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THE INFLUENCE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT Supriyaningsih, Fuad1 Department of Accounting, Faculty of Economics and Business Diponegoro University, Jl. Prof. Soedharto SH TembalangSemarang, Indonesia 50239. Phone: +622476486851 ABSTRACT Current study tests the impact of audit committees to the real earnings management.Using the manufacturing public listed companies from Indoensia Stock Exchange from 2012 until 2014, we found that that financial and accounting expertise of audit committee members and audit committee size have positive effect on real earnings management. Furthermore, we also found that the dual positions of the audit committee chairman have a negative effect on earnings management. The Tenure of audit committee chairman however, has no impact on real earnings management. Keywords: real earnings management, characteristics of audit committee, good corporate governance, agency theory. INTRODUCTION Indonesia Stock Exchange (IDX) has required all listed companies to implement good corporate governance. This is because the good corporate governance is a tool to connect the company management with board of directors and stakeholders. Based on this, Indonesia Stock Exchange issued a regulation No: Kep-315 / BEJ / 06 / -2000 enhanced with regulations No .: Kep-339 / BEJ / 07 / -2001 on July 1, 2001 related to the establishment of an audit committee, independent commissioner and board secretary of listed companies. Indonesia Stock Exchange reconfirmed the rules with the issuance of Bapepam Chairman Decree No .: Kep-29 / PM / 2004, in which the contents of the decision requires companies listed on the Stock Exchange to have an audit committee. The regulations require a minimum of three independent people who make up the audit committee. One of the three members is from an independent commissioner who will be the chairman of the audit committee. In addition, one of the three members must have expertise and capabilities in the field of accounting and finance. With three members, the board formed an audit committee in order to assist the 1Corresponding author commissioners in their duties. The audit subsidies from the government committee has a role in helping (Subramanyam and Wild, 2013). commissioners in overseeing the Earnings management can be management doing the financial reporting categorized into the accrual earnings process. The role makes the audit committee management and real earnings management, is often linked to the quality of financial based on whether or not to have a direct reporting. The existence of the audit impact on cash flow. Accrual management committee should be able to improve the earnings are earnings manipulation using quality of financial reporting and company's methods and accounting estimates that are internal control quality that aims to provide not a direct impact on cash flow. Instead, the protection to shareholders. real earnings management is earnings Nevertheless, within the last ten manipulation using operational activities years many scandals appeared related to that directly affect to the cash flow. Real financial reporting. That makes the earnings management is known in the post effectiveness of audit committees in Sarbanes Oxley Act (SOX) period. overseeing the financial reporting process in Compared by accrual earnings management, the company was often questioned (Vafeas real earnings management has received little in Putri, 2011). The collapse of several large attention in the research literature. companies that never happened raises Therefore, this study focuses on real questions related to supervision by the board earnings management. of directors and the audit committee due to Roychowdhury (2006) the manipulation of doing accounting comprehensively investigate earnings records. Those manipulation activities are management through real activities. known as earnings management (earnings According to Roychowdhury (2006) management). earnings management through real activities According to Schipper (1989), is activity originating from normal earnings management is interference in the operational practices, which encouraged determination of earnings that is done manager desire to mislead some deliberately for personal gain. Earnings stakeholders as a general statement users management can occur for several reasons, into believing that certain financial reporting such as to increase the manager purposes has been fulfilled in a credible form compensation, boost stock prices, and get of operational operation. Research results show that managers typically take three TSHupErIiNyaFnLiUnEgsNiChE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT Fuad Diponegoro University types of activity manipulation of real activity, namely (1) manipulation of the sale, (2) a reduction in discretionary costs (general and administrative expenses and cost of sales), and (3) excessive production (overproducing). Earnings management actions undertaken by management is the accounting reality that is difficult to accept by the user, can damage the credibility of financial reporting (Subramanyam and Wild, 2013). The responsibility of the board of commissioners is to act as representatives of the shareholders in all respects, so the commissioners must supervise the manager to restrict the activity of the real manipulation. Although the audit committee plays a major role in the regulatory process of financial reporting, it is unclear whether the audit committee can effectively inhibit the activity of real earnings management. Research related to the effectiveness of the audit committee have been done, but until now there are still few empirical evidences that founded about how the characteristics of the audit committee impact real earnings management. Visvanathan (2008) used data pre-SOX to examine the relationship between real earnings management and three characteristics of audit committee, specifically the independence of the audit committee, the audit committee size, and frequency of audit committee meetings. The results showed that the frequency of audit committee meetings negatively affect the real income related management discretionary cost reductions, but not for the manipulation of sales activity and activity overproducting. Mughni (2014) had a research related to the influence of the characteristics of the audit committee and audit quality on earnings management. The characteristics of the audit committee is used, which is a measure of the audit committee, financial expertise of audit committee members, the number of audit committee meetings. The results showed that only financial expertise that have a significant effect on earnings management. THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT Agency theory is a theory that describes the relationship between the agent and the principal. On the one hand manager have a role to be agent and on the other as the principal (owner of the company) (Hendriksen and Breda, 1992). Agency theory occurs because of a conflict of interest between the principal (owner) and agent (management). In the agency theory all individuals are assumed to do things just based on their self-serving. The owners (principals) are assumed to be mainly interested in the acquisition of the yield on the investment that the owners do on a company. While management (agent) is assumed to receive compensation that is derived from a monthly compensation and also compensation gained from involvement in an agency relationship (Anthony and Govindarajan, 2011). This conflict of interest raises the existence of information asymmetry. Asymmetry of information is an imbalance gained between information of manager as a provider of information to the shareholders and stakeholders in general as consumers of information. There are two kinds of information asymmetry, namely: Adverse selection, which is compared with the shareholders, the management is know more information about the situation and prospects of company.That condition can cause the information given to the principal does not fully rendered by the agent. Moral hazard, which is shareholders doesn't know all the activities doing by the management, so that management can take action beyond the knowledge of shareholders. Such actions constitute a breach of contract and not ethically. Implementations of basic earnings management can be explained by the theory agency. Earnings management occurs because of a conflict of interest between the principal andagents. Management has more information than shareholder so that it can trigger asymmetric information.Asymmetry information involve management to have motivation and strong chance to practice earning management. User of financial report difficult to accept earning management practice by management. Earning management can decrease credibility of financial reporting. Schipper (1989) contend that earning management is management's interference for determining of company's profit to gain individual motive. There are several reasons from management doing earnings management, among which is to raise stock prices by increase profits, increasing manager compensation, and to get subsidies from the government. Roychowdhury (2006) comprehensively investigate earnings management through real activities. His research states that the management usually doing three types of activity manipulation of real activity, namely: Sales Manipulation Manipulation is defined as the sales manager effort to increase sales during the years for the purpose of achieving profit targets. Management generates additional sales by offering a limited discount price and by offering soft credit terms. As a result, sales volume increased and resulted in higher income for the year but the cash flow decreased due to smaller cash inflows due to credit sales and discounts offered. Reducing Discretionary Expenses Management can increase profits by reducing discretionary costs. Cost discretionary companies consist of cost of sales, R & D costs, marketing costs, and general and administrative expenses. Overproducing Manufacturing companies can carry out large-scale production (overproducing) is to produce the goods in larger quantities than is needed in order to achieve the expected demand so that profit will increase. With this excessive production of fixed overhead costs divided by the number of units of goods in large quantities would bring the cost per unit and the cost of goods sold decreased. The decline on cost of goods sold will result increasing operating margins. Company should strive to reduce their earning manipulation with doing implementation of good corporate governance.

