

Analysis of The Effect of IFRS Convergence on Earnings Management with Corporate Governance as a Moderating Variable (Empirical Study on Non-Financial Companies Listed on the Indonesian Stock Exchange Before and After IFRS)

Evi Rahmawati

Faculty of Economics and Business
Universitas Muhammadiyah Yogyakarta
Yogyakarta, Indonesia
(erahmawati77@gmail.com)

Mia Setiawani Putri

Faculty of Economics and Business
Universitas Muhammadiyah Yogyakarta
Yogyakarta, Indonesia
(Putrimia2015@gmail.com)

Abstract—This study aimed to analyze the effect of IFRS convergence on earnings management with corporate governance mechanism as a moderating variable. Earnings management was measured using discretionary accruals. The corporate governance mechanism as a moderating variable includes the proportion of independent commissioners, size of commissioner boards, auditor quality, institutional ownership, audit committee, and managerial ownership. The samples used in the study were non-financial companies listed on the Indonesia Stock Exchange (IDX) before and after IFRS. The results of this study showed that the convergence of IFRS had a significant effect. Furthermore, the results of this study revealed that the adoption of IFRS can prevent earnings management actions taken by managers. Corporate governance mechanism can strengthen and minimize the effect of earnings management during the convergence of IFRS.

Keywords: IFRS Convergence, Earnings Management, Corporate Governance

I. INTRODUCTION

The times are rapidly demanding changes in communication to produce information to interact. Changes in technology can make it easier for humans to communicate with each other and exchange information between countries, called *globalization*. Globalization has a huge impact, especially in the economic field. The change in globalization leads to the emergence of financial standards. Each country has different financial standards, so the same standards are needed to uniform information in financial statements.

International Financial Reporting Standards (IFRS) are international standards used by various countries to improve the quality of international financial statements (*International Accounting Standards / IAS*) consisting of four major world organizations, namely the International Accounting Federation Standard Board (IASB), the European Community Commission (EC), the International Organization of Capital Market (IOSOC), and the International Accounting Federation (IFAC). Ball (2006)

suggests that IFRS does not result in the desired financial statements. This is due to differences in the legal system so that corporate governance is needed. Corporate governance emphasizes issues related to the overall direction, control and accountability of the company and the community's conception of the scope of corporate (Conforth, 2014).

One of the actions taken by company managers is to manipulate earnings. Manipulation of earnings is often also referred to as earnings management which can be interpreted as an act of the manager in manipulating financial statements with limitations on accounting principles that aim to provide asymmetric information for users of financial statements.

Earnings management is a management behavior in making accounting policies of predetermined standards aimed at improving company quality. Earnings management often does not report the company's real financial statements. Based on the background of the problems above, this study aimed to analyze the effect of IFRS convergence on earnings management with corporate governance as a moderating variable consisting of the proportion of the board of commissioners, the size of the board of commissioners, audit quality, institutional ownership, audit committee, and managerial ownership, controlled by company size, leverage, and ROE.

II. LITERATURE REVIEW

A. Agency Theory

Earnings management is always closely related to agency theory. According to Jao and Pagalung (2011) revealed the existence of the relationship between agents and principals. Agents are the management that organizes companies while principals are shareholders. The agency theory arises because of the separation of interests between agents and principals.

B. Corporate Governance

According to the Forum for Corporate Governance in Indonesia (FCGI) that corporate governance is a set of rules about the relationships between various parties, namely shareholders, corporate managers, creditors, the government, employees, and other stakeholders related to rights and obligations between them.

C. Derivative Hypothesis

In agency theory, there is a relationship between principals and agents (Jao dan Pagulung, 2011). Management is required to present financial statements as a form of responsibility to shareholders. Meanwhile, principals must know management capabilities in companies with asymmetric information to do earnings management. According to Ismail *et al.* (2013), with the application of IFRS-based accounting standards on the quality of corporate earnings, there is a decline in earnings after the company applies the standards, eventually harming the company. The focus of IFRS is principle-based, encouraging management to realize the budget and provide a logical opinion and detailed disclosure using a fair value approach so that management is difficult to do earnings management. Based on the explanation above, the first hypothesis proposed in this research is as follows:

H1: IFRS convergence has a negative effect on earnings management.

