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The Effect Earnings Management on Financial Performance

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Abstract: The usefulness of this study was to determine the effect of management Return on Financial Performance. Forms of earnings management in the form of: 1) reporting earnings aggressive (earning aggresiveness), by delaying the recognition of expenses and the current losses and or accelerate the recognition of income and future returns, 2) avoid reporting income (loss avoidance), namely to avoid reporting income negative, increasing the earnings reporting, and meet the profit forecast by analysts. 3) smoothing earnings (earnings smoothing), namely the use of accounting policy to hide the economic shock on the operating cash flow of the company. The main focus of the users of the financial statements in this research is to provide information about the company's performance is measured by income and its components. While the investors and creditors as users of financial statements using past earnings information to help assess the company's prospects.

Keywords: Earnings Management, Financial Performance.

INRODUCTION

Indonesia's economy require alternative sources of funding other than through bank credit, which is through the capital market. Over the past decade, the stock market began to show an important role in mobilizing funds to support the estab-building the national economy (Farid&Siswanto, 2001). The development of the capital market has been able to provide a substantial contribution to the development of national economy. It can be seen from the number of companies that went public since reactivated the Indonesian capital market in 1977 to 1987 is 24 companies with a total issuance value Rp.679,50 billion, has experienced a large increase to 411 companies in 2004 with emission values total Rp.314.76 trillion (Financial Statistics Indonesia, Bank Indonesia, 2004). The development shows that many public companies to increase its capital by issuing their securities to the public. Through the capital market, the funds available can dialoksikan to the most productive use of these resources. To realize the optimal allocation of resources in the capital market, companies must provide transparent information to the public and useful in making economic decisions. Despite the investment and credit decisions reflect the expectations of investors and creditors about the company's performance in the future, expectations are usually based at least in part evaluate the financial performance of companies in the past.

Bhattacharya, Daouk and Welker (2003), states that the company's reported earnings contain vagueness or lack of accountability between accounting profit that can be observed and economic profits that can not be observed, called the earnings opacity. The reported profit companies may be unclear because of the complex interaction between, at least three factors, namely the motivation of managerial, accounting standards, and the implementation of accounting standards. Managers have incentives to manage earnings reports by using policies accrual permitted by accounting standards with the aim to cover the performance of the actual company, for example, reported a higher return and hide realized gain unfavorable (loss) which may trigger intervention by other parties.

Leuz, Nanda and Wysocki (2003) states that the earnings management practices in a country depends on the size of capital markets, the spread of share ownership, strong or weak investor rights, and legal enforcement. Research results indicate that the

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lower earnings management practices in countries that have large capital markets, ownership spread, strong investor rights, and a strong legal enforcement. In the investment community in the United States there is great attention to earnings management practices that have eroded public confidence and disrupt the efficient flow of capital in the capital market. The community of states that managers abuse the freedom given by Generally Accepted Accounting Principles (GAAP) and intentionally change the content of the information in the financial statements that may mislead users of the report (Wooten, 2003). Arthur Levit, chairman of the Securities Exchange Commission (SEC), in a speech in September 1998 on "The Numbers Game" stated that SEC was concerned and give full attention to the earnings management practices and their negative influence on the quality of earnings and financial reporting (Levitt, 1998). Chairman of the commission concerns the American capital market and the investment community on earnings management practices has triggered many researchers to be able to provide empirical evidence on earnings management practices worldwide. The research findings Bhattacharya,

Daouk and Welker (2003) on earnings management practices throughout the world shows the countries in Asia, including Indonesia have a high level of earnings management. For example, speed up the recognition of future income to hide the poor performance of the present, so that reported earnings do not reflect the actual performance (Leuz, et al., 2003, p.510). Earnings management is inappropriate, and abuse such as earnings management occurs when people take advantage of the inherent flexibility in the application of GAAP to the purpose to obscure financial volatility true, and in turn will hide konsekuesi-consequences right from management decisions (Levitt, 1998, p. 16). The manager misused the freedom given by the accounting principles and intentionally change the content of the information in the financial statements of self-interest, thereby misleading the report users. The opportunistic behavior of managers that can occur because of weak corporate control mechanisms. Cases of violations of financial reporting by public companies is handled by Bapepam mainly involves a violation of the principle of lawyer-expression of an accurate and transparent, this would be very detrimental to the users of financial statements, especially investors, because the information published by the company containing the error was made basic decisions investation. When the error information published was announced, stock prices fell and investors harmed.

2.1. DEFINITION OF PROFIT MANAGEMENT

Financial reporting purposes and how it relates to the definition of accrual accounting, as presented by the Financial Accounting Standards Board (FASB) in a variety of Statement of Financial Accounting Concepts (SFAC). The main focus of financial reporting is financial information about the company's performance provided by the measurement of income and its components (FASB 1978, SFAC 1, para.43). Accrual accounting attempts to record the effects of the financial transactions and business events as well as other environments that have consequences for cash at a company in a period when the transactions, events and the environment occurs from the only period in which the cash is received or paid by an entity (FASB 1985, SFAC 6, paragraphs 139). Using accrual accounting accrual, defferal, and procedure-posedur allocation with the objective of linking revenues, expenses, gains and losses in a period to reflect the company's performance during a period of at just a list of cash coming in and cash out. Thus, recognition of revenues, expenses, gains and losses and its relation to the increase or decrease in the assets and liabilities, including reconcile expenses with revenues, allocation and amortization, are the essence of the use of accrual accounting to measure the performance of the entity (FASB 1985, SFAC No. .6, para.145). Thus, the objective principle of accrual accounting is to help investors assess the performance of the economy during the period through the use of basic accounting principles such as revenue recognition and matching (Dechow and Skinner, 2000).

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Definition of earnings management is important for accountants because it allows an understanding of the development of net profit for the reporting to the investors or to a contract / agreement. Some definitions of earnings management is presented as follows: "... a purposeful intervention in the external financial reporting process, with the intent of Obtaining some private gain (Schipper, 1989, p.92). "Earnings management Occurs when managers use jugdment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlyaing economic performance of the company, or to influence cotractual outcomes that depend on Reported accounting numbers" (Healy and Wahlen, 1999, p.368). Given that managers can choose accounting policies from a set of policies (for example, GAAP), it is natural to expect that they will choose policies so as to maximize Reviews their own utility and / or the market value of the firm. This is called earnings management (Scott, 2003, p.368). Of the three of these definitions can diintisarikan that earnings management is considered selection of the accounting policies used by management in the preparation of the transaction and financial reporting of the company to achieve certain goals, for example: to influence the outcome of contractual depends on the number of reported earnings (debt contract or compensation) and or to affect the market value of the company. The preparation of financial statements in violation of generally acceptable accounting principles (general accepted accounting principles / GAAP) expressed either as the management of profit and fraud. Mulford and Comiskey (2002, p.3) defines the creative accounting practices in general designation for the game following financial figures:

Tabel2.1 Common labels for the financial numbers game

Label	Definition
"Aggressive accounting"	A forceful and intentional choice and application of accounting principles done in an effort to achieve desiren result, typically higher current earnings, whether the practices followed are in accordance with GAAP or not
"Earnings management"	The active manipulation of earnings toward a predetermined target, which may be set by management , a forecast made by analysts, or an amount that is consistent with a smoother, more sustainable earnings stream
"Income smoothing"	A form of earnings management designed to remove peaks and valley from a normal earnings series, including steps to reduce and "store" profits during food years for use during slower years.
"Fraudulent financial reporting	Intentional misstatement or omissions of amounts or disclosures in financial statements, done to deceive financial statement users, that are determined to be fraudulent by an administrative, civil, or criminal proceeding
Creative accounting practices	Any and all steps used to play the financial numbers game, including the aggressive choice and application of accounting principles, fraudulent financial reporting, and any steps taken toward earnings management or income smoothing.

Sumber: MulforddanComiskey, (2002, p.3)

According to Mulford and Comiskey (2002), earnings management is an earnings manipulation intended to create an impression (impression) on business performance, for example to meet the targets set by management or prediction made by analysts. Impression on business performance changed not always stated that earnings management mengahasilkan income measurement meaningless. For example, the rate of profit managed (managed earnings number) is an indicator of future earnings expectations better. Furthermore, the volatility of earnings figures are managed in a row gives an index of financial risk is more realistic than the profit figures are not managed (unmanaged earnings). However, earnings management can result in omissions and misstatements are material numbers and proper disclosure, and this action is intended to deceive or cheat the users of financial statements.