Good corporate governance achievable with formed an audit committee. The audit committee is a committee formed by the board of directors in order to help carry out its duties and functions. According Tugiman (1995) the audit committee is a group of people elected by a larger group to do a particular job or to perform specific tasks or the number of commissioners of client companies are responsible to assist the auditor in maintaining their independence from management. Their audit committee is expected to be able to improve the quality of financial reporting produced by management and is also expected to be able to improve the company's internal control aimed at giving protection to shareholders. This study examineanything of the characteristics of audit committee that can reduce the activity of earnings management. Characteristics of the audit committee are independent variables in this study. Characteristics of the audit committee used that is expertise financial accounting and audit committee members, the size of the audit committee, tenure the chairman of the audit committee, and the number of positions that were held by the chairman of the audit committee. The framework in this study, namely: Picture 1.1 Research Framework Hypothesis Development Financial and AccountingExpertise of Audit Committee Member The first characteristic of audit committee is financial and accounting expertise of audit committee members. Members with financial and accounting expertise can enhance the supervisory function owners of the company (the principal) on the management (agent) in order not to harm the owner of the company. Based on the Decree of Chairman of Bapepam Number: Kep- 29 / PM / 2004 stating that one of the three members of the audit committee must have an educational background in accounting or finance. Knowledge in the field of accounting and finance can be used as the basis for audit committee members in their duties. Financial and accounting expertise of audit committee members are expected to reduce a material misstatement in presenting financial statements so as to reduce the activity of earnings manipulation by management. Thus, the greater the audit committee members with expertise in accounting and finance make the quality of financial reporting for the better and secure. Previous research showed that the accounting and financial expertise of audit committee members can facilitate the audit committee to be more effective in controlling the financial reporting process.Bedard et al., (2004) showed that aggressiveness earningmanagementnegatively affected with accounting and financial expertise of audit committee members. Krishnan and Visvanathan (2008) found that accounting conservatism is positively related with financial and accounting expertise of audit committee members. Based on the above explanation, the first hypothesis, that is: H1: Financial and accounting expertise of audit committee members has negative effect on real earnings management. Audit Committee Size The second characteristic of audit committee is audit committee size. Audit committee size help oversee the management (agent) that does not harm the owner (the principal). The larger of the audit committee size oversight of management (agents) in the conduct of financial reporting becomes more increased. Based on the Decree of Chairman of Bapepam Number: Kep- 29 / PM / 2004 which requires the contents of the audit committee consisting of at least three independent people. The amount of audit committees are more likely to have members with expertise varied to monitor the practices of financial reporting done by management (agent) is more effective, so that the owner (principal) was reporting produced have good quality and guaranteed (Baxter and Cotter, 2009). Thus, the larger of the audit committee size is expected to reduce their earning manipulation activities by management. Based on the above explanation, the second hypothesis, that is: H2: Audit committee size negatively affect to the real earnings management. Tenure Chairman of Audit Committee The third characteristic of audit committee istenure chairmanof audit committee. Tenure chairmanof audit committeewith a long tenure can improve owner's company (principal) supervision toward the management (agent). Chairman of the audit committee with a long tenure has greater the experience and expertise oversight of financial reporting, so we can easily find misstatements made by management. The longer tenure chairman of the board can gain relevant knowledge related to chairman's job from time to time to improve the performance of their work (Fiedler, 1970 in Sun and Lan 2014). Beasley (1996) found that manipulation of financial statements has possible lower value than the company had an average longer tenure chairman of the board. Therefore, the chairman of audit committee with a long tenure is expected to be more effective in overseeing the management compared than chairman of the audit committee who has shorter tenure, so that the resulting financial reporting will be more qualified. Based on this explanation, the third hypothesis is: H3: Tenure chairman of the audit committee negatively affect toward the real earnings management. The Number of Positions that were be Held by the Chairman of Audit Committee The fourth characteristic of audit committee is the number of positions that were is held by the chairman of audit committee. The chairman of audit committee has double positions outside the company can gain experience and greater expertise in monitoring managers (Bedard et al., 2004). Another that, the chairman of audit committee may also have a great reputation to motivate his members so that it can work better (Shivdasani, 1993 in Sun and Lan 2014). A large number of positions that were be held by the chairman of audit committee should be able to reduce earnings management activities conducted by the management (agent), so that owner's company (the principal) can feel confident about the financial reporting because it has better quality. Bedard et al., (2004) proved earnings management is negatively related to the average number of positions that were be held by the chairman of audit committee outside the company. The results showed that the number of positions that were be held by the chairman of audit committee outside the company more effective to detain the earnings management. Based on the above explanation, the fourth hypothesis is: H4: The number of positions that were be held by the chairman of audit committee negatively affects toward the real earnings management. RESEARCH METHODS Population and Sample The population in this research is manufacturing companies listed in Indonesia Stock Exchange in period 2012- 2014. The reason for using a manufacturing company as a population is because the population in the manufacturing sector is more than other sectors. In addition, the data contained in the financial statements on manufacture companies is more complete and complex. The data used are the financial statements and annual reports for three years from 2012 to 2014. The reason for using the data for 2012-2014 is because the data year 2012-2014 provide an overview of Supriyaningsih Fuad Diponegoro University the current condition of the company which is the latest data of the company. The sampling technique used in this research is purposive sampling, is a technique commonly used in the sampling process based on certain criteria predetermined. The criteria were used: (1) Company listed on the Stock Exchange and issued financial statements and annual reports in a row and complete for the period ended December 31, 2012 to 2014; (2) manufacturing company issued financial statements using the currency of rupiah; and (3) the company used as a sample is a company with full information relating to the calculation indicators and variables used in this study. Table 1 Purposive Sampling Explanation Amount Manufacturing companies listed in Indonesia Stock Exchange in period 2012-2014 Companies that do not meet the criteria Companies thatmeet the criteria Outlier 688 (544) 144 (33) Total samples within 3 years 111 Source : Secondary data were processed, 2016 Measurement of Real Earnings Management This study uses real earnings management as the dependent variable. Real earnings management is earnings manipulation by using the operations that directly impact on cash flow. Based on previous research, measurement of real earnings management in this study uses the calculation concept of Royhowdhury (2006) which uses three approaches, specifically: the abnormal production cost caused by manipulation of the manufacturing process, the abnormal operating cash flow caused by manipulation of sales activity, and discretionary expenses caused by the manipulation of operating expenses. The first step is calculating the cost of normal production (PROD),discretionary expense (DISX), and operating cash flow (CFO) following the results of the regression for each company. The second step is calculating the normal rate on PROD, CFO, and DISX separately. The concept for the calculation of the normal level of production costs (PROD), normal levels of operating cash flow (CFO), and normal levels of discretionary expense (DISX), are: Normal Level of Production Costs (PROD) 〖PROD 〗 _t/A _(t-1) □(= α _(0))+ β _(1) 1/A _(t-1) + β _(2) S _t/A _(t-1) + β _(3) 〖ΔS 〗 _t/A _(t-1) + β _(4) 〖ΔS 〗 _(t-1)/A _(t-1) + which: A _(t-1) = total asset inyear t-1 S _t = Net sales in year t 〖ΔS〗 _t = variance of net sales from year t-1 to t 〖PROD〗 _t= production cost in year t α_0 = Constanta β_(1-4) = Coefisien ε = error Normal Level of Operating Cash Flow (CFO) 〖CFO 〗 _t/A _(t-1) □(= α _(0))+ β _(1) 1/A _(t-1) + β _(2) S _t/A _(t-1) + β _(3) 〖ΔS 〗 _t/A _(t-1) + ε _t Dimana: CFOt = operating cash flow in year t DISXt = discretionary expense in yeart (selling expense, general and administrative expense) The third step is calculating the abnormal PROD (APROD), abnormal CFO (ACFO), and abnormal DISX (ADISX). Abnormal value is calculated by subtracting the actual value with the predicted abnormal value (Cohen et al., 2008). The concept of the calculation is as follows: Abnormal Level of Cost Production 〖APROD〗 _t = 〖PROD〗 _t/A _(t-1) □(-) [β _(1) 1/A _(t-1) + β _(2) S _t/A _(t-1) + β _(3) 〖ΔS 〗 _t/A _(t-1) + β _(4) 〖ΔS 〗 _(t-1)/A _(t-1)] Which: 〖APROD 〗 _t= Abnormal Level of Cost Production in year t Abnormal Level of Operating Cash Flow Normal Level of Discretionary 〖ACFO〗 _t = 〖CFO 〗 _t/A _(t-1) Expense (DISX) □(-) [β _(1) 1/A _(t-1) + β _(2) S _t/A _(t- 〖DISX 〗 _t/A _(t-1) □(= α_(0))+ 1) + β _(3) 〖ΔS 〗 _t/A _(t-1)] β _(1) 1/A _(t- 1) + β_(2) S _(t-1)/ A _(t- Which: 1) + ε _t 〖ACFO 〗 _t =abnormallevel of Which: operating cash flow in year t 70 TSHupEriINyaFnLiUnEgNsiChE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT AbnormalLevel of Discretionary Expense A〖 DISX〗 _t = 〖DISX 〗 _t/A _(t- 1) □(-) [β _(1) 1/A _(t-1) + β_(2) S _(t- 1)/A _(t-1)] Which: A〖DISX 〗 _t =abnormal level of discretionary expense in year t Companies that seek to manipulate earnings tend to have higher APROD, while ACFO and ADISX lower. The final step is combining three sizes of real earnings manipulation into a proxy named RM. The concept of the calculation is as follows: 〖RM〗 _t = □(〖APROD〗 _t- 〖 ACFO〗 _t- 〖ADISX〗 _t) which: 〖RM〗 _t = Real earning management in year t Analysis Method Hypothesis testing used multiple linear regression analysis (multiple regression). Multiple linear regression analysis aimed to test hypothesis whether there is influence between the independent variable on the dependent variable. In general, multiple linear regression analysis model can be written as follows: |RMt |=α+β _1 ACEXPt +β _2 ACSIZEt +β _3 ACTENt +β _4 ACOTHt +β _5 ROAt +β _6 SIZEt +β_ 6 MBt+ ε_(i,t) which: RMt : real earning management α : constanta β_(1-6) : coefisien ACEXPt : Financial and accounting expertise of audit committee members, as measured by number of members who have expertise or experience in the field of accounting and finance. ACSIZEt : Audit committee size, measured by the number of audit committee members that exist in every company. ACTENt : Tenure chairmanof the audit committee, as measured by the number of tenure of the chairman of the audit committee since the first appointment until the period of the study ACOTHt : The number of positions that were held by the chairman of the audit committee, measured by the number of positions that are concurrently chairman of the audit committee, both within and outside the company. SIZEt : The size of the company, based on the natural logarithm of market value. ROAt : Return on asset MBt :