D. The Moderation of Proportion of Independent Commissioner Boards on the Relationship between IFRS Convergence and Earnings Management

The agency theory suggests that there is a conflict between principals and agents where agents get more information than principals, causing information asymmetry (Priantinah, 2008). To do earnings management with asymmetric information, a proportion of independent commissioner boards is necessary. If the proportion of independent commissioner board is higher, the financial statements produced will be better (Supriyono, 2014). The focus of IFRS is principle-based, encouraging management to realize the budget, provide quality financial statements and detailed disclosures using a fair value approach so that management is difficult to do earnings management. The more proportion of independent commissioner board is, the lower the earnings management will be. Based on the explanation above, the second hypothesis developed in this research is as follows:

H2: The proportion of independent commissioner boards reinforces the negative relationship between IFRS convergence and earnings management.

E. The Moderation of Size of Commissioner Boards on the Relationship between IFRS Convergence and Earnings Management

The agency theory explains the emergence of conflicts between principals and agents where agents get more

information than principals, causing information asymmetry (Priantinah, 2008). With asymmetric information, management can do earnings management. To prevent earnings management within companies, the size of commissioner boards is necessary. According to Midiastuti and Machfoedz (2003), the size of commissioner boards has a positive effect on earnings management. Adopting IFRS as accounting standards encourages openness in all fields to provide timely and accurate disclosures for any problems that occur within companies to prevent earnings management by managers. Based on the description above, the third hypothesis proposed in this research states as follows:

H3: The size of commissioner boards reinforces the negative relationship between IFRS convergence and earnings management.

F. The Moderation of Auditor Quality on the Relationship between IFRS Convergence and Earnings Management

According to Marpaung and Latrini (2014), auditor quality is a condition in which auditors must know and disclose about an error in the accounting system of auditees. If the audit quality gets better, accounting violations will be reduced, thereby decreasing earnings management actions influenced by IFRS convergence. IFRS can prevent management from manipulating data. The greater the quality of the auditor is, the lower the earnings management will be. Based on the explanation above, the fourth hypothesis developed is as follows:

H4: Auditor quality reinforces the negative relationship between IFRS convergence and earnings management.

G. The Moderation of Institutional Ownership on the Relationship between IFRS Convergence and Earnings Management

Institutional ownership is ownership controlled by institutions such as investment companies, insurance companies and banks, or other institutions tested with the number of shares owned (Fadhilah, 2014). Meanwhile, principle-based focused IFRS convergence is done through a fair value approach to report quality financial statements to prevent earnings management actions with high institutional ownership. Based on the above explanation, the fifth hypothesis is formulated as follows:

H5: Institutional ownership reinforces the negative relationship between IFRS convergence and earnings management.

H. The Moderation of the Audit Committee on the Relationship between IFRS Convergence and Earnings Management

An audit committee is a committee determined by the commissioner board to carry out supervision in managing the company. The JSE regulation No. Kep-305/BEJ/07-2004 requires that each public company in Indonesia forms

audit committee with a minimum of 3 members chaired by one independent commissioner of the company with two external people who are independent of the company and master or have accounting and financial background. Adopting IFRS as accounting standards will encourage openness in all fields strengthened by the existence of a high audit committee. Based on the above explanation, the sixth hypothesis developed in this research states as follows:

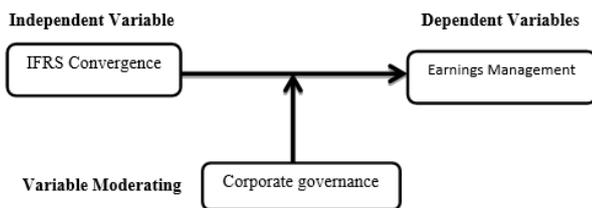
H6: Audit committee reinforces the negative relationship between IFRS convergence and earnings management