2.2. Earnings Management Motivation

Healy and Wahlen (1999) suggested that the researchers have tested many different motivations for earnings management, include: 1) expectations and assessment of capital markets (capital market expectation and valuation), 2) contracts made with regard to accounting numbers and 3) government regulation. Widespread use of accounting information by investors and financial analysts to help assess the stocks may be creating incentives for managers to manipulate earnings in an effort to influence the share price performance in the short term. Many studies conducted to support the motivation of earnings management related to capital markets (capital market motivation), which are: 1) that managers have an incentive to 'manage' profits by avoiding reporting losses and a decrease in net earnings (Burgstahler and Dichev, 1997), reported growth and an increase in its quarterly profit with the aim to meet the expectations or estimates of profit according to analysts (Degeorge, et al. 1999), and the consequences of non-fulfillment of benchmark earnings cause a drop in stock prices massively (Skinner and Sloan, 2000), 2) shows that managers manage earnings when equity offerings, namely by reporting high profit with improper and is associated with high discretionary accruals, and there is a strong relationship between earnings management with the share price performance in the subsequent periods after the bidding firm's equity (Dechow et al., 2000), 3) shows that market participants were "deceived" by the earnings management practices, that is, when market participants overestimate the persistence of low earnings quality now and underestimate the persistence of current high earnings quality (Sloan, 1996).

DeFond and Jiambalvo (1994) found that the company increased its profit one year prior to the violation of the agreement, and interpret it as evidence of earnings management of the company is closely related to the loan agreement. Research Sweeney (1994) also found that the company violated the agreement makes changes to accounting methods that increase profitability, but it was done after the violation. These findings indicate that the company made no changes to accounting methods particular to avoid breaching the loan agreement, but the change in accounting method was created to reduce the possibility of violations of the agreement in the future. The contracts give rise to compensation boost earnings management is supported by many studies that suggest that managers use to boost bonus accounting considerations on the basis of reported earnings. Healy (1985, in Healy &Wahlen, 1999) and Holthausen et al. (1995) pointed-out that companies with bonuses that reached the upper limit is likely to report a profit accrual suspended when the limit achieved from the companies that do not have a limit bonuses. Guidry et al. (1998) found that the divisional manager for a large multinational company tends to suspend the profit when the profit target in the bonus program can not be achieved and when they declared to have reached the maximum bonus allowed under the program.

The accounting standard setter shows attention to earnings management that aims to avoid regulation of the industry. Actually, the entire industry is set to a certain degree, but there are some industries (banking, insurance, and utility industries) facing regulators is ekspilit monitoring related to accounting data. Banking regulations require that banks must meet capital adequacy requirements are made in the form of accounting numbers. Insurance regulation requires that an insurance company must meet the minimum conditions of financial health. These regulations create incentive to manage the variables income statement and balance sheet to the attention of regulators. Some studies show evidence that banks are approaching the minimum capital requirements tighten

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loan-loss provisions (loan loss provisions), lowering the elimination of loans, and recognize abnormal gains on portfolio securities (Beatty and Petroni, 2002). There is also evidence that the insurance companies are financially weak and risky attention regulator will reduce claims loss reserves, and enter into reinsurance transactions (Healy &Wahlen, 1999).

2.3.Teknik Profit Management

Earnings management techniques most commonly includes the use of the flexibilities contained in generally accepted accounting principles. Levitt (1998) states that the accounting flexibility in being permitted to deal with developments in the business environment. Earnings management is inappropriate, and abuse such as earnings management occurs when people take advantage of the inherent flexibility in the application of GAAP to the purpose to obscure financial volatility true, and in turn will hide konsekuesi-consequences right from management decisions (Levitt, 1998, p. 16). Mulford and Comiskey (2002) states that the earnings management techniques can be done both inside and outside the limits of generally acceptable accounting principles (GAAP). Management techniques earnings are still within the limits of GAAP include: a) changes in depreciation methods, changes in useful lives are used for depreciation, changes in the estimated residual value for the purpose of depreciation and changes to the amortization period for intangible assets, b) determination of the allowance for doubtful accounts -ragu or loan receivables, allowance for deferred tax assets and the determination of the assets that have been depleted of its useful life, c) the estimated percentage of completion stage of completion of the contract, the estimated elimination of which is required for a particular investment, consideration is needed for the elimination of inventories and consideration of whether the decline in market value an investment of temporary or long term.

Furthermore, efforts to manage income generating misstatements or omissions in material amounts or disclosures are feasible. This action-kan intended to defraud users of financial statements, accounting forms and fraudulent financial irregulaities reporting is often used for such actions (Mulford and Comiskey, 2002, p.66) also called abusive earnings management (Levitt, 1998, p.16). Levitt (1998) describes techniques "accounting magic" that they do indeed describe the abuse the most daring on the flexibility contained in accrual accounting, namely: big bath charge, cookie jar resevers, the concept of materiality and improper revenue recognition. The concept of the background charge is a big bath when the company hopes to have success in the profitability in the future, the company will recognize all doubtful in a year, so as not to burden the periods in the future with continuous losses. Mechanical cookie jar resevers companies do to keep watch for the period in which the earnings numbers are not so favorable. The Company recognizes the amount of cash received as unearned income, not as income, basically the company store revenue for the period in which there is a threat of future earnings would be below market expectations.

Some examples of earnings management proposed Securities Exchange Commission (SEC) in Accounting and Auditing Enforcement Releases (AAERs) include abuse of activity accounting normal, namely the recognition of revenue, accrued expense (accrual of expenses), capitalized costs, and asset disposals (Mulford and Comiskey, 2002, P.67). Pengakuanpendapatan premature or fictitious income is the most common form used in earnings management. For example, the recording period for revenue and shipments next period (premature revenue recognition), and recording revenue on sales that do not exist or no delivery of goods ordered (fictitious revenue recognition). Giroux (2004) provides an example of management techniques gain the most commonly used, namely: revenue recognition aggressive (recognizing revenue early in the cycle of operation), choose the capitalization of the charge-operating costs, and allocating costs in a longer period (extend the useful life of fixed assets). Because many accounting techniques that provide alternatives and considerations profesinal, then the choice of accounting (accounting choise) is an important component in the earnings management. Methods for inventory, depreciation and accounting for securities is a choice example of the accounting practices used for earnings management (Giroux, 2004, p.5).

2.4. Detection of Earnings Management

Accrual basis (accrual basis) was agreed as the basis of preparation of financial statements for a more rational and reasonable compared to the cash basis (cash basis). Some studies indicate earnings have greater information content than operating cash flow, since earnings information resulting from the use of accrual reduce timing and mismatching problems that arise in the measurement of cash flows (Dechow, 1994; Sloan, 1996). Accrual-based financial statements involves many estimates and estimates. Various options are available in accrual accounting principles generally acceptable and accruals to manipulate these vulnerabilities allow earnings management (Belkaoui, 2004). In the accounting literature, discretionary accruals have the same meaning as the earnings management (Kothari, 2001, p.161). Men-detection of manipulation of accounting policy relating to accruals (discretionary accruals) is a difficult thing, for example, the company increased depreciation and amortization, this may occur due to excessive recorded a liability for product warranty, contingent liabilities, and rebates, or perhaps because of noted a lot of bad debts and obsolete inventory (Scott, 2003, p.281).

The use of discretionary accrual financial statements are intended to be informative that the financial statements to reflect circumstances se, verily. But the fact discretionary accrual management used to raise or lower the reported income for personal gain so that the consolidated statements do not reflect the real situation. Healy (1985) examine the earnings management by comparing the average total accruals scaled by lagged total assets to variable separation (partitioning variable) earnings management. Healy study differs from most other earnings management studies in which he predicts systematic earnings management that occur in each period. Variable separator dividing the sample into three groups: one group's profit forecast is raised, and the two groups to profit derived. Then the average total accrual of the estimation period used to measure nondiscretionary accrual. Model nondiscretionary accrual as follows:

$$NDA\tau = \frac{\Sigma_t \, TA_t}{T} \qquad (1)$$

Where:

NDA = nondiscretionary estimated accrual

TA = total accruals scaled by lagged total assets

$t = 1,2, \ldots. T$ is the years covered in the estimation period ; and

τ = year in the period of the event (event period)

Model DeAngelo (1986) examine the earnings management by calculating the difference in the total accrual , and assuming that these differences have an expected value is zero under the null hypothesis does not occur earnings management . This model uses the latest period total accruals scaled by lagged total assets as nondiscretionary measurement accrual. So DeAngelo for nondiscretionary accrual models are :

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$$NDA\tau = TA_{\tau\text{-}1} \quad (2)$$

