The adjusted R^2 value of 0.099 indicates that only 6.6% of the variation in earnings management can be explained by the variables of information asymmetry and audit tenure, while the remaining 93.4% is influenced by other factors that were not examined.

This suggests that other factors such as corporate governance mechanisms, audit quality, managerial ownership, leverage, or external pressure from investors and regulators may have a greater influence on profit management practices than the variables used in this study.

DISCUSSION

The Impact of Information Asymmetry on Earning Management

The results of the study indicate that information asymmetry has a significant effect on earnings management. This finding supports agency theory, which explains that differences in interests between principals (shareholders) and agents (managers) will give rise to opportunistic practices, one of which is earnings management. In conditions of high information asymmetry, managers have more access to internal information than shareholders, giving them significant opportunities to adjust profit figures in accordance with their personal interests or to meet specific targets. For example, management may engage in income shifting or accrual manipulation to present financial performance that is better than the actual condition.

This finding also reinforces previous studies such as Wiryadi and Sebrina (2013), Mahawyahrti and Budiartha (2016), and Suwarno et al. (2020), which state that the higher the level of information asymmetry, the greater the tendency for profit management practices to occur. Furthermore, this finding also shows that limited access to information for external investors weakens the monitoring mechanism, thereby increasing the likelihood of management manipulating financial statements. Thus, companies need to improve the quality of information disclosure in order to minimise profit management practices and strengthen shareholder confidence.

The Influence of Audit Tenure on Earning Management

Unlike information asymmetry, the results of this study indicate that audit tenure does not significantly affect earnings management. This suggests that the length of an auditor's engagement with a client does not always correlate with the likelihood of earnings manipulation. In theory, a long audit tenure has the potential to reduce auditor independence due to overly close relationships with clients. This condition can weaken auditor objectivity and increase the risk of earnings management practices. However, the results of this study indicate that this theory does not fully apply in practice in food and beverage manufacturing companies.

Regulatory factors appear to play an important role in this regard. In Indonesia, there are rules that limit the length of an auditor's engagement with a client, requiring auditors to rotate after a certain period. This rule effectively prevents the development of overly close emotional ties between auditors and clients. In addition, stricter supervision from the Financial Services Authority (OJK) and the Indonesia Stock Exchange also makes auditors more cautious in issuing audit opinions. Therefore, even though the audit engagement period is quite long, auditor independence is still maintained.

This finding is in line with the research by Suwarno et al. (2020), which also found that audit tenure is not a dominant factor in influencing profit management practices. In other words, other factors such as audit quality, auditor reputation, and internal control mechanisms are likely to play a greater role in suppressing profit management practices than the length of the audit period.

The Simultaneous Influence of Information Asymmetry and Audit Tenure on Profit Management

The simultaneous test results indicate that information asymmetry and audit tenure jointly have a significant effect on earnings management. This means that although audit tenure does not have a significant effect in a partial ( ) analysis, when combined with information asymmetry, both variables still play a role in explaining variations in earnings management practices. In other words, earnings management is a phenomenon that is not influenced by a single factor but by a combination of several interrelated factors.

However, the adjusted R^2 value of only 0.099 or 6.6% indicates that the contribution of these two variables is relatively small in explaining the variation in earnings management. This means that the majority (93.4%) of the variation in profit management is influenced by factors outside the scope of this study. These factors may include corporate governance mechanisms, managerial ownership, audit quality, firm size, leverage, and pressure from the capital market. This reinforces the notion that profit management is a complex phenomenon with diverse determinants.

These findings are important for stakeholders, particularly investors and regulators, as they indicate that oversight of profit management practices is insufficient if it focuses solely on information asymmetry and audit tenure. A more comprehensive approach is needed, incorporating other more significant variables to provide a more accurate picture of the causes of profit management practices in companies.

CONCLUSION AND RECOMMENDATIONS

Based on the results of the research and analysis conducted, it can be concluded that:

A. Conclusion

1) Information asymmetry has a significant effect on profit management. This proves that the greater the information asymmetry between managers and shareholders, the greater the likelihood of managers engaging in profit management practices.

2) Audit tenure does not significantly affect profit management. The length of the auditor's relationship with the client does not necessarily influence management behaviour in manipulating profits.

3) Information asymmetry and audit tenure simultaneously have a significant impact on profit management. However, the contribution of these two variables is only 6.6%, indicating that there are other more dominant factors influencing profit management practices.

B. Recommendations

Based on the research findings and analysis presented, the following recommendations can be provided in this study:

1) *For Company Management:*

2) There is a need to enhance transparency and openness of information to reduce information asymmetry between management and shareholders. This can be achieved through more detailed, accurate, and timely disclosure of information.

3) *For Auditors:*

Auditors need to strengthen their independence and objectivity despite having long audit engagements. Internal oversight at public accounting firms also needs to be improved so that auditors are not overly emotionally attached to their clients.

4) *For Investors and Shareholders:*

Investors should be more observant in analysing financial statements by paying attention to the potential for profit management practices due to information asymmetry. The use of non-financial indicators is also important to assess a company's performance comprehensively.

5) *For Further Research:*

It is recommended to include additional variables such as corporate governance mechanisms, audit quality, institutional ownership, and leverage, which may have a greater influence on profit management practices.

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