Market-to-book ratio members (ACEXPt) minimum value is 1.0 and a maximum value is 3.0 with an average value is 2.261. This suggests that most companies listed on the Indonesia Stock Exchange in the year 2012-2014 has been implement the requirement of the Capital Market Supervisory Agency and Financial According to Krishnan and Visvanathan (2008), accounting expertise and financial shared by members of the audit committee can be interpreted as directors who are or who have been included in one of the members of the following groups: graduates from accounting, auditor, certified public accountant (CPA), principal or chief financial officers (CFO), controlier, and principal or chief accounting officers (CAO). Institution (BAPEPAM LK), that is at least 1 member who has accounting and financial expertise.The standard deviation is 0.747 indicates a variation contained in the audit committee financial accounting expertise. For the variable size of the audit committee (ACSIZEt) minimum value is 3.0 and a maximum value is 4.0 with an average value is 3.063. This suggests that most manufacturing companies have implementation requirements of the Capital Market Supervisory Agency and Financial Institution (BAPEPAM LK) is a minimum RESULTS AND DISCUSSION Table 2 shows the results of descriptive statistic tests. The results showed that the number of samples (N) is 111. The maximum value for the variable of real earnings management (RMt) is1.242, while the minimum value is 0.004. The average value is 0.346. Standard deviation of real earnings management variable is 0.256 can shows the variation of the value of inter-company from year to year. For variable accounting and financial expertise on audit committee have 3 members of audit committee. The standard deviation is 0.244 indicates a variation contained in the variable size of the audit committee. For variable tenure chairman of the audit committee (ACTENt) minimum value is 0.0 and a maximum value is 13.0. The average value is 5.243 that are shows the majority of the company's audit committee chairman on manufacture serves more than one period. The standard deviation is 4.110 indicates a variation contained in this variable. TSHupEriINyaFnLiUnEgNsiChE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT For a variable number of positions that were be held by the chairman of the audit committee (ACOTHt) minimum value is 0. 0 and a maximum value is 4. 0 with an average value is 1.532. This indicates that a portion the chairman of the audit committee have another positions both within the company and outside the company. The standard deviation is 0.922 indicates the variation contained in this variable. Table 2 Descriptif Statistic Test Result Variabel N Minimum Maximum Mean Std. Deviation REM 111 0,004 1, 242 0, 346 0, 256 ACEXP 111 1,0 3,0 2,261 0,747 ACSIZE 111 3,0 4,0 3,063 0,244 ACTEN 111 0,0 13,0 5,243 4,110 ACOTH 111 0,0 4,0 1,532 0,922 ROA 111 -0,170 0,350 0,079 0,096 SIZE 111 4,143 10,165 7,098 1,541 MB 111 -2,695 52,394 3,688 6,563 Source : Secondary data were processed, 2016; REM:Real earnings management; ACEXP: Financial accounting expertise of audit committee members; ACSIZE :Audit committee size; ACTEN: Tenure chairman of the audit committee; ACOTH :The number of positions that were held by the chairman of the audit committee; ROA: Return on asset;SIZE:The size of the company; MB: Market-to-book ratio Table3 shows the results of Variance Inflation Factors (VIF) for each independent variable to test multicollinearity between each independent variable. The results shows each independent variable has a value of VIF is less than 10. Based on these results it can be concluded that there is no multicollinearity of each independent variable. Table 3 also shows the test of hypothesis in this research. The following are the results of testing hypothesis were made: Influence of Financial and Accounting Expertise of Audit Committee Members toward the Real Earnings Management From the test results have shown the value of the variable probability of financial accounting expertise of audit committee members is smaller than the 0.05 level that is equal to 0.019 (0.019 <0.05). This means that the variable financial accounting expertise of audit committee members significantly affect the real earnings management. However, the direction coefficient indicates a positive direction. The results of this test mean that the financial accounting expertise of audit committee members to make real earnings management increases. Thus hypothesis 1 which states that "financialand accounting expertise of audit committee members negatively affect the real earnings management" is rejected. Based on the Decree of Chairman of Bapepam Number: Kep- 29 / PM / 2004 states that have at least one member with expertise in accounting and finance. Although most of the companies listed in the Indonesia Stock Exchange has followed the rules has not yet been able to reduce their earnings management. The results can be seen by the average value for the variable financial accounting expertise (ACEXPt) of 2.261. The value of the average shows that most companies have members with expertise in accounting and finance more than one person. The large number of members with expertise in the financial and accounting rather than reducing earningsmanagement, but instead make more practice earningsmanagement in the company's. This can be due to the audit committee members who do not have an educational background in accounting or finance considered to have the ability in the field of accounting and finance when to be a member of the audit committee. In addition, the appointment of independent directors to be the chairman of the audit committee independence is questionable. Problems independence and expertise in accounting and finance may cause the audit committee is more likely to side with management when there is disagreement between management and the external auditor. Therefore, earnings management conducted by the management because support from the audit committee. This condition may cause financial accounting expertise of audit committee members have positive influence on earnings management of real (Sanjaya, 2008 in Ariyani 2011). Influence of Audit Committee Size toward Real Earnings Management From the test results have shown the value of the variable probability of audit committee size is smaller than the significant level of 0.05, which is equal to 0.000 (0.000 <0.05). This means that the variable audit committee size significantly affect the real earnings management. However, the direction coefficient of the audit committee size showed a positive direction. The results of this test mean that the audit committee size make real earnings management increases. Therefore, hypothesis 2 which states that "the audit committee size negatively affect the real earnings management" is rejected. Based on the Decree of Chairman of Bapepam Number: Kep- 29 / PM / 2004 stated that the establishment of an audit THE INFLUENCE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT Supriyaningsih Fuad Diponegoro University committee must have at least three members. Although the average company is already implementing these rules, it still has not been able to reduce their real earnings management activities. The results showed that the audit committee size would increase the occurrence of earnings management. It can be caused due to the small number of audit committee members. The number of members is too little can cause problems due to the lack of division of duties of members (Klein, 2012). This leads to make supervision toward management when financial reporting processes less qualified, this condition allows management doing fraud. This condition may cause the audit committee size is a positive influence on real earnings management. Influence of Tenure Chairmanof the Audit Committee toward Real Earnings Management From the test results have shown the value of the variable probability tenure chairman of the audit committee is greater than the significant level of 0. 