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THE EFFECT OF MOTIVATION AND OPPORTUNITIES ON EARNINGS MANAGEMENT

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ABSTRACT

This study aims to examine the effect of earnings management motivations and earnings management opportunities on real earnings management. Earnings management is an action performed by the management that can affect the level of reported earnings. The level of earnings management is not only influenced by the motivation of management for self-interest or for the benefit of the company but also influenced by the opportunities available for management to be able to practice earnings management. Previous research generally ignored various factors that could give managers opportunities to practice earnings management, and considered that the ability to practice earnings management was the same between companies.

Motivation earnings management consists of the cost of debt covenant breach and political costs. Earnings management opportunities include information asymmetry from asset structure, auditor quality and corporate governance quality. Debt covenant cost is measured by leverage, political cost is measured by firm size, asset structure is measured by investment opportunity set, corporate governance quality is measured by good corporate bygovernance index and real earnings management is measured by using three activities (abnormal operational cash flow, abnormal production costs and abnormal discretionary costs).

The sample is selected purposively from 136 manufacturing companies listed on the Indonesia Stock Exchange during the period of 2012-2015. The analysis is based on annual financial report data from 67 manufacturing companies listed on the Indonesia Stock Exchange.

The result of analysis shows that financial leverage, asset structure, and quality of corporate governance influence earnings management, on the contrary firm size and quality of auditor have no effect to real earnings management.

Key words: corporate governance, earnings management, debt covenant, political cost, audit quality.