I. The Moderation of Managerial Ownership on the Relationship between IFRS Convergence and Earnings Management

Managerial ownership is the ownership of shares controlled by directors, management, commissioners and parties involved in making corporate decisions (Anggraeni, 2013). Managerial ownership owned by companies can prevent the increase in earnings management due to the corporate IFRS convergence in two ways, namely *first*, by risk management process and *second*, by monitoring. High-quality corporate governance will increase the quality of monitoring to prevent earnings management. Adopting IFRS as accounting standards will encourage openness in all fields to prevent earnings management. Based on the above explanation, the next hypothesis proposed in this research is as follows:

H7: Managerial ownership reinforces the negative relationship between IFRS convergence and earnings management.

Research Model



PICTURE I. Research Model

III. RESEARCH METHOD

A. Research Variables

Dependent Variable

The dependent variable used in this research is earnings management. Earnings management uses discretionary accruals. Discretionary accruals are the relationship between total accruals and operating cash flows. This study used the Modified-Jones Model developed by Dechow *et al.* (1995). Here are several formulas used for calculating earnings management:

1. Calculating total accruals

$$TA_{it} = NI_{it} - CFO_{it} \dots \dots \dots (1)$$

2. Determining coefficient regression (Dechow *et al.*, 1995)

$$\frac{TA_{it}}{A_{it-1}} = \beta_1 \frac{1}{A_{it-1}} + \beta_2 \left(\frac{\Delta REV_{it}}{A_{it-1}} - \frac{\Delta REC_{it}}{A_{it-1}} \right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}} \right) + \epsilon_{it} \dots \dots \dots (2)$$

3. Calculating Non-Discretionary Accruals (NDA)

$$NDA_{it} = \beta_1 \frac{1}{A_{it-1}} + \beta_2 \left(\frac{\Delta REV_{it}}{A_{it-1}} - \frac{\Delta REC_{it}}{A_{it-1}} \right) + \beta_3 \left(\frac{PPE_{it}}{A_{it-1}} \right) \dots \dots \dots (3)$$

4. Calculating Discretionary Accruals (DA)

$$DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it} \dots \dots \dots (4)$$

Description :

TA_{it} = Total accruals of i-company in t-period

NI_{it} = Net profit of i-company in t-period

CFO_{it} = Cash flow from operating activities of i-company in t-period

A_{it-1} = Total assets of i-company in t-period

ΔREV_{it} = Change in income of i-company in t-period

ΔREC_{it} = Change in receivables of i-company in t-period

PPE_{it} = Fixed assets of i-company in t-period

DA_{it} = Discretionary accruals of i-company in t-period

NDA_{it} = Non-discretionary accruals of i-company in t-period

β = Regression Coefficient

ϵ =Error = Term of i-company in t-period

Independent Variable

The independent variable in this study is IFRS convergence. IFRS convergence can be measured using dummy variables by giving a score of 1 if the IFRS is implemented by the company, and a score of 0 if the IFRS is not implemented, as can be seen in the report of changes in equity in financial statements (Nastiti, 2015).

Moderating Variable

1. The proportion of Independent Commissioner Board
The proportion of independent commissioner boards can be measured by dividing the number of independent commissioner boards with the total number of commissioner boards in the company (Nastiti,2015).
2. Size of Commissioner Board
The size of commissioner boards can be calculated by the total members of commissioner boards in the company based on the company's annual report (Nastiti,2015).

3. Auditor Quality

Auditor quality can be measured by using the size of Public Accounting Firms (PAF) with dummy variables by giving a score of 1 for companies that have been audited by the Big 4 Public Accounting Firms and a score of 0 for companies that have been audited by the non-big 4 Public Accounting Firms (Nastiti,2015).

4. Institutional Ownership

Institutional ownership can be measured by the percentage of the number of shares owned by institutions of the total amount of circulating share capital (Nastiti, 2015).

5. Audit Committee

Audit committees can be measured by seeing the total members of audit committees in annual reports.

6. Managerial Ownership

Managerial ownership is measured by seeing the percentage of shares controlled by management in making decisions.