05, which amounted to 0.772 (0.722> 0.05). This means that the variable tenure of audit committee chairman does not affect the real earnings management. Therefore hypothesis 3 which states that "the tenure of audit committee chairman negatively affect the real earnings management" has been rejected. The long duration appointment chairman of the audit committee is apparently not affecting the earnings management. This can be due to a decline in the performance chairman of the audit committee. This performance degradation can be caused by the chairman of the audit committee has to know about the company's condition, so that the chairman of the audit committee have felt no need to work hard again to oversee the management. The action taken by the chairman of the audit committee could lead to other audit committee members to do the same. It can create an audit committee is no longer effective when oversee management to the financial reporting process. This condition may lead to tenure chairman of the audit committee has no effect on earnings management. Influence of Number of Positions that were be held by the Chairman of the Audit Committee toward the Real Earnings Management From the test results have shown a probability value of a variable number of positions that were held by the chairman of the audit committee is smaller than the significant level of 0.05, which amounted to 0.045 (0.045 <0.05). This means that a variable number of positions that were held by the chairman of the audit committee significantly affect the real earnings management. In addition, the direction coefficient of the size of the audit committee showed a negative direction. The results of this test mean that the number of positions that were held by the chairman of the audit committee makes real earnings management is reduced. Therefore hypothesis 4 which states that "the number of positions that were held by the chairman of the audit committee negatively affect the real earnings management" are accepted. Based on the average value for a variable number of positions that were held by the chairman of the audit committee (ACOTHt) that is equal to 1.532 with a maximum value is 4.0 and a minimum value is 0. 0 indicates that the majority of the chairman of the audit committee has more than one position. A large number of positions that were held by the chairman of the audit committee were effective for reducing their earnings manipulation carried out by the management. A large number of positions that were held by the chairman of the audit committee are made chairman of the audit committee more experienced as it faces a different situation for every company where he worked. With the experience, of course, that isenhancing the knowledge and expertise of the chairman of the audit committee. Increasing the expertise and experience is the basis for the chairman of the audit committee to motivate members to work better. With so many positions that were held by the chairman of the audit committee, pointed out that the chairman of the audit committee also has a good reputation, so of course the chairman of the audit committee will give a maximum contribution to the company. Therefore, oversight toward management will increase and reduce manipulation practice by management. Table 4 Hypothesis Test Result Variables B t Variance Inflation Factor (Constant) ACEXPt ACSIZEt ACTENt ACOTHt ROAt SIZEt MBt -0,898 0,061 0,328 0,001 -0,040 1,732 -0,002 0,009 -3,760 2,378** 4,212* 0,291 -2,033** 8,136* -0,154 3,080* 1,311 1,272 1,183 1,134 1,478 1,711 1,259 THE INFLUENCE OF AUDIT COMMITTEE CHARACTERISTICS ON REAL EARNINGS MANAGEMENT Supriyaningsih Fuad Diponegoro University Source : Secondary data were processed, 2016; *: significant at level 0,01; **: significant at level 0,05; Real earnings management: dependent variable; ACEXP: Financial accounting expertise of audit committee members; ACSIZE: Audit committee size; ACTEN: Tenure chairman of the audit committee; ACOTH: The number of positions that were held by the chairman of the audit committee; ROA: Return on asset;SIZE: The size of the company; MB: Market-to-book ratio CONCLUSION The purpose of this study is to examine the influence of the characteristics of the audit committee toward real earnings management. This is their conclusion based on the analysis of data that has been described in previous chapters: 1. The first characteristic ofaudit committee, that is financial and accounting expertise of audit committee members. The results show the financial and accounting expertise of audit committee members has significant positive effect on real earnings management. 2. The second characteristic of audit committee, thatis audit committee size. The results showed that the audit committee size has significant positive effect on real earnings management. 3. The third characteristics of audit committee that isthe audit committee tenure. The results showed that the tenure of the audit committee has no significant effect on real earnings management. 4. The fourth characteristic of audit committee, which is the number of positions that were held by the chairman of the audit committee. The results showed that the number of positions that were be held by the chairman of the audit committee has significant negative effect on the real earnings management. Research conducted has weakness and limitations that reduce the perfection of research results. The next research is expected to pay attention to the limitations of this study. Limitations of this study are: 1. Many companies do not attach the complete information related to the audit committee in the annual report, so it cannot be sampled. 2. The sample of companies used as a research object only manufacturing company, so it has not been able to include results for all companies listed on the Indonesian Stock Exchange. 3. The result has not been able to provide empirical evidence toward tenure the chief of audit committee variable. Future studies are expected to present the results of a higher quality and accurate by watching that is some suggestion: 1. Future studies may use different sample other than manufacturing companies, such as financial companies and banks due to the financial sector has different characteristics with the company on manufacture. 2. The next research can add variables to the characteristics of the audit committee, such as the frequency of audit committee meetings, the independence of the audit committee, and so on. This is because there are many variables that can be used to explain the relationship of audit committee characteristics and earnings management. REFERENSI Anthony, N. Robert danGovindarajan, Vijay. 2011. Sistem Pengendalian Manajemen. Jilid 2. Tanggerang: Karisma Publishing Group. Aryani, Winda. 2011. Mekanisme Corporate Governance dan Manajemen Laba Melalui Manipulasi Aktivitas Riil. Undergraduate Thesis. Universitas Diponegoro. Bapepam. 2004. Peraturan Nomor IX.I.5: Pembentukan dan Pedoman Pelaksanaan Kerja Komite Audit. Keputusan Ketua BAPEPAM Nomor: Kep-29/PM/2004. 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HOW MANDATORY IFRS ADOPTION CHANGES FIRMS' OPPORTUNISTIC BEHAVIOR: EMPIRICAL EVIDENCES FROM THE EARNINGS MANAGEMENT PERSPECTIVE