DeAngelo Model can be viewed as a special case of the model Healy , where the estimation period for nondiscretionary accrual is limited to observation previous year . And this model is appropriate if nondiscretionary accrual follow a random walk . Jones (1991) suggested a model that reduces the assumption that nondiscretionary accrual is constant . This model seeks to control the impact of changes in the economic environment companies in nondiscretionary accrual. Jones model for nondiscretionary accrual in the period of the event are :

$$NDA\tau = \alpha_1 (1/A_{\tau\text{-}1}) + \alpha_2 (\Delta REV\tau) + \alpha_3 (PPE\tau) \quad (3)$$

Where

$\Delta REV\tau$ = revenue in reduced revenue τ τ - 1 divided by total assets τ - 1

PPE τ = gross property plant and equipment to total assets ratio of τ τ - 1

$A\tau$ - 1 = total assets $A\tau$ - 1 ; and $\alpha 1$, $\alpha 2$, $\alpha 3$ = parameter specific company

Estimation parameters specific company $\alpha 1$, $\alpha 2$, and $\alpha 3$ is obtained by using the following model in the estimation period :

$$TA\tau = a_1(1/A\tau\text{-}1) + a_2 (\Delta REV\tau) + a_3 (PPE\tau) + v\tau \quad (4)$$

where a1 , a2 and a3 show the OLS estimates of $\alpha 1$, $\alpha 2$, and $\alpha 3$, and $TA\tau$ is τ total accrual in the year divided by total assets . Jones model is successful in explaining the variation in total accrual in the quarter . The implicit assumption in this model is that it is a nondiscretionary income accrual. Modifications Jones model (modified Jones model) dirangcang to eliminate conjectured tendency of Jones model to measure discretionary accruals with an error when performed on revenues discretion . In this model , nondiscretionary estimated accrual during the event period , as follows :

$$NDA\tau = \alpha 1 (1/A\tau\text{-}1) + \alpha 2 (\Delta REV\tau - \Delta REC\tau) + \alpha 3 (PPE\tau) \quad (5)$$

Where ,$\Delta REC\tau$ = net receivable in the year reduced net receivable τ τ - 1 divided by total assets at year- τ - 1 . Adjustments are made relative to the Jones model is the change in income adjusted for changes in net receivables in the event period . This model implicitly assumes that all changes in credit sales at the event as a result of earnings management . This is based on the premise that earnings management is done by discretion on recognition of revenue from the sale of credit than cash sales . Industrial model used by Dechow and Sloan (1991) . This model is similar to the model Jones reduces nondiscretionary accrual assumptions that are constant over time , and this model assumes that the variations in the determinant nondiscretionary accrual is common among companies in the same industry . Industrial model for nondiscretionary accrual are :

$$NDA\tau = \gamma 1 + \gamma 2 \ median_j (TA\tau) \quad (6)$$

Where. medianj ($TA\tau$) = the median value of total accruals scaled by lagged assets for all companies not sampled in the 2-digit SIC codes are the same. While $\gamma 1$ and $\gamma 2$ are firm-specific parameters are estimated using OLS on observation in the estimation period.

The ability of the industry model to reduce measurement errors in discretionary accrual critically dependent on two factors, namely: 1) the industry model only eliminates variations in nondiscretionary accrual common to companies in the same industry, if there is a change in nondiscretionary accrual then the large reflecting reaction to certain changes in the corporate environment, so the industrial model can not dig the whole nondiscretionary accrual of proxy discretionary accruals, 2) industry model eliminates variations in discretionary accrual relating to companies in the same industry, potentially causing problems. Severity of the problem depends on the extent of earnings management stimulus associated with companies in the same industry. Dechow, Sloan and Sweeney (1995) tested five models of discretionary accruals (ie models Healy 1985, DeAngelo in 1986, Jones 1991, Mods Jones and industrial model used Dechow and Sloan 1991), the results indicate that the Jones model and modified model developed by Jones (1991) the most popular used and provide testing earnings management of the most powerful (powerful). However, testing of potential earnings management misspecified for all current models dividing earnings management variables correlated with company performance. Based on the conclusions Dechow et al. (1995), to reduce the specs were wrong (misspecification) which reduces the possibility of the withdrawal of the wrong conclusions, Kothari, Leone and Wasley (2002) suggested performance-matched Jones models to measure discretionary accruals, ie by entering the company's performance (Return On Assets) to the modified Jones model. The formula used by Kothari et al. (2002) are as follows:

$$TA_{it} = \delta_0/ASSETS_{it-1} + \delta_1 \Delta SALES_{it} + \delta_2 PPE_{it} + \delta_3 ROA_{it-1} + v_{it} \qquad (7)$$

Where ROA it-1 is the return on assets in the period t-1

The study Kothari, et al. (2002) showed that performance-matched discretionary accruals Jones models measure with good specifications (well specified) and very strong (powerful).

2.5. Company Financial Performance

Performance is the end result of an activity. The company's performance is the accumulation of all the end result of the activity and the company's work processes (Robbins and Coulter, 2005, p.465). Managers need to provide a means to monitor and measure the performance of companies. The financial statements provide financial information that is useful for managers to analyze the results of its work in managing the company, and helpful for other users in making economic decisions. Financial performance measurement can be done based on the performance of accounting (accounting measure of performance), and can also be based on the performance of the market (market based measure). (Rhoades, et al., 2001, p.313; Dutta&Reichelstein, 2005, p. 1069) .Perdebatan on the measurement of financial performance based on cash flow models or the profit model has long been underway. Proponents of performance measurement is based on cash flows to say that cash is the fact while profit is only an opinion (Penman, 1992 & Rappaport, 1998; in Hirst& Hopkins, 2000, p.14). Proponents claim that the cash flows accounting profit is subject to manipulation by the manager, their conservative bias in accounting standards, and sometimes ignore important elements of economic profit.

By using operating cash flow as a measure of financial performance have an advantage because it does not rely on stock return which assumes that capital markets are not efficient in its ability to detect opportunistic management behavior (Bowen, et al., 2004). Furthermore, any mechanical relationship between accruals current with future earnings of the accrual reversals avoided. However, operating cash flow have problems with timeliness as the performance metric (Dechow, 1994). In particular, the negative cash flow can generate investment in the project and does not produce a positive NPVnya poor operating performance. Therefore, operating cash flow is likely to be a good measuring tool for financial performance only to companies that stable. This motivates the use of metrics based on other income as a measure of financial performance, such as return on assets, return on ivestment, and others.

The role of information in the securities market and the securities market predictions to justify the use of market reaction in the formulation of accounting. According to one interpretation predictive approach, observing the reaction of the capital market can be used as a guide to evaluate and choose among alternative accounting measurement (Belkaoui, 2004, p.408). For example, Gonedes (1972) stated that the observation of the reaction of the market as a receiver output accounting determines the evaluation of the actual information content of accounting numbers generated through accounting procedures. Likewise Beaver and Dukes (1972) states that the method that produces the highest profit figure relation to the price of securities is most consistent with the information that results in efficient pricing of securities that is the method that should be reported. In other words, predictive approach like the adoption of accounting numbers which have the highest regard to the market price. This requires evaluation of the usefulness of accounting numbers transmitted on capital market transactions as an aggregated, which means the focus is on securities market reaction is not the individual investors who make up the market (in Belkaoui, 2004, p.408). Stock return performance measurement allows for testing the efficiency of the stock market where investors may have been anticipating the behavior of managers in financial reporting and have been included in the prevailing stock price (Belkaoui, 2004, p.426). Thus, the relevance of accounting information and selection of accounting measurement procedures can be tested by the market reaction is reflected in the market price of the equity.

Stock prices and accounting data provide different types of information are fundamental. The stock price look forward (forward-looking) while accounting information look backward (backward-looking or historical). The stock price may rise when the market receives less accurate information about the company's cash flow and earnings in the future. But when the market becomes more accurate information, shareholders and other interested parties need not rely on accounting information (Dutta&Reichelstein, 2005).

These three performance measures, namely operating cash flow and return on assets (the company's operating performance), as well as the share price (performance shares), each has its own advantages, therefore the performance of the three measurements used in this study.

2.6 Prior Research On Earnings Management, Financial Performance

Several previous studies about earnings management, corporate performance and corporate governance, can be divided into two groups, namely: 1) research on the influence of corporate governance mechanisms to earnings management, and 2) research on the effect of earnings management and governance mechanisms on financial performance company. Several studies have tried to explain how corporate governance factors affect the behavior of the manager with the decisions that benefit themselves and ultimately affect the confidence of investors. Weak governance is often used by company management to private interests through the selection of accounting policies in preparing the financial statements. Past research has shown that there is a relationship between earnings management with corporate governance mechanisms, and interpret it as evidence that the weak governance pose excessive managerial opportunism.