Control Variable

1. Company Size

The company size is obtained from the natural logarithm (Ln) of the company's total assets at the end of the year (Kurniawati,2015).

2. Leverage

Leverage uses the ratio of *Debt to Asset*, which is the ratio of total liabilities to total assets owned by a company at the end of the year (Kurniawati, 2014).

3. Return on Equity (ROE)

ROE can be measured from total income before interest and taxes divided by total equity.

B. Sample Determination

The population in this study was non-financial companies listed on the Stock Exchange before and after IFRS. The sampling method used in this study was purposive sampling. Purposive sampling is a sampling technique done not randomly. The criteria of the samples to be examined in this study are as follows:

1. Non-financial companies listed on the Indonesia Stock Exchange before and after IFRS.
2. The companies that have annual reports and financial statements.
3. The annual reports and financial statements are presented in rupiah.
4. The companies have data on the proportion of independent commissioners, the size of commissioner boards, auditor quality, institutional ownership, audit committee, and managerial ownership.

C. Analysis Method

This research aimed to test a moderating variable in influencing the relationship between variables. This relationship test was carried out using Moderated Regression Analysis (MRA) which is a multiple linear regression test in which the regression equation contains multiplication between the independent variable and the moderating variable. The data were processed using SPSS 21 program.

The equation in this study is as follows:

$$Y = \alpha + \beta_1.X_1 + \epsilon$$

$$Y = \alpha + \beta_1.X_1 + \beta_2.X_2 + \beta_3.X_3 + \beta_4.X_4 + \beta_5.X_5 + \beta_6.X_6 + \beta_7.X_7 + \beta_8.X_1.X_2 + \beta_9.X_1.X_3 + \beta_{10}.X_1.X_4 + \beta_{11}.X_1.X_5 + \beta_{12}.X_1.X_6 + \beta_{13}.X_1.X_7 + \beta_{14}.SIZE_{i,t} + \beta_{15}.LEVI_{i,t} + \beta_{16}.ROE_{i,t} + \epsilon$$

Description :

Y = Earnings management

α = Constant

β_{1-16} = Slope or Regression Coefficient

X1 = IFRS Convergence

X2 = Proportion of Independent Commissioner Boards

X3 = Size of Commissioner Board

X4 = Auditor Quality

X5 = Institutional Ownership

X6 = Audit Committee

X7 = Managerial Ownership

X1.X2 = Interaction of IFRS Convergence with Proportion of Independent Commissioner Boards

X1.X3 = Interaction of IFRS Convergence with Size of Commissioner Boards

X1.X4 = Interaction of IFRS Convergence with Auditor Quality

X1.X5 = Interaction of IFRS Convergence with Institutional Ownership

X1.X6 = Interaction of IFRS Convergence with Audit Committee

X1.X7 = Interaction of IFRS Convergence with Ownership Managerial

SIZE_{i,t} = Size (Company Size)

LEVI_{i,t} = Leverage

ROE_{i,t} = Return on Equity (ROE)

IV. RESEARCH RESULTS AND ANALYSIS

A. Descriptive Statistics Analysis

Descriptive statistics explains or describes data can be seen from the mean, standard deviation, minimum value, and maximum value of the variables (the proportion of independent commissioners, the size of commissioner boards, institutional ownership, audit committee, and managerial ownership). The following are the results of the descriptive statistical analysis in this study.

Table 1. Descriptive Statistics of Research Variables

Variable	N	Mean	Deviation Std	Min.	Max.
EM	152	0.0737	0.27379	-2.80	1.23
PDKI	152	0.3812	0.08585	0.20	0.75
UDK	152	4.03	2.122	2	13
KI	152	61.2800	19.50154	1.67	99.00
KA	152	3.07	0.274	3	5
KM	152	11.2696	15.90072	0.00	89.45
SZ	152	23.5612	4.72000	14.00	29.55
LV	152	0.3521	0.33539	0.01	2.85
ROE	152	10.7038	19.36784	-40.47	147.31

Source: Results of Data Processing using SPSS, 2019

Description : EM (Earnings Management); PDKI (Proportion of Independent Commissioner Boards); UDK (Size of Commissioner Board); KI (Institutional Ownership); KADT (Audit Committee); KM (Managerial Ownership); SZ (Size); LV(Leverage); ROE (Return On Equity); KIFRS (IFRS Convergence); dan KA (Audit Quality).