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ABSTRACT

The purpose of this research is to examine the effects of International Financial Reporting Standards (IFRS)-based accounting standards on both accrual-based and real earnings management. We utilized modified Jones model as a proxy for accrual based earnings management, while abnormalities found on cash flow from operations, discretionary expenses and production expenses are used as proxies for real earnings management. Using data from Indonesian manufacturing firms from 2009 to 2014, we found that adoption of IFRS limits discretionary behaviour in earnings management while the earnings management from real activities is more prevalent in the post IFRS period.

Keywords: IFRS, Real Earnings Management, Accrual Earnings Management, Panel Data Analysis.

INTRODUCTION

Managerial opportunistic behaviour in the scope of financial reporting has become one of the main concerns for years. Agency theory has long argued that when the ownership and management are separated, the accounting and operational functions are affected by agency conflicts (Jensen and Meckling, 1976) and increase the information asymmetry between principal and managers. As a consequence, managers may have the incentive to make decisions to fulfil their interest while to some extent, neglecting the interests of principal. Earnings management practice is one of those activities as a result of agency conflicts.

Numerous researches have tried to uncover the reasons (and consequences) of the earnings management practice. However, we emphasized the roles of accounting standards that may inhibit (or foster) managerial opportunistic behaviour through earnings management.

International Financial Reporting Standards was gradually implemented in Indonesia since 2012 in a hope to increase accounting and financial reporting quality. Researches however are stand divided about this. For example, more flexible accounting standard as in IFRS provides a greater scope for the discretion policy and involve a higher degree of subjectivity implied in the application of criteria (Jeanjean and Stolowy, 2008). These "flexible" rules encourage managers to have a broader space in applying their policies that can be used for their own interests if there is no effective control mechanism. Callao and Jarne (2010) maintained that firms regulated by the "loose" accounting standards tend to engage more earnings management (Callao and Jarne, 2010). Additional evidences showed that the principle-based accounting standards in IFRS provides more flexibility and hence looser as compared to the competing generally accepted accounting principles (GAAP) which is known to be "rules-based". Capkun et al. (2012) also documented that earnings management increase can be observed among the companies in the countries that allow early IFRS adoption.

However, Pelucio-Grecco et al. (2014) found that IFRS have restricted effect on earnings management in Brazil after the full implementation of IFRS. Sellami and Fakhfakh (2014) on the other hand found that there is a decrease in the value of the absolute discretionary accruals during the six years after the mandatory adoption of IFRS in France. Doukakis et al. (2014) shows that mandatory IFRS does not significantly affect the level of accrual and real earnings management.

Our research on the other hand, does not attempt to test whether there is a blessing (or curse) after IFRS implementation. Rather, we try to uncover the earnings management practices on the accrual properties of accounting and manager's tendencies to manage their reported earnings through real operational activities; which are also one of our contributions in the financial accounting literature. Healy (1999) maintained that accrual-based earnings management are usually conducted by using extensive judgment in preparing the financial reporting and modifying financial transactions to mislead the users of financial statements about the firms' real performance. Roychowdury (2006) on the other hand, define real earnings management as management desire to mislead the users of financial reporting by manipulating the operational activities that are supposed to in normal fashion. Our contributions also stem from the fact that the impact of IFRS to real earnings management is categorized into their three main activities, namely: abnormal production costs, abnormal net cash flow from operations and abnormal discretionary expenses. We also test whether IFRS may inhibit or foster those activities

The remainder of the paper is organized as follows. Section 2 provides a review of relevant literature and hypotheses development. Section 3 describes the sample selection, variable measurement and research design. Section 4 presents the result. Section 5 provides summary conclusions, limitation of this study and future research potentials.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Earlier researches have documented that IFRS may change how management behaves in managing their earnings. For example, Christensen et al. (2008) found that income smoothing is significantly lower among the firms that voluntarily adopt IFRS prior to its effective date. They further found that mandatory adopters perceive that the cost of early adoption outweighs its benefits. However, Capkun et al. (2012) noted that earnings management increased can be observed among the firms that voluntarily adopt IFRS.