Beasley (1996), found that the inclusion of members outside the board (of commissioners) improve the effectiveness of the board in monitoring the management to prevent fraudulent financial statements. This finding was supported by the results of research Uzun et al. (2004) which showed that the percentage of firms with high external party council increase the effectiveness of the board of commissioners in monitoring the management to commit fraud financial statements, and there is evidence that companies that commit fraud financial statements have external board percentage is lower. Results of research Warfield, et al. (1995) in

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contrast to the findings of research Gabrielsen, et al. (2002) which uses the Danish stock market data, pointed-out that there is a positive relationship between managerial ownership with discretionary accruals. This means that the greater managerial ownership will increase earnings management. These contrasting results due to the characteristics of different corporate ownership structure between the US and Denmark, managerial ownership in companies in Denmark is as high as an average of 59% when compared with companies in the United States only 17%. However, managerial ownership can reduce extreme accrual policy on the company in a regulated industry, namely the company's transportation and public facilities. Yeo, Tan, Ho and Chen (2002) examined the relationship between managerial ownership with profit management, use of data companies in Singapore with managerial ownership an average of 27%. Their results found that managerial ownership relationship with earnings management is significant negative for the category of managerial ownership is less than or equal to 25%, but significantly positive for the category above 25%. This shows that when the managerial ownership is less than or equal to 25%, earnings management decreases with increasing managerial ownership. But when the managerial ownership increases beyond 25%, the manager did an aggressive earnings management through discretionary accruals to increase reported earnings.

The owner institutional often characterized as the investors were sophisticated (sophisticated investors), which has the advantage of the individual investors to acquire and process the relevant information, so that it can carry out monitoring with more effectively and are not easily misled by the actions of managers who 'manage' earnings company. So in this case ownership by institutional investors have a negative correlation with earnings management (Yeo, et al., 2002). The negative relationship between institutional ownership with earnings management is supported by research conducted at the Jakarta Stock Exchange (JSX) by the Institution and Mas'ud (2002), using data from non-banking and insurance companies 1995-2000. But in other literature, namely in Bushee (1998), Matsumoto (2002) and Graham, et al. (2004), states that institutional investors are owners of temporary (transient owners) were very focused on short-term profits, and therefore pressing managers to manage earnings boost short-term profit research results Gideon (2005), Sylvia and Yanivi (2004), using data from the years 2000-2002 the company listed on the JSE, showed positive but insignificant relationship between institutional ownership with earnings management. Several previous studies are summarized in Table 2.2 below.

table 2.2Some Accomplished Research On Mechanism

Corporate Governance, Earnings Management and Corporate Performance

1) Research on the influence of corporate governance mechanisms to earnings management

	Research	Data	Variable	Result	Conclusion
1	Gabrielsen (2002)	76 companies listed on the stock exchange Denmark	Independent Variables : -Managerial ownership Dependent Variables : -Profit management Control variables :	Positive / insignificant Negative / significant	Not managerial ownership is positively correlated significantly to earnings management .

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			- Regulated industry (firm transportation and public utilities)		
2	Yeo, *et al.* (2002)	(1990 -1996)	Independent Variables : -Managerial ownership - Ownership of stock in large quantities by external parties (outside blockholders) Dependent Variables : -Profit management	Negative / significant (<25%) Positive / insignificant (>25%) Negative / significant (<25% dan>25%)	Managerial ownership is negatively correlated with earnings management in companies in regulated industries
3	Matsumoto (2002)	Companies that report earnings meet or exceed analysts ' expectations (1993-1997) A sample of 29 460 reports quarterly profit	- Independent Variables : - Institutional Ownership - Demands stakeholders - Relevance profit value - Long-term growth prospects -Lawsuits Dependent Variables : Profit management	Positive / insignificant Positive / insignificant Negative / significant , Positive / insignificant Positive / insignificant	There is a positive relationship between institutional ownership , the demands of stakeholders , the risk of lawsuits and the prospect of long-term growth with earnings management .

2) Research on the effect of earnings management on the financial performance of companies

	Research	Data	Variable	Result	Conclusion
1	Coles, *et al.* (2001)	144 Companies in United States (1984-1994)	ndependent Variables : - The structure of leadership - Composition of the board - Ownership structure (CEO &blockholder) - Compensation CEO Dependent Variables :	Positive / insignificant Negative / insignificant Negative / insignificant Positive / insignificant	There is no significant relationship between the structure of governance and corporate performance (EVA & MVA)

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	Research	Data	Variable	Result	Conclusion
			Economic value added (EVA) Market value added (MVA)		
	Research	Data	Variable	Result	Conclusion
2	Welch (2003)	114 perusahaanterdaftar di bursa efek Australia (1999-2000)	Independent Variables : - Ownership of shares by top management and the board - Ownership of shares by top 5 Dependent Variables : - Tobin 's Q - Profit rate	Positive / insignificant (Tobin 's Q) , significant (profit rate)	Share ownership by management significant positive effect on the company's operating performance (profit rate) but not significant to the company's value (Tobin 's Q) .
3	Penget *al.* (2004)	530 perusahaan China yang terdaftar di bursa efek Shanghai danShenzen 1992 -1996	Variable Idependen : Outside directors : -Institutional - Individual Dependent Variables : - Return on Equity - Sales growth	Positive / insignificant	The board of directors outsiders (mostly institutional) positively associated with sales growth .

	Research	Data	Variable	Result	Conclusion
4	Bowen, *et al* (2004)	1009 non-financial companies in the industry (1992-1995)	Independent Variables : - Stockholder rights - Board monitoring - Institutional Ownership - Managerial ownership - Profit management Dependent Variables : - Cash flow from operations - Return on asstes Stock returns Negative / significant Negative / significant Negative / significant Negative / insignificant Positive / significant		Corporate governance mechanisms (right stockholders , Board monitoring, institutional ownership) can limit opportunistic earnings management Earnings management mepengaruhi financial performance (CFO , ROA , RET) positively

The research in this dissertation aims to examine the effect of earnings management and its interaction with the mechanisms of corporate governance on corporate performance. The difference of this study with previous studies mainly in the research of this dissertation included an external audit as one of the external governance mechanism, the estimated earnings management using performance-matched Jones model used in the study Kothari et al. (2002), as well as earnings management and its interaction with the corporate governance mechanisms tested its effect on financial performance using the interaction model (in Bobko, 1995, p.217).

FRAMEWORK

The framework of this research at the start of the organization's existence as a basis for analyzing corporate governance, followed by a discussion of agency theory agency problem that is causing opportunistic behavior of management in the company's financial reporting. Agency theory as a guide for positive accounting theory that aims to menngembangkan hypotheses about the factors that affect the world of accounting practices and to test the validity of this hypothesis empirically. The capital market provides a place for testing positive accounting theory, because accounting provides information to the capital market and stock price changes due to changes in certain accounting. The organization is a social entity consciously coordinated, consisting of two or more persons, whose function is based on sustainability to achieve a common goal or set of goals (Robbins, 2003, p.465). The company is a business organization that is instrumental in whose capital collected for the activity of production and distribution of goods and services, as well as for investment. Companies must constantly be able to increase profits from their business activities and profits for shareholders (Monks and Minow 2004, P8)

The main purpose of a company is to create an environment that is conducive to obtain long-term profit, which comes from two main sources, namely the increase in profit from core operations (core business), and an increase in profits from sales growth of existing products, or sales resulting from the introduction new products (Kim and Nofsinger, 2004). The development of business activities require additional capital and also brings risks. Ability to raise capital and control risk are important in the success or failure of a company. Acquisition of capital and the ability to control risk is influenced by the manner or form of corporate governance. A company may take the form of individual businesses (sole proprietorship), firm (partnership) or corporation (corporation).

According to proprietary theory, the owner is the center of attention. Assets owned by the owner, and the debt is the obligation of the owner. Revenue will increase ownership and reduce the burden of ownership, so the net profit immediately increased its interest, this reflects an increase in wealth of the owner. This theory is used to form a sole proprietorship organization, because in this form of organization in general there is a personal relationship between management and the owners. This theory is also a logical framework for the organizational form of partnership, but this theory less acceptable to the corporate form of organization (Hendriksen and Breda, 2001) .In the theory of the entity (entity theory), business corporations are considered to have a separate existence from its owners, accompanied by the separation of ownership management (Schroeder, et al., 2005, p.473). Assets reflects the company's right to memproleh goods and services or other benefits, while the debt is the obligation of the company. The company's net profit is generally reflected in terms of changes in stockholders' equity, not the profits of the shareholders.