Table 2. Table of Dummy Variable

		Frequency	Percentage
KIFRS	Dummy = 0	50.2	50%
	Dummy = 1	50.2	50%
KA	Dummy = 0	42.2	77%
	Dummy = 1	42.2	77%

Source: Results of Data Processing Using SPSS, 2019

Pre and post-IFRS convergence were measured by using dummy variables, showing a value of 0.50. This suggests that 50% of the company samples had not used IFRS convergence in financial reporting, and the rest companies had used it. Meanwhile, auditor quality showed a mean of 0.77 or 77%, indicating the companies had an average auditor quality of 77%. Audit quality can be measured using dummy variables by giving a score of 1 for companies that have been audited by the Big 4 Public Accounting Firms and a score of 0 for companies that have been audited by the Non-Big 4 Public Accounting Firms.

B. Discussion

Model 1

Table 3. Significance Test of Individual Parameter

Variable	Unstandardized Coefficients		Sig.
	B	Std. Error	
(Constant)	0.107	0.018	0.000
KIFRS	-0.064	0.032	0.049

Source: Results of Data Processing Using SPSS, 2019

The results of hypothesis testing based on Table 4.3 above are as follows:

Testing the negative effect of IFRS convergence on earnings management (H_1) : The partial test results of the IFRS convergence variable can be seen in the t-test results above, showing a probability value of 0.049 (< 0.05) and a coefficient value of -0.064. The negative value indicates that the IFRS convergence had a negative effect on earnings management, so it can be concluded that **Hypothesis 1 was accepted**. The results of this study are supported by the previous study by Ismail *et al.* (2013) finding that the application of IFRS-based accounting standards to the quality of corporate earnings can decrease earnings to harm the company.

Model 2

Table 4. Significance Test Results of Individual Parameters (t-Value)

Variable	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error			
(constant)	-0.429	0.245	Beta	-1.751	0.082
KIFRS	0.115	0.084	0.287	1.360	0.176
PDKI	0.118	0.059	0.165	2.003	0.047
UDK	0.092	0.032	0.248	2.858	0.005
KA	0.099	0.036	0.207	2.738	0.007
KI	0.025	0.020	0.094	1.216	0.226
KADT	0.043	0.147	0.022	0.292	0.771
KM	0.040	0.025	0.142	1.601	0.112
KIFRS*	-0.317	0.067	-0.809	-4.720	0.000
PDKI					
KIFRS*	-0.135	0.038	-0.506	-3.521	0.001
UDK					
KIFRS*	-0.108	0.052	-0.201	-2.066	0.041
KA					
KIFRS*	-0.024	0.010	-0.237	-2.316	0.022
KI					
KIFRS*	-0.110	0.051	-0.314	-2.170	0.032
KADT					

KIFRS* KM	-0.080	0.038	-0.267	-2.126	0.035
SZ	0.105	0.055	0.149	1.898	0.060
LEVER AGE	0.021	0.011	0.147	1.933	0.055
ROE	-0.009	0.012	-0.056	-0.742	0.460

Source: Results of Data Processing Using SPSS, 2019

- 1.) Testing the effect of IFRS convergence on earnings management with the proportion of independent commissioner boards as a moderating variable (H_2):

As can be seen in the table of t-test above, the partial test results of the interaction of IFRS convergence with the proportion of independent commissioner boards showed a probability value of 0.000 (< 0.05) and a coefficient value of -0.317, indicating a negative value. In other words, the proportion of independent commissioner boards reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 2 was accepted**. According to Supriyono (2014), if the higher proportion of independent commissioner boards will result in better financial statements. Furthermore, it is supported by Tiswiyanti *et al.* (2012) finding the negative effect of independent commissioner boards on earnings management. This is because the greater the proportion of independent commissioner boards is, the greater the decision making to balance the differences in interests will be, reducing the occurrence of earnings management.