Further studies have also documented the impacts of IFRS adoption (or convergence) on accounting quality. Chen et al. (2010) for instance, found a convincing evidence of earnings management and absolute discretionary accruals and variations of unexplained accruals. Furthermore, they documented that IFRS encourages companies to engage in income smoothing practices. On the other hand, Aussenegg et al. (2008) using the sample from 17 European countries found that earnings management decrease can be observed among the firms following IFRS adoption as opposed to countries-specific (i.e., domestic) standards.

Firms also possess another alternative to manage their earnings through manipulating their real operational activities. Graham et al. (2005) conducted a survey indicating that managers prefer real earnings management instead of accrual-based earnings management. Empirical measures of Roychowdhury (2006) also showed that the avoidance of losses reporting by the managers can be used through manipulation of their real activities management. A study conducted by Zang (2012) found the trade-off and substitution between accrual-based and real earnings management. She also documented a negative correlation between accrual and real earnings management.

IFRS Adoption and Accrual Earnings Management

As previously mentioned, IFRS provides inherent flexibility in applying the assets estimation through, for example, fair values method. This flexibility is provided through various alternatives in depreciation methods, inventory and revenue recognition, among others. Therefore, IFRS may provide broader room for the managers to achieve and set particular earnings that is not provided by prior, GAAP-based standards.

Prior researches, to some extent also concur with the above lemma. For example, Jeanjean and Stolowy (2008) analysing the deviation of the income distribution as a proxy of earnings management examined the impact of IFRS on three countries (i.e., Australia, United Kingdom and France). They found that earnings management in those countries are not declining and even increasing in France. Callao and Jarne (2010) also showed that the earnings management increased since the adoption of IFRS in 11 countries in Europe. Using data in New Zealand from 2002-2009, Kabir et al. (2010) found that discretionary accruals are higher after the adoption of IFRS and shows a lower quality of earnings at the time of IFRS implementation as compared to the pre IFRS. Therefore, we state our first hypothesis as follows:

***H1**:* Accrual earnings management practices are higher after IFRS convergence

IFRS Adoption and Real Earnings Management

Indeed, better accounting standards guarantee a better accounting quality, where they may increase the value relevance of financial reporting and earnings variability, among others. This will also yield that the firms' financial reporting can be easily scrutinized by the auditors and regulators. As a consequence, firms may opt to engage in real earnings management as it is more difficult to detect when they try to manage their earnings rather than using accruals.

Earlier researches have also noted that IFRS may increase the real management activities. One of the notable researches include Lippens (2008) that tested both real and accrual-based earnings management for the firms in EU countries following mandatory IFRS adoption. He expected that the rate of accrual earnings management will increase in the period after mandatory adoption of IFRS and level of real earnings management will decline during the period. However, using the periods of 2000-2006 he showed that level of accrual and real earnings management increase significantly in the period after mandatory adoption of IFRS. In a survey study, Graham et al. (2005) found that managers prefer managing earnings through real activities than through accrual policy. This is in line with Zang (2012) stating that the manager doing the manipulation of earnings through real activities first and then adjust the level of target profit by the use of discretionary accrual policies. Hence, the following hypothesis is proposed:

H2: earnings management through real operational manipulation increases after firms adopt IFRS

RESEARCH METHOD

Sample Selection

The population in this study includes all manufacturing listed firm in Indonesian Stock Exchange from 2009-2014.The study excludes observations with negative book value of equity and missing values. Data was taken from audited financial statement and annual report of the firm that publish at Indonesian Stock Exchange website (http://www.idx.com). As a result, we found a balanced sample set consist of 438 observation.

Accrual Earnings Management Measure

In this research, accrual earnings management is calculated using Modified Jones Models developed by Dechow et al. (1995). They showed that Modified Jones Model is way better in earnings management detection rather than the original Jones model. They further also further added the change in account receivable in order to control for the possibility to use revenue as a source of earnings management. Modified Jones Models based on Dechow et al. (1995) are as follows:

$$TA_{it}/Assets_{it-1}=\alpha_0(1/Assets_{it-1})+\alpha_1(\Delta Sales_{it}/Assets_{it-1})+\alpha_2(GPPE_{it}/Assets_{it-1})+\varepsilon_{it} \quad (1)$$

where TA_{it}=total accruals, which is calculated as firm net income minus cash flows from operations; $Assets_{it-1}$=total assets for firm; $\Delta Sales_{it}$=change in sales; $GPPE_{it}$=gross property, plant and equipment.

Estimated parameters from (1) are then used to estimate the firm-specific nondiscretionary accruals (NDA_{it}):

$$NDA_{it}=\alpha_0(1/Assets_{it-1})+\alpha 1(\Delta Sales_{it}/Assets_{it-1}–\Delta AR_{it}/Assets_{it-1})+\alpha_2(GPPE_{it}/Assets_{it-1}) \quad (2)$$

Where NDA_{it}=non-discretionary accruals; ΔAR_{it}=change in accounts receivable from year t-1 to year t, while all other variables are as previously defined.

We use discretionary accruals (DA) which is the difference between total accruals and the fitted nondiscretionary accruals to measure accrual earnings management, which is defined as

$$DA_{it}=(TA_{it}/Assets_{it-1})–NDA_{it} \quad (3)$$

Where DA_{it}=discretionary accruals for firm i in year t.

Real Earnings Management Measure

Roychowdury (2006) defined real earnings management as the difference in operating practices with normal operating practice, motivated by the desire of management to mislead stakeholders so that they believe that the purpose of a particular financial reporting have been achieved in the normal operation practice of the company. Some areas that can be exploited in real activities manipulation include overproduction, sales management and reduction of discretionary expense.

We use the following regression models for earnings management in three possible areas, including production (PROD), sales management (CFO) and discretionary expense reduction (DIEXP) is as follows:

$$PROD_{it}/A_{it-1}=\alpha_0+\beta_1(1/A_{it-1})+\beta_2(S_{it}/A_{it-1})+\beta_3(\Delta S_{it}/A_{it-1})+\beta_4(\Delta S_{it-1}/A_{it-1})+\varepsilon_{it} \quad (4)$$

$$CFO_{it}/A_{it-1}=\alpha_0+\beta_1(1/A_{it-1})+\beta_2(S_{it}/A_{it-1})+\beta_3(\Delta S_{it}/A_{it-1})+\varepsilon_{it} \quad (5)$$

$$DISX_{it}/A_{it-1}=\alpha_0+\beta_1(1/A_{it-1})+\beta_2(S_{it-1}/A_{it-1})+\varepsilon_{it} \quad (6)$$

where $PROD_{it}$ equals to production costs, which is the cost of goods sold plus inventories yearly change; CFO_{it} is firms' cash flows from operations; $DISX_{it}$ is discretionary expenses that is measured as selling, general and administrative expenses and A_{it-1} is firms' total assets; and ΔS_{it}=yearly sales changes.