Shareholders' rights is to receive dividends or profits are distributed, and the inside of the net assets upon liquidation of the company as an equity holder's right is not as the owner of a particular asset. This theory was developed by William Paton in 1922, and this theory is suitable to be applied in the corporate organization (Hendriksen and Breda, 2001). If the two sides in the agency relationship is assumed to be selfish, then there is a reason that the agents do not always act in the interest of the principal. Principals may restrict the difference of importance to establish incentives (incentive) eligible for the agent and designing monitoring (monitoring) to limit the activities of agents who deviate. In some situations, incentives and monitoring can make the agent had to pay, namely the costs of bonding (bonding costs), to ensure that she would not take certain actions that make the principal losses. In connection with the principal agent will occur costs of monitoring and bonding, and there would be a difference between the decision agent with a decision to maximize the welfare of the principal. The decline in welfare in dollars (rupiah) experienced principals with regard to these differences is also the cost of the agency relationship, referred to as the residual loss (residual loss). So the costs of the agency is the sum of the costs incurred by the principal monitoring, bonding costs incurred by the agent, and the residual loss (Jensen and Meckling, 1976). Therefore, the principal has two options are not mutually exclusive (not eliminated), namely incentives and monitoring.

In order to reduce the costs of the agency need to design a contract, including a contract between management and owners (shareholders), the contract between management and creditors, and the contract between the management and the community. Therefore, based on the view that the company is a series of contracts, there is a demand for monitoring the contract-konrak. Financial reports are seen as a control mechanism for the agency problem by converting the information into (inside information) into information to outside parties (outside information), and looked at the accounting net income as a measure of managerial performance to control the problem of moral hazard in two ways complementary: 1) net income can be included in the contracts of executive compensation to motivate the performance of managers, and 2) net income to reflect the securities market and the labor market so that managers who are negligent will suffer a loss in the profit decline, reputation and market value over time (Scott, 2003). However, these financial statements are vulnerable to manipulation by the manager for personal gain.

The financial statements were used as a control mechanism becomes ineffective because of their manager's behavior is selfish. The manager intervened in external financial reporting with the purpose of personal gain (Schipper, 1989), and managers use accruals in financial reporting policy to mislead stakeholders (stakehorders) about the economic performance of companies (Healy and Wahlen, 1999). Therefore, we need a system that can align the interests of shareholders and management, known as the system of governance perusahaan.Agar governance system to work well, we need a mechanism to ensure and oversee the corporate governance system in order to run in accordance with the directions set. There are two mechanisms of corporate governance, namely: the internal mechanism and external mechanisms. Internal mechanism focuses on the function of the commissioners, while the external mechanism basing on the market, especially the market takeover and also involve parties outside the company is a regulator with a set of regulations (standards, rules and laws), investors, as well as the reputation of other agents (accountants, advisors legal, financial analyst). Both mechanisms of internal and external mechanisms designed to ensure optimal business performance (Walsh and Seward, 1990, p.442). Earnings management is often used by managers who have more information about the company to create a bias in the interest pribaginyaindormasi eventually leading to a decline in the company's financial performance. Therefore, earnings management is seen as the agency problem that raises agency costs. Corporate governance mechanisms can affect earnings management relationship with the company's financial performance.

THEORY ENTITIES

The emergence of corporate organization followed by the separation of ownership with management (ownership and management) and limited liability (limited libilities) for owners, encouraging the evolution theories of ownership, one of which is the entity theory. Theory entity (entity theory) developed by William Paton in 1922, regards the company as the center of attention for the purposes of accounting and financial reporting. The essence of this theory is that creditors and shareholders give the resources to the company, and the company's presence is separated from the two groups (Schroeder, et al., 2005, p.472) .According to the entity theory, is the right enterprise assets and capital show the source of assets, consisting of debt and shareholder capital. Both creditors and shareholders are the owners of capital, although they have different rights associated with earnings, risk control and liquidation. Profits of a wealth of entities to be distributed as dividends to shareholders. Because the business unit is responsible to meet the demands of the owner of capital, entity theory called "income centered" and consequently the air-profit orientation. Accountability by the management company to the owners of capital resolved by the measurement of operating and financial performance of the company (Belakoui, 2004, p.216). Entity theory is suitable primarily for application in the corporate form of business enterprise (Hendriksen and Breda, 2001, p.772.)

Positive Accounting Theory and Agency Theory

Positive accounting theory (positive accounting theory) developed by Jensen (1976) and Watts and Zimmerman (1986), aims to explain and mem-prediction selection of accounting standards by management to analyze the costs and benefits of financial disclosures particular in relation to various individuals and allocations economic resources. Positive theory is based on the proposition that the managers, shareholders, and regulators are rational and they are trying to maximize its interests (Belakoui, 2004, p.446). The most widely studied areas in the positive accounting includes contracts between management and owners of the company as well as a contract debt (debt covenants), this area is closely related to the theory of agency (Hendriksen and Breda, 2001, p.213). Agency theory (agency theory) is a positive accounting theory that seeks to explain the practices and accounting strander (Schroeder, et al., 2005, p.114). Agency theory comes from a famous paper proposed by Berle and Means (1932), the first reference to the nature of the company and the cooperative relationship between principal and agent. Later developed by Jensen and Meckling (1976) in the theory of the firm, which sees the contractual relationship is the essence of the company, not just the relationship with employees but also with suppliers, customers, creditors and others. Agency theory based on the assumption that both agents and principals are motivated by self-interest, namely to maximize the benefits of subjectivity (Schroeder, et al., 2005, p.114) .In the agency theory, the main problem the agency relationship is the problem of asymmetric information (Scott, 2003 p.106). The manager has more information about the company's current condition and prospects of the company in the future than information held by investors, so that managers can use the information on his behalf and harm the other party. problem motivating business managers in order to act in the interests of the shareholders.

Problems agency (agency problems) can occur in all forms of organization, but the organizational form of the company's corporate business (corporate form of business enterprise) faced the possibility of the agency problem that is bigger than individual organizational forms (sole proprietorship) and the form of firm organization (partnership). Forms of business corporations have the advantage that most with their access to capital markets, so that the ownership of shares of public companies will be spread among various investors, the common shareholders, institutional investors, public shareholders, large block holders, and other companies (Kaen, 2003, p .18). Research for positive paradigm-agency requires the efficient market hypothesis and view accounting as a supplier of accounting information to the capital markets (Schroeder, et al., 2005, p.114). Earnings management can affect investors by providing incorrect information. Information is very important in the stock market, because the capital markets using financial information to set the price of securities, investors use financial information to determine its investment decisions, and market efficiency is based on the flow of information to the capital markets. If the information is not correct, it is not possible for the stock market can correctly assess its securities. Earnings management can obscure the actual financial performance and reduce the ability of shareholders in the decision, so that earnings management is seen as a problem and the agency costs (Xie, et al., 2003, p.297)

Methods Used

This research is explanatory (explanatory research) that describes the symptoms that arise from the object of research and searching for answers to the problems posed. This method aims to test the hypothesis and explain the causal relationship between two or more variables of the study (Cooper and Schindler, 2003, p.11). In this study the variable-variables to be tested, which is the object of research, are:

1. Earnings management and financial performance of the company, these variables are calculated from the financial statements of companies listed on the Jakarta Stock Exchange from 1998 to 2004.

Variable Profit Management

Earnings management is measured using Absolute value of abnormal accruals, the magnitude of adjustments made by the manager to arrive at the profit figures reported, the higher the absolute value that presented the greater discretion (policy) of accounting managers do (Bowen, et al., 2004). Abnormal (discretionary) accruals are measured by subtracting the normal (non-discretionary) accruals of total accruals. To measure discretionary accruals used performance-matched Jones model (1991) proposed by Kothari et al. (2002), by entering the company's performance (Return On Assets) into the model of Jones (1991). The formula to estimate discretionary accruals are as follows:

$$DAC_{it} = TAC_{it}/A_{it-1} - [\alpha(1/A_{it-1}) + \beta_1(\Delta REV_{it}/A_{it-1}) + \beta_2(PPE_{it}/A_{it-1}) + \beta_3(ROA_{it-1})$$

Where :

DACit = Discretionary Accruals for firm i in year t

Tacit = Total accruals (net income - cash flow from operation) for company i in year t

Ait – 1 = Total Assets for firm i in year t -1

ΔREVit = change in net sales of the company i in year t - 1 to year t

PPEit = Gross Property, Plant and Equipment for company i in year t

ROAit - 1 = Return on Assets for the company i in year t -1

α , β1 , β2 and β3 are the specific industry estimated regression coefficients from cross - sectional follows:

$$TAC_{it}/ A_{it-1} = \alpha(1/A_{it-1}) + \beta_1(\Delta REV_{it}/A_{it-1}) + \beta_2(PPE_{it}/A_{it-1}) + \beta_3(ROA_{it-1}) + e_{it}$$