- 2.) Testing the effect of IFRS convergence on earnings management with the size of commissioner boards as a moderating variable (H_3):

The partial test results of the interaction of IFRS convergence with the size of commissioner boards using the t-test showed a probability value of 0.001 (< 0.05) and a coefficient value of -0.135, indicating a negative value. This indicates that the size of commissioner boards reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 3 was accepted**. The results of this study are consistent with the study of Rahnamay and Nabavi (2010) revealing that the size of commissioner boards had a negative effect on earnings management. Besides, Klein (2002) stated that the size of commissioner boards is related to the audit committee in carrying out the task. If the size of commissioner boards increases, the task of the members of commissioner boards will be more specific because of the existence of committees in supervising the company so that it can reduce earnings management practices.

- 3.) Testing the effect of IFRS convergence on earnings management with auditor quality as a moderating variable (H_4):

The partial test results of the interaction of IFRS convergence with auditor quality using the t-test showed a probability value of 0.041 (< 0.05) and a coefficient value of -0.108, indicating a negative value. Therefore, it can be concluded that auditor quality reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 4 was accepted**. This result is supported by the study of Marpaung and Latrini (2014) stating that audit quality is a condition where auditors must know and disclose an error in the auditing accounting system.

- 4.) Testing the effect of IFRS convergence on earnings management with institutional ownership as a moderating variable (H_5):

The partial test results of the interaction of IFRS convergence with institutional ownership using the t-test showed a probability value of 0.022 (< 0.05) and a coefficient value of -0.024, indicating a negative value. In conclusion, institutional ownership reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 5 was accepted**. The results of this study are in line with the previous study conducted by Fadhilah (2014) revealing that institutional ownership is ownership controlled by institutions such as investment companies, insurance companies and banks, or other institutions tested by the number of shares owned. Meanwhile, according to Herawati (2014), the supervision conducted by companies and institutional investors can prevent deviant actions taken by managers.

- 5.) Testing the effect of IFRS convergence on earnings management with audit committee as a moderating variable (H_6):

The partial test results of the interaction of IFRS convergence with audit committee using the t-test showed a probability value of 0.032 (< 0.05) and a coefficient value of -0.110, indicating a negative value. Therefore, it can be obtained that the audit committee reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 6 was accepted**. The results of this study are following JSX No.Kep-305/BEJ/07-2004 requiring that every public company in Indonesia must form an audit committee with a minimum of 3 members chaired by one corporate independent commissioner with two external people who are independent of the company as well as master and have an accounting and financial background.

- 6.) Testing the effect of IFRS convergence on earnings management with managerial ownership as a moderating variable (H_7):

The partial test results of the interaction of IFRS convergence with managerial ownership using the t-test showed a probability value of 0.035 (< 0.05) and a

coefficient value of -0.080, indicating a negative value. Therefore, it can be concluded that managerial ownership reinforced the negative relationship between IFRS convergence and earnings management, so **Hypothesis 7 was accepted**. The results of this study support the previous study by Anggraeni (2013) stating that managerial ownership is ownership of shares controlled by directors, management, commissioners and parties involved in corporate decision making. Another study conducted by Jao and Pagulung (2011) reveals that large share ownership can be seen from their economic value which can be used to monitor.

IV. CONCLUSION AND SUGGESTION

A. Conclusion

This study was conducted to examine whether the effect of IFRS convergence on earnings management with corporate governance as a moderating variable. The existence of corporate governance within a company can reduce earnings management actions regulated based on financial accounting standards that have been converged so that managers cannot take actions that are only beneficial for themselves.

B. Suggestion

Based on the results, discussion and conclusions above, we suggest further research to add years of research to reduce frauds committed by managers to produce better research results. Besides, further research is expected to be able to use other company sectors and replace the control variable in this study. Future works can also use logistic tests as a comparison to this study.

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