

## **ABSTRACT**

The objective of this research was to investigate the inefficiency of fixed asset investment in mediating the relationship of free cash flow to earnings management and test the controlling shareholder in moderating the relationship of free cash flow with fixed asset investment inefficiency. Research problem is whether the use of free cash flow for the inefficiency of fixed asset investment could ultimately improve earnings management and whether the controlling shareholder is a contextual factor in the use of free cash flow for the inefficiency of fixed asset investment. The research to investigate a new empirical evidence related to earnings management practices that caused free cash flow used in investing activities of fixed assets that are not efficient.

Using the financial statements of manufacturing companies listed in Indonesia Stock Exchange year observations over the period 2010-2015. Based on purposive sampling, 114 samples manufacturing companies. Completion path estimation model using Structural Equation Modeling (SEM) with WarpPLS program version 5.0.

The results of this research show that the direct free cash flow have positive significant relationships with earning management through accruals. Then, the direct free cash flow have positive significant relationships with earning management through real activities. The results also show that fixed-asset investment inefficiency mediate the association of free cash flow with discretionary accruals and real earnings management. The results also indicate that the controlling shareholders as moderate in the relationship of free cash flow with fixed asset investment inefficiency.

**Keywords :** free cash flow, discretionary accruals, real earnings management, inefficiency of fixed asset investment, controlling shareholders.