Variable Company Financial Performance

Company's financial performance is measured by three performance measures, namely: the operating performance (return on assets and cash flow from operations), and market performance (stock return) (Bowen, et al., 2004; Krishnan, 2003; Bhagat& Black, 2002) , as follows:

1) Performance of operating cash flow (Cash Flow from Operations) is calculated using the formula:

CFO = Cash Flow from Operations: Total Assets

2) Performance Return on Assets (ROA):

ROA = Income Before Extraordinary Items: Total Assets

3) Stock Return (RET) is calculated using daily stock price weighted average for the period of 12 months ended on December 31, according to the formula: RET = (Pricet - Pricet-1): Pricet-1

All three aforementioned measurements used for each measurement have strengths and weaknesses that affect the interpretation of the empirical results. First, measurement of operating cash flow as a performance measurement has an advantage because the future cash flows do not rely on the measurement of accrual earnings are susceptible to be manipulated, and not rely on the measurement of stock market price which was based on assuming that capital markets are not efficient in its ability to detect earnings manipulation. However, operating cash flow has drawbacks relating to his time as a measurement of performance (Dechow, 1994). Second, the measurement of performance using earnings (ROA) reducing the timeliness issue as highlighted in the cash flow, but these measures are prone to be manipulated through the use of excessive accruals by managers in preparing the earnings reporting. Third, the stock return performance measurement allows for testing the efficiency of the stock market where investors may have anticipated the opotunistik behavior of managers in financial reporting and have been included in the prevailing stock price.

So using three different measurements of financial performance of companies provide more information about the strength of empirical findings and allow for additional interpretation. For example, if the excessive use of accrual policy by the manager is not related to stock return but beruhubungan with cash flow, it can be presumed that the managers take advantage of accounting policies for private purposes but investors had anticipated and reflected in stock prices.

3.1 DATA AND POPULATION RESEARCH

Necessary data in this study is entirely secondary data as follows:

1) Data for variable profit management, financial performance and corporate governance mechanisms derived from the annual financial statements publikasian (annual report), and the stock price for the period ended December 31, 1997 and 2004. The data are obtained from the Capital Market Reference Center (PRPM) Indonesia, the Capital Market Data Center (PDPM), the Institute of Business and Information Technology Indonesia (IBII), as well as other publications in the Jakarta Stock Exchange.

To obtain the data with a homogeneous business characteristics, selected companies listed on the Jakarta Stock Exchange from 1998 to 2004. The determination of the studied company in the industry group manufakur for companies outside the group in this industry regulation and a different accounting treatment on transac- transactions and financial reporting that may affect the accrual policy and analysis of financial performance. Industry classification and the number of listed companies are presented in Table 3.3. following.

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Table 3.3Industrial Classification and Number of Listed Companies Years 1998-2004

Industrial classification	Total Company						
	1998	1999	2000	2001	2002	2003	2004
1. AGRICULTURE	6	10	8	9	9	9	9
2. *Mining*	6	6	6	8	9	9	10
3. *Basic Industry and Chemicals*	**50**	**54**	**55**	**60**	**59**	**58**	**60**
4. *Miscellaneous Industry*	**48**	**48**	**50**	**51**	**51**	**50**	**50**
5. *Consumer Goods Industry*	**38**	**37**	**39**	**42**	**42**	**40**	**40**
6. *Property, Real Estate & Building Construction*	26	29	31	34	32	31	31
7. *Infrastructure, Utilities & Transportation*	12	13	13	13	13	15	16
8. *Finance*	59	52	49	53	57	61	62
9. *Trade, Service and Investment*	45	41	47	60	65	68	70
Total	290	290	298	330	337	341	348

Sumber: *Jakarta Stock Exchange, Fact Book*

The manufacturing company according to the Jakarta Stock Exchange (JSX) is divided in three classes of industry , namely Basic Industry and Chemicals as many as 50 companies , 48 companies Miscellaneous Industry , and Consumer Goods Industry as many as 38 companies , total manufacturing enterprises as many as 136 companies . The population of manufacturing firms from 1998 to 2004 , there were 20 who no longer listed in the Jakarta Stock Exchange (delisted) . At the end of 2004 , the population of manufacturing companies to target as many as 116 research companies . Companies for which data are available entirely as many as 22 companies , so that manufacturing companies can be examined as many as 94 companies . Determination of the number of manufacturing companies surveyed can be seen in Table 3.4 .(List of companies surveyed is available in Appendix 1)

Table 3.4Total Manufacturing Company Investigated

Information	Total Company
Companies that have been listed on the JSE in 1998 Non-manufacturing companies	290 (154)
Manufacturing company Manufacturing companies are no longer listed on the JSE (delisting) until the end of 2004	136 (20)
Companies listed on the JSE in 1998 until 2004 Companies that data are not fully available	116 (22)
Manufacturing companies diteli	94

This research was conducted using pooled data for 94 manufacturing companies during the period 1998 to 2004, means the unit of observation of this study are the financial statements of 94 companies manufacturing for 7 years (N = 658)

3.2. Hypothesis testing

In this study, there are two hypothesis, namely 1) the earnings management influence on the company's financial performance, and 2) earnings management interaction with corporate governance mechanisms affect the company's financial performance. To test the effect of earnings management on the financial performance of companies with corporate governance mechanisms as moderating variables (moderating variable), required testing of the interaction effect of earnings management variables with the variables of governance mechanisms on the financial performance of the company, which can be explained in the drawings and the following formula.

4.1 RESULTS AND DISCUSSION

Simple regression analysis is used to test the first hypothesis which aims to determine the effect of earnings management on the financial performance of the company. As for the second hypothesis test, ie testing the effect of earnings management interaction with corporate governance mechanisms on the financial performance of the company, used multiple regression analysis with interactive models. Here are described the hypothesis testing results of research and discussion about the influence manajamen profit and its interaction with the governance mechanisms of the financial performance of companies in the manufacturing industry are listed in the Jakarta Stock Exchange period 1998 to 2004. Prior to the discussion of the results of hypothesis testing, presented an overview of the following objects research that earnings management data, financial performance and corporate governance mechanisms based on descriptive statistics with the minimum, maximum and average profit rata.Manajemenmeasured using the absolute value of abnormal accruals, the magnitude of adjustments made by the manager to arrive at the profit figures reported (Bowen, et al., 2004). The magnitude of abnormal accruals, also called discretionary accruals, scaled by total assets, are presented in the following table.

Table 4.1Earnings Management and Total Assets
Companies Manufacturing Year 1998-2004.

Year	Profit management (%)			Profit management (billion USD)			Total Assets (billion USD)		
	Min.	Maks	Rata2	Min.	Maks	Rata2	Min.	Maks	Rata2
1998	0,54	63,23	14,80	0,33	3.103,59	227,91	29,55	29.168,15	1.551,42
1999	0,02	33,90	7,84	0,04	1.634,49	116,06	34,86	24.025,99	1.844,67
2000	0,22	60,31	12,68	0,97	5.412,21	200,28	34,31	22.203,52	1.814,85
2001	0,16	98,97	9,96	0,18	2.315,07	156,67	38,16	26.862,74	2.065,26
2002	0,10	83,98	11,12	0,46	4.036,76	183,93	39,26	26.573,55	2.102,92
2003	0,10	214,63	12,06	1,58	1.319,10	158,61	33,40	26.185,61	2.059,64
2004	0,16	66,29	7,58	0,60	2.629,72	120,78	34,16	27.404,31	1.923,56

Source : the data processing

From Table 4.1 shows that the highest average earnings management occurred in 1998 , a year after the financial crisis , which amounted to 14.80 % of total average assets Rp1.551,42 billion , or by Rp227,91 billion . On average the lowest earnings management occurred in 2004 amounted to 7.58% and in 1999 amounted to 7.84% , in other years the level of earnings management on average above 10 % , which in 2000 amounted to 12.68 % , 2002 was 11.12 % , and in 2003 amounted to 12.06 % (data management of income is provided in Appendix 3) . The financial performance of the company , namely return on assets (ROA) , cash flow from operations (CFO) and stock return (RET) , are presented in the following table .

Table 4.2Company Financial Performance : ROA , CFO , and RET

Companies Manufacturing Year 1998-2004 .