As with prior researches, this study used the residuals found in equations (4), (5) and (6) to measure abnormal production cost (ABN_PROD), abnormal net cash flow from operations (ABC_CFO) and abnormal value of discretionary expenses (ABN_DISEXP), respectively.

In line with Zang (2012) and Cohen and Zarowin (2010), among others, the value of ABN_CFO and ABN DISX are multiplied by -1 so that the higher value indicates the higher manipulation through price discounts and cutting discretionary expenses. To test the second hypothesis, we use the summated, composite score. We also run sensitivity tests, in which real earnings management proxies are separately regressed on IFRS.

Panel Data Regression

Panel data regression was used to test our hypotheses, since our study employs cross sectional firms and multiple years. Using panel regression analysis for these multidimensional types of data gives more efficient estimate (Baltagi 2005). Furthermore, with the panel data analysis, the unobserved heterogeneity both in time as well companies can also be controlled. The panel regression models are tested based on the following models:

$$ABS\_DA=\alpha_0+\alpha_1 IFRS_{it}+\alpha_2 BIG4_{it}+\alpha_3 GROWTH_{it}+\alpha_4 SIZE_{it}+\alpha 5\ LEV_{it}+\alpha_6 ROE_{it}+\alpha_7 REAL_{it}+\varepsilon_{it} \quad (7)$$

$$REAL=\alpha_0+\alpha_1 IFRS_{it}+\alpha_2\ BIG4_{it}+\alpha_3 GROWTH_{it}+\alpha_4 SIZE_{it}+\alpha 5\ LEV_{it}+\alpha_6 ROE_{it}+\alpha_7 ABS\_DA_{it}+\varepsilon_{it} \quad (8)$$

where ABS_DA=absolute value of accrual earnings management; REAL=total value of real earnings management; IFRS=dummy variable, 1 for 2012-2014 periods and 0 otherwise. We used several control variables including growth (GROWTH), audit size (BIG4) financial leverage (LEV), firm size (SIZE) and profitability (ROE). BIG4 is a dummy variable indicating that whether the firms hired a Big 4 auditor, GROWTH is measured as the sales change to control for the growth on earnings management. In order to control for the effect of firm size on earnings management, we measure SIZE as the natural logarithm of firm's market value. LEV is the firm's financial leverage which is the proportion of total liabilities to as the ratio of total liabilities to prior year's total assets. Return on equity (ROE) is measured as the net income over last year's shareholders equity. Researches (for example Doukakis 2014 and Zang 2012) have also concluded that real earnings management is conducted when firms do not have enough flexibility in earnings management through accrual discretions. Therefore, we also use accrual-based earnings management (ABS_DA) as one of the control variables for the real earnings management regression.

RESULTS

Descriptive Statistics

The descriptive statistics of model are shown on the Table 1. The variable ABS_DA indicates an average of 0.108 which means that the average value of accruals that generated by management discretion compared to the previous year assets on manufacturing company in Indonesia. Our study also indicates that 40.6% of our sample was being audited by BIG4.

The variable sales growth (GROWTH) have an average value of 0.097 which shows that the average sales increase against the previous year on manufacturing company in Indonesia is 9.6%. While 45.1% of assets are financed by debt, the average of return of equity was 12.4%.

Table 1
DESCRIPTIVE STATISTICS

	N	Mean	Maximum	Minimum	Std. Dev.
REAL	438	1.113	2.783	-0.152	0.499
ABS_DA	438	0.108	0.416	0.001	0.074
SIZE	438	21.131	25.17	18.060	1.482
GROWTH	438	0.097	0.800	-0.499	0.183
LEV	438	0.451	0.914	0.0413	0.193
ROE	438	0.124	0.591	-0.271	0.117
IFRS	438	0.500	1.000	0.000	0.500
BIG4	438	0.406	1.000	0.000	0.491

Notes: ABS_DA: Accrual Earnings Management; REAL: Total Real Earnings Management; IFRS: IFRS Adoption, Dummy 1 after IFRS Adoption from Year 2012-2014, 0 Prior to IFRS Adoption from Year 2009-2011; BIG4: Type of Auditor, Dummy 1 Audited by BIG4, 0 Audited by Non BIG4; GROWTH: Sales Growth; SIZE: Firm Size; LEV: Leverage; ROE: Return on Equity

The correlation statistics which are displayed in Table 2 showed that discretionary accrual has a positive relationship with real earnings management. On the other hand, the real earnings management is negatively correlated with the audit size (BIG4) and profitability (ROE) and positively correlated with leverage (LEV).

Table 2
CORRELATION RESULTS

	1	2	3	4	5	6	7	8
1 ABS_DA	1							
2 REAL	0.143***	1						
3 IFRS	0.037	0.027	1					
4 BIG4	-0.021	-0.200***	0.028	1				
5 SIZE	0.006	-0.082	0.134***	0.344***	1			
6 GROWTH	0.076	-0.054	0.073	0.008	0.082	1		
7 LEV	0.066	0.479***	-0.015	-0.180***	0.247***	0.038	1	
8 ROE	0.027	-0.109**	-0.140***	0.249***	0.060	0.235***	-0.182***	1

Source: EVIEWS output, 2016
** significant at the 0.05 level
*** significant at the 0.01 level

Panel Regression

Table 3 presents the regression analysis results of regression model (7) and regression model (8). Our statistics indicate that the models satisfy all the classical assumptions. For example, as appeared in Table 3 the VIF scores are all less than 10, indicating no serious multicollinearity issue. We also corrected the standard errors for their possible biases due to heteroscedasticity using the White's method. As been highlighted earlier, we also conducted the Hausman test to control for time and cross sectional heterogeneity. The tests indicate that fixed effect model is used for the discretionary accrual and random effect model is used for the real earnings management.

On the first model where the dependent variable is the accrual earnings management the adjusted R-squared value is 0.489. This indicates that the discretionary accrual is explained by the variation of IFRS and all the control variables (BIG4, SIZE, GROWTH, LEV, ROE and REAL) by 48.9%. F-statistics (6.292) for this is also significant at 1% indicating that all the variables significantly affect discretionary accrual.

The first hypothesis (H1) is regarding the adoption of IFRS that may have a positive association with the change in accrual earnings management practices. Our regression results showed that IFRS adoption has a lower discretionary accrual by 2.1% as compared to the firms that have yet to implement IFRS (t-value=-2.713). Surprisingly, our finding cannot confirm our hypothesis that earnings management is increased after IFRS convergence. Rather we found that inverse association in which earnings management is reduced following IFRS convergence.

We also test whether real earnings management is increased after the infusion of IFRS. The Adjusted R-squared of this particular model is 0.259. In this regards, we found that real earnings management is higher in the post IFRS implementation by 5.2% as compared to the prior IFRS implementation (t-value=2.522; p=0.0120).

