ABSTRACT

The purposes of this study are to examine the influence of surplus free cash flow towards earnings management and the role of good corporate governance as well as the ownership structure in moderating the relationship between surplus free cash flow and earnings management. In this study, good corporate governance is proxied with audit quality and independent audit committee, while the ownership structure is proxied with institutional ownership and managerial ownership.

Based on the partial least square (PLS) analysis towards 104 sample manufacturing companies listed in Indonesia Stock Exchange in 2013-2014 selected using purposive sampling, it is found that surplus free cash flow has significant positive effect on earnings management. Meanwhile, the testing towards the 4 (four) moderating variables which is supposed to reduce the positive impact of surplus free cash flow towards the earning management concludes that institutional ownership is proven to reduce the impact of positive surplus of free cash flow toward earnings management. Managerial ownership variable is found to have significant positive effect on the relationship between surplus free cash flow and earnings management. The audit quality and independent audit committee, on the other hand, does not significantly influence the relationship between surplus free cash flow and earnings management. These findings indicate that the agency problem caused by surplus free cash flow will encourage management to do earnings management. Furthermore, the earnings management actions can be minimalized through monitoring mechanisms done by the institutional ownership.

Keywords: surplus free cash flow, earnings management, good corporate governance, ownership structure, audit quality, independent audit committee, institutional ownership, managerial ownership.