Tahun	*Return On Assets* (ROA)			*Cash Flow from Operation*			*Stock Return* (RET)		
	Min.	Maks.	Rata-rata	Min.	Maks.	Rata-rata	Min.	Maks.	Rata-rata
1998	-0,71	0,25	-0,09	-0,67	0,35	0,06	-0,92	0,75	-0,52
1999	-0,41	0,33	0,05	-0,34	0,52	0,11	-0,89	6,92	0,64
2000	-1,02	1,16	-0,05	-0,24	0,31	0,07	-0,72	1,66	0,16
2001	-0,61	1,49	0,01	-0,35	0,42	0,07	-0,91	1,25	-0,33
2002	-1,11	2,50	0,10	-0,87	0,37	0,06	-0,77	1,65	-0,07
2003	-0,55	4,68	0,08	-0,32	0,95	0,07	-0,74	2,22	0,05
2004	-1,44	0,40	0,004	-0,32	0,87	0,07	-0,78	1,92	0,32

Source: the data processing

Table 4.2 shows the financial performance of both ROA, CFO and RET lowest average occurred in 1998, namely ROA amounted to -9%, CFO of 6%, and RET by -52%. In 1999 happens improved financial performance of the company, reported ROA positive average by 5%, while the CFO average of 11% and RET average of 64% is the highest performance from 1998 to 2004. But in the following years happen again a decrease in the company's performance, especially the price of new shares recovered in 2004. (Data financial performance of manufacturing firms surveyed are presented in Appendix 3) .In 2001, companies listed on the Jakarta stock Exchange are required to have independent directors at least 30 % of all members of the board of commissioners. The following table presents an overview of the proportion of independent directors and the number of commissioners manufacturing company during the years 1998-2004.

Table 4.3Number and Proportion of Independent Commissioner

Companies Manufacturing Year 1998-2004.

Tahun	JumlahKomisarisIndependen			ProporsiKomisarisIndependen			Emiten Di atas Rata-rata (Persentase)	Emiten Di bawah Rata-rata (Persentase)
	Min	Maks.	Rata-rata	Min	Maks.	Rata-rata		
1998	0	0	0	0	0	0	0	0
1999	0	0	0	0	0	0	0	0
2000	0	0	0	0	0	0	0	0
2001	0	3	1	0	50	26	57	43
2002	0	5	1	0	60	32	74	26
2003	0	6	1	0	75	34	33	67
2004	1	4	2	20	75	38	39	61

Source: the data processing

In Table 4.3, it appears that from 2001 to 2004, manufacturing companies have an average of one person independent board or approximately 30%. There are still companies (issuers) are up to 2003 do not yet have independent commissioners, but in 2004 all manufacturing companies surveyed have had at least 1 person board of directors. Most listed companies have independent directors in proportion below average. There are several companies that have had great independent commissioner with a large number of commissioners as well, such as PT Astra International has 6 independent directors and the number of board of trustees as many as 13 people.

4.2.Hasil Data Analysis

Research data analysis performed using regression analysis to test the hypotheses: 1) the impact of earnings management on the company's financial performance, and 2) the effect of earnings management interaction with corporate governance mechanisms on the financial performance of the company. The first hypothesis testing using simple regression analysis are summarized in the following table.

Table 4.9

Results Effect Analysis Management LabaTerhadap

Company Financial Performance

VARIABEL DEPENDEN	CFO	ROA	RET
VARIABEL INDEPENDEN: DAC	KOEFISIEN -0.144985	KOEFISIEN -0.016959	KOEFISIEN -0.156602
R SQUARE	0.015352	0.000073	0.000714

Table 4.9 (Attachment 4) .menunjukkan that earnings management (DAC) negatively affect the entire company's financial performance, CFOs with R square 0.015352, 0.000073 square ROA with R and RET with R square 0.000714. Based on these test results, earnings management can explain variations in cash flow (CFO) of 1.5%, while earnings management capabilities to explain the ROA and RET is very small in the amount of 0.0073% and 0.0714%. The regression coefficient indicates that earnings management affects CFO decrease of 14.50%, a decrease in ROA of 1.69% and 15.66% decrease RET

DISCUSSION

Effect of Earnings Management Company Financial Performance Against

Hypothesis testing results show that earnings management negatively affect the company's financial performance, the negative influence of the opportunistic behavior mencermin-management company. The management tried to cover up the actual operating performance of companies in order to report better performance for its own sake or his company, but the company's financial performance showed a declining trend in the long term. The study provides empirical evidence to support the notion Bowen, et al. (2004) which states that if the managerial opportunism it serves as a trigger of earnings management, it can be estimated negative correlation between earnings management with the company's financial performance. In connection with the agency theory, opportunistic behavior that is not expected by the parties related to the company's contract is the result of the agency problem unresolved.

In such problems, the agent acting on behalf of itself and deviate from the interest of the principal. This study supports the view earnings management in the perspective of opportunistic behavior managerial (managerial opportunistic behavior), and supports research Xie et al. (2003) who found a negative relationship management earnings and financial performance of companies shows that the opportunistic behavior of managers in corporate financial reporting lower the company's financial performance (measured by book value of total assets, sales and market value of equity). This study does not support the research Bowen, et al. (2004) which stated earnings management in the perspective of the contract efficiently (efficient contracting) and concluded that shareholders benefit from earnings management that can provide a signal about the competence of the managerial or financial performance of companies in the depan.Hasil research shows that earnings management negatively affect the performance of the enterprise market (stock return), but the effect is very small. It supports the efficient market hypothesis (also called "no-effect hypothesis) in the theory of capital markets which states that there is no change in the stock price due to changes in accounting procedures. The investors had been anticipating the behavior of managers in financial reporting and is already included in the prevailing stock price.

The negative effect on the earnings management stock return shows that the market is aware of opportunist motivations of earnings management practices by the company. Consequently, greater earnings management will lead to lower gains on shares (stock return). The research findings support several previous research. The research result Xie, et al. (2003) showed a negative correlation between earnings management with the company's stock performance (measured by the market value of equity), and research results Silvia and Yanivi (2004) which indicates that earnings management negatively affect the value of the company (measured by stock market return). accounting report is not the only source of information used in making economic decisions. External factors likely to affect the company's financial performance. The economic crisis that occurred in mid-1997 that began with the weakening of the rupiah against foreign currencies led many companies reported poor financial performance. Companies in the manufacturing industry have a worse financial performance than the financial performance of companies in other industries as a result of the crisis. During the study period, the rupiah against foreign currencies, especially the USD, fluctuate greatly. The weakness of the exchange rate can make it difficult for the company to generate profits and cash inflows that are expected, as well as the investor difficult to make a profit on the shares they own.

Associated with business ethics, earnings management is unethical if there fictitious transactions that deliberately deceive users of financial statements of the company. As revealed by Skousen, et al. (2004), that basically there is universal agreement on an action is ethical or unethical. But sometimes managers do not agree with the auditor about what he perceived as under-reporting in accordance with accounting principles generally acceptable with the intention of deceiving. For example, in the case of Worldcom, the company's financial manager with persistent justify his decision to capitalize and instead impose direct telephone access fees amounted to 3.8 billion dollars. Background capitalization is based on its understanding of the appropriate accounting standards. In the view of the manager, "reporting that deviates (fraudulent reporting)" is ethical and in accordance with GAAP. Different views on the profit management from the well, there are no consequences, until a bad view. The view that there are no consequences earnings management (no consequency) come from the academic community that is based on the assumption that the full disclosure of earnings management. The authors do not doubt the assumption that the full disclosure (full disclosure), the market can process the effect of earnings management on the financial performance efficiently and securities can be valued properly. While the regulators seem to believe that earnings management is another area that is problematic, and the view that earnings management is not feasible because of the intervention of the company's managers to conceal the company's operating performance with the use of accounting estimates made fraudulent and does not make sense

Very difficult to determine whether the actions of earnings management which are carried out manager of the company's ethical or unethical, because it is difficult to determine whether a manager has melapaui limit and violate the principles of accounting generally acceptable, and there are no signs stating "heart carefull: do not cross this line. " It is also a personal ethics and all of a manager's ability to know that the financial reporting is distorted and tend to cheat is part of the action stems from an attempt to polish the financial statements, but may end up as a fraud penuh.Suatu important consideration for managers is whether the timing of the transaction is appropriate or changes in accounting methods or estimates made to communicate the economic performance of a business better, or whether the earnings management techniques used with the intention of deceiving. In this regard, Skousen, et al. (2004) states that if the earnings management is done to deceive potential investors, lenders, governments, and other parties interested in the company, the earnings management has a real risk for the loss of credibility in the future, and many people believe that actions to trick the other party is wrong, regardless of the economic consequences that arise.