Table 3
REGRESSION RESULTS FROM THE POOLED SAMPLE

	Estimate (t-value)		**Variance Inflation Factors (VIF)**	
	ABS_DA	**REAL**	**ABS_DA**	**REAL**
Constant	-1.572*** (-4.646)	2.400*** (4.009)		
IFRS	-0.021*** (-2.714)	0.052** (2.522)	1.068	1.062
BIG4	-0.020 (-0.858)	-0.070 (-0.997)	1.298	1.296
SIZE	0.070*** (4.422)	-0.076*** (-2.844)	1.370	1.311
GROWTH	0.005 (0.297)	-0.219*** (-3.549)	1.093	1.090
LEV	0.035 (0.815)	0.476*** (4.031)	1.596	1.205
ROE	0.145*** (2.673)	-0.213 (-1.323)	1.202	1.201
REAL	0.150*** (7.650)		1.396	
ABS_DA		1.484*** (8.833)		1.012
Adjusted R^2	0.489	0.259		
F-statistic	6.292***	22.827***		
Hausman Prob	0.00	1.00		

Source: EVIEWS output, 2016

Notes: ABS_DA: Accrual Earnings Management; REAL: Total Real Earnings Management; IFRS: IFRS Adoption, a dummy variable in which 1 is after IFRS adoption from year 2012-2014, 0 prior IFRS adoption from year 2009-2011; BIG4: Auditor Type, a dummy variable in which 1 is audited by BIG4 and 0 otherwise; GROWTH: Sales Growth; SIZE: Firm Size; LEV: Leverage; ROE: Return on Equity

** significant at the 0.05 level

*** significant at the 0.01 level

However, as sensitivity tests, when we decompose the real earnings management intro its three known activities, we found that Earnings management is lowered in the post IFRS implementation only from sales management activities (i.e., abnormal cash flow from operations, ABN CFO, t=-1.962) and reduction of discretionary expenses (AB_DISEXP, t=-3.135). Nevertheless, we cannot find that real earnings management through over production (ABN_PROD) is different in the post, *vis a vis*, pre IFRS implementation (t=0.348) (Table 4).

Table 4 **REGRESSION RESULTS FOR INDIVIDUAL PROXIES REAL EARNINGS MANAGEMENT**			
	ABN_CFO	**ABN_PROD**	**ABN_DISEXP**
Constant	0.023(0.251)	-1.412***(-3.507)	-5.806***(-6.549)
IFRS	-0.011*(-1.962)	0.003(0.348)	-0.068***(-3.135)
BIG4	0.036***(2.754)	0.006(0.165)	0.090(1.099)
SIZE	0.003(0.646)	0.060***(3.157)	0.222***(5.263)
GROWTH	-0.070***(-4.449)	0.041**(1.986)	0.318***(6.885)
LEV	-0.150***(-5.518)	0.250***(4.987)	0.137(1.245)
ROE	0.403***(11.237)	-0.374***(-6.648)	-0.443***(-3.581)
REAL			
ABS_DA	-0.756***(-17.618)	0.269***(4.472)	-0.519***(-3.922)
Adjusted R^2	0.540	0.893	0.857
F-statistic	74.383***	47.084***	34.280***

Source: EVIEWS output, 2016

Notes: ABN_CFO: Abnormal Value of Cash Flow from Operation; ABN_PROD: Abnormal Value of Production; ABN_DISEXP: Abnormal Value of Discretional Expenses; ABS_DA: Accrual Earnings Management; REAL: Total Riil Earnings Management; IFRS: IFRS Adoption, dummy 1 after IFRS adoption from year 2012-2014, 0 before IFRS adoption from year 2009-2011; BIG4: Type of Auditor, dummy 1 audited by BIG4, 0 audited by non BIG4; GROWTH: Sales Growth; SIZE: Firm Size; LEV: Leverage; ROE: Return on Equity

* significant at the 0.10 level
** significant at the 0.05 level
*** significant at the 0.01 level

DISCUSSION AND CONCLUSION

This study tests the impacts of mandatory IFRS adoption on earnings management from Indonesian manufacturing firms. Although prior researches have put serious attention on how IFRS may affect the earnings management behaviour, but they tend to focus more on accrual-based earnings management. This study however tries to focus both on accounting (i.e., discretionary accrual) and operational aspects of earnings management, namely real earnings management.

Based on a sample of 438 observations from Indonesian Stock Exchange (IDX) for fiscal years of 2009 to 2014, we found several interesting findings. First, adoption of IFRS has a negative association with accrual earnings management. It means therefore, there is a decrease in the level of discretionary accruals on manufacturing companies in Indonesia after a period of implementation of IFRS. In line with Doukakis (2014), the implementation of IFRS may increase the firm's transparency and improve the overall quality of financial reporting. In this case, analysts, investors, capital market authority are at better position to evaluate and monitor firms' accounting quality and may make informed decision based on firms' accounting options and basic assumptions. As a consequence, managers may not be at ease to falsify or manipulate its performance in their financial reports. Zeghal (2012) also mentioned that the adoption of IFRS improves the quality of earnings by limiting the selection of management decision by eliminating allowed accounting alternative and provide a more consistent approach to accounting measurements. The results of this study are also consistent with a research conducted by Sellami and Fakhfakh (2014) and Brad et al. (2006) that found the adoption of IFRS tend to decrease the earnings management practice based on discretionary accruals.

In contrary, we found that real earnings management tend to be higher in the post IFRS period. A trade-off explanation is provided by Cohen et al. (2008) maintain that a decline in one type of earnings management may be because of the substitution of another method of earnings management had already occurred. A survey conducted by Graham (2005) also indicate that managers prefer engaging in real earnings management practice rather than accrual earnings management, as real activities directly affect the cash flow (Cohen and Zarowin 2010). Cohen and Zarowin (2010) also provide further justifications the reasons real earnings management is preferred. As previously mentioned, aggressive accrual earnings management may lead to higher risk of surveillance by the auditor and perhaps, regulators. Second, less flexibility is available when the firms engage in accrual earnings management (i.e., less slack in discretionary accrual for the following periods). This finding also in-line with Zang (2012) that examined the effect of trade-offs between accrual earnings management and real earnings management and generate a negative relationship between both earnings management.

Like any other research, this study has also some limitations which is necessary to be mentioned. First, observation on this research is the manufacturing sector. Thus, this research has yet to represent the overall corporate sector in Indonesia Stock Exchange. Second, we do not properly (and comprehensively) test the presence of the trade-off between real earnings management and accrual based earnings management and whether the trade-offs prevails following IFRS adoption. We leave this interesting area for further research. Third, due to data availability, we do not differentiate mandatory vs. voluntary adopters of IFRS and thus their respective outcomes to the earnings management are left unexplored. Fourth, it is also interesting to examine the real earnings management using alternative proxies such as long-term asset sales, stock options, stock repurchases and structuring investment transactions and corporate fundings.

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