Interaction Effect of Profit Management with Corporate Financial Performance Against Tenure

The results of this study indicate that earnings management interaction with the company's relationship with its auditors duration (tenure) 3 years (or less) positive effect on operating performance (CFO) and stock performance (RET) company. In contrast, earnings management interaction with the tenure of 9 years (or more) negatively affect operating performance (CFO) and stock performance (RET) company. These results indicate that in the early years of the company's relationship with its auditors were able to reduce the potential for profit management so that the abnormal earnings management provides benefits in economic decision-making for the parties concerned to enhance the company's financial performance. These findings support the view of the regulator which was based on the threat to the objectivity of the auditor, that the high audit quality in the early years of his client's relationship with the auditor, and audit quality will be damaged with the length of auditor relationship with his client. Issuers listed on the JSE had a relationship with its auditors on average over 8 years, and more than 60% of issuers of manufacturing from 1998 to 2002 have a relationship with the auditors above average. In accordance with the alleged regulator, the duration of the company's relationship with its auditors clicking directions at reduced independence which led to a decrease in the quality of auditing, which auditors are not independent for reporting fraud were found in the accounting system client, which in turn will lower the company's operating performance and public confidence in financial statements company.

Low quality auditing that leads to decreased quality of a company's reported earnings, and reflects weak corporate governance structure that causes excessive managerial opportunism. According to Bowen et al. (2004), interpreting the relationship between earnings management with the quality of poor governance as evidence that the structure of weak governance pose managerial opportunism is an interpretation that is premature, but show that earnings management have negative consequences for the wealth of its shareholders (shareholders' wealth). These results indicate that the interaction of earnings management with tenure old (9 years or more) lower the company's financial performance (CFO and RET. This finding nememberikan evidence to strengthen the statement proposed by Bowen et al. (2004), that the use of accounting services public longer a weak governance mechanisms that can lead to managerial opportunism and hurt shareholders and other parties with an interest in the company.

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The study's findings support several previous research, the study Casterella et al. (2002) which states that the longer a client auditor relationship with the greater likelihood of an audit failure. The findings are supported by the results of research Chung (2004), which indicates that the restriction length auditor and client relationships generate greater impetus for auditors to maintain the independence, which is able to effectively control the excessive manipulation of corporate profits. The company itself voluntarily reduce earnings management in responding to the public's attention. However, due to the length restriction rule auditor relationship with the client, the company can not avoid replacement auditors. The results support some of the previous research. Research Chung (2004) provide evidence that the rotation of audit regulation in Korea, audit quality is increased when the auditor relationship with the client is limited. This indicates that audit firm rotation rules can enhance auditor independence and encouraging higher for the auditor to withstand the pressure of the management company. The findings of this study support Johnson and Lys (1990) which showed that the replacement auditor can improve the quality of the audit because it allows the company to replace its auditors with more efficient new auditor. In this case, maintaining the auditors are not able to adequately provide services can reduce the quality of the audit.

Interaction Effect of Managerial Ownership Profit Management with Corporate Financial Performance Against

The results showed that the interaction of earnings management with managerial ownership has positive influence on operating performance (CFO and ROA), but negatively affect the stock performance (RET) company. The positive influence earnings management interaction with managerial ownership on operating performance (CFO and ROA) supports the results of previous research (Welch, 2003, Bhagat& Black, 2002) which is showing that pe-increase in managerial ownership reduces abnormal earnings management thus increasing urge to the influence of corporate performance maximization negative earnings management interaction with men carrying managerial ownership of research results Gabrielsen (2002) which showed that an increase in managerial ownership strengthen relationships income number (which is the result of the accrual of the company) with a share price decline. In other words, the rate of profit is less than helpful for the stock market as managerial ownership increases. Some of the results of previous studies (Yeo, et al., 2002; Institution &Mas'ud, 2002; Warfield, et al., 1995) indicate that the ownership greater managerial reduce the impetus for the manager to do the management of opportunistic profit, that profit the reported may reflect actual performance. Results were contrary to the results of research Gabrielsen, et al. (2002) which showed that managerial ownership has positive effect on earnings management and negatively affect earnings response, which means that the managerial ownership

large increases encouragement for managers to earnings management and lower the quality of reported earnings.

Gabrielsen, et al. (2002) explains that the difference in results of these studies due to differences in corporate ownership structure that reflects the institutional provisions adopted in the country. Research Warfield, et al. (1995) and another study using American stock market data, indicate that the shares of the company-owned management companies in the United States an average of 17%, while research Gabrielsen, et al. (2002) showed that the average managerial ownership in Denmark is as high as 59%. Managerial ownership in companies listed on the Jakarta Stock Exchange on average by 6%, lower than the company's managerial ownership in America. With the managerial ownership structure an average of 6%, the results of this study menundukung research Yeo, et al., (2002), Institution and Mas'ud (2002) and Warfield, et al.1995) which states that the increase in managerial ownership reduces management opportunistic profit, as indicated by the positive effect of earnings management with the company's operating performance (Bowen, et al., 2004).

Shares of companies in Indonesia concentrated on (and dominated by) family shareholders or certain parties (Lukviarman, 2001), so that the study supports the results of research Gabrielsen, et al. (2002) which states that the profit figures of little use to the capital market as managerial ownership increases. A mechanism is needed to correct the adverse consequences arising from the separation of ownership with company management, one is to increase ownership by management. Theoretically, the greater the degree of the company's shares by the manager, the more likely managers act in the interests of the shareholders. But the managerial ownership is too large increases the potential for the manager to do so earnings management and lower the quality of reported earnings and lower performance of the company. The results of this study do not support some earlier research, including research Bowen, et al. (2004) and Coles, et al. (2001), failed to find evidence that increased managerial stock ownership significantly reduce earnings management so as to enhance the company's stock performance

Interaction Effect of Institutional Ownership Profit Management with Corporate Financial Performance Against

The results of this study indicate that earnings management interaction with institutional ownership positively Affects the overall performance of the company's financial officer (CFO, ROA, and RET). This means that institutional ownership can take on its role as a major shareholder in the management company mengendali-reducing opportunistic behavior of managers in financial reporting and improve financial performance. Reviews These findings support the results of research Yeo, et al. (2002), Institution and Mas'ud (2002)

which shows that the proportion of institutional ownership, a larger monitor activities more effective management so as to restrict the actions of managers in 'manage earnings' company mislead users in decision making ekonomi.Hasil report of this study also supports the hypothesis proposed by the Pound (1988) , that hypothesis efficient supervision (efficient monitoring hypothesis) and hypotheses alignment of strategic (strategic alignment hypothesis), which states that institutional shareholders are better able to acquire and mem-process the relevant information, and institutional shareholders together with the commissioners are able to benefit mutually beneficial to cooperate on issues tertentu.sehingga more effective in monitoring and enhancing performance management activities of the company.

Institutions have the right to appoint commissioners and its role as majority shareholder to be able to oversee the management of the company and ensure that the company is managed for the benefit of shareholders and other parties concerned. As stated in The Cadbury Report (1992) that is based on the magnitude of the portion of the company's shares, institutional investors have the potential to exercise control over the actions of the board of directors, where the potential is rarely available for minority shareholders. Based on the potential economies of scale in obtaining corporate data and positive relationship between shareholder value by increasing the performance of companies, large shareholders have a higher incentive to be involved in managing the company than small shareholders. The same thing was stated Stiglitz (1985; Keasey, 1997, p.29) .bahwa large shareholders have stronger incentive than the small shareholders to obtain the necessary information for effective management control.

The results also support the statement Bowen, et al. (2004), that the institutional shareholders characterized as a sophisticated investor who has the advantage in acquiring and processing the relevant information. Therefore, institutional shareholders can potentially misuse oversee the actions or policies taken by managers in the process of accounting or financial reporting. The results of this study do not support the hypothesis of a conflict of interest (conflict of interest hypothesis) which states that institutional shareholders have a business relationship with the company, making them less likely to actively hinder the actions or decisions of the management.

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5. CONCLUSION

Earnings management influence on the financial performance of companies with corporate governance mechanisms as a key enabler in companies in the manufacturing industry are listed in the Jakarta Stock Exchange during the period 1998-2004, concluded as follows. Earnings management negatively affect the company's financial performance, reflecting the opportunistic behavior of company management in financial reporting affect the decline in financial performance management company profit perusahaan.Interkasi affect the company's financial performance, as follows: Interaction of earnings management positive effect on the company's financial performance (ROA and RET). These results indicate that the activity of management in financial reporting thus improving the company's financial performance. Interaction earnings management with managerial ownership has positive influence on operating performance (CFO and ROA), but negatively affect the stock performance (RET) company. These results indicate that an increase in managerial ownership reduces earnings management thereby increasing the impetus for the maximization of the company's operating performance, but the profit figure that is the result of the accrual of the company less useful for assessing the capital market in the securities of companies when managerial ownership increases. Interaction earnings management with institutional ownership positively affects the company's financial performance (CFO, ROA, and RET). These results show that institutional ownership can take on its role as a major shareholder in the control of management of the company, thereby reducing the opportunistic behavior of managers in financial reporting and improve financial performance.

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