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IFRS, Family Ownership and Earnings Management in The Indonesian Banking Industry

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ABSTRACT

The adoption of the IFRS is lauded by many countries as it improves the quality of financial reporting and reduces the likelihood of earnings management. The IFRS being principle-based standards promote firms to practice substance over form more profoundly with its inherent flexibility. Given the unique ownership nature of the Indonesian banking with high family ownership concentration, this study examines the effects of such ownership and the IFRS adoption on earnings management. The samples for this research consist of 160 firm-year observations from the 2006 – 2011 period. Findings from the study suggest that the adoption of the IFRS requirements has a good effect on reducing earnings management and concentrated family ownership also help to mitigate the earnings management. The combined effects of both the IFRS adoption and the concentrated family ownership strengthen the negative effect of the IFRS on earnings management only in the case of ownership exceeding 50 percent. At this level of ownership, the family owners align their interests with the minority shareholders.

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INTRODUCTION

This research aims at examining the effects of International Financial Reporting Standards (IFRS) adoption on earnings management in the Indonesian banking industry. The Indonesian Institute of Chartered Accountants (IICA) made a public commitment to adopt International Financial Reporting Standards (IFRS) from December 2008. Indonesia's accounting standards previously do not fully follow IFRS but it was to converge gradually.

There are two basic accounting standards: rule-based and principle-based standards. IFRS is widely recognized as the champion of principle-based standards. Principle-based standards provide more extensive guidance on accounting standards compared with rule-based standards. Ball (2006) argued that application of IFRS provides more accurate and comprehensive financial statements. IFRS will then provide better information to the investors. Thus, IFRS provide better quality financial statements compared with rule-based standards (Brown, 2011). The level of earnings management is expected to decrease after the adoption of IFRS. Research evidence indicates that IFRS adoption has a negative effect on earnings management (Dimitropoulos, Asteriou, Kousenidisand Leventis, 2013; Key & Kim, 2020; Kwon, Naand Park, 2019; Lee, 2019; Pelucio-Grecco et al., 2014; Zeghal, 2012).

On the other hand, there are arguments that IFRS have provided more flexibility for managers to use their judgment. Managers have more opportunities to manage earnings. Therefore, IFRS have a positive effect on earnings management (Ahmed, 2013; Callao and Jarne, 2010; Jeanjean and Stolowy, 2008; Mongrut and Winkelried, 2019) which suggests that the level of accrual earnings management increases after the adoption of IFRS. Malikov et al. (2018) provided evidence that companies engage in classification shifting of revenue to achieve higher earnings. In addition, there is evidence that the adoption of IFRS has no significant effect on earnings management (Ahmed, 2013; Wang and Campbell, 2012).

However, most of the evidence on the effect of IFRS adoption on earnings management is from the non-financial sectors except Gebhardt and Novotny-Farkas (2011) and Leventis et al. (2011). The banking industry has unique characteristics as compared to the non-banking industry, for example, the banking industry has tight monitoring controlled by the regulatory agencies. Therefore, banks have more incentives to engage in income smoothing (Gebhardt and Novotny-Farkas, 2011). In Indonesia, the banking industry is monitored by the central bank (Bank of Indonesia) and the Financial Services Authority of Indonesia. The banking industry has a higher impact on the economy and there are numerous evidences of banking scandals that have significant effects on the economy. In Indonesia, a recent major financial scandal was Centurygate which involved the Century Bank. Manganaris et al. (2015) argued that banks have a significant role in the financial markets, therefore it is of interest to find out how banks react to the IFRS adoption.

Previous studies showed that IFRS adoption has a negative effect on discretionary accruals among European banks (Gebhardt and Novotny-Farkas, 2011). This result is in line with Leventis et al. (2011) who found that earnings management in European banks decreased significantly after the adoption of IFRS. Further, a study by Palea and Scagnelli (2017) found that the ability of net income to predict future cash flows has increased. Therefore, IFRS adoption has a positive effect to improve earnings quality. On the other hand, Liu and Sun (2015) found that IFRS adoption has no significant effect on discretionary accruals and the earnings response coefficients. The adoption of IFRS may not have a positive effect on the earnings quality. A study by Lin et al. (2012) and DeFond, Gao et al. (2019) showed that the post adoption of IFRS increased earnings management activity and reduced value relevance. Earnings quality decreases after the adoption of IFRS. The evidence of the effect of IFRS and earnings management is inconclusive. Therefore, it is important to examine the effect of IFRS on earnings management. This study focuses on the effects of IFRS on earnings management in the Indonesian banking industry.

Indonesia has unique characteristics on ownership structure relating to companies. Most Indonesian companies are owned by families (Carney and Child, 2013; Setiawan et al., 2016). Carney and Child (2013) investigated the effect of the financial crisis on ownership structure in the East Asian countries. They found that the level of family ownership in Indonesia is still high although the percentage is less than before. Prabowo and Simpson (2011) found that family ownership in Indonesia has a negative effect on firm performance. The negative effect becomes stronger when family ownership enables greater involvement on the control decisions. Family ownership is actively involved in strategic decision making in Indonesian firms (Untoro et al., 2017). Therefore, managers engage in accrual earnings management to achieve specific earnings targets (Achleitner et al., 2014). Hence, it is of interest to investigate the effect of family ownership on earnings management in the Indonesian banking industry and the role of family ownership on the effect of IFRS adoption on earnings management.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Earning management

Healy and Wahlen (1999) argued that earnings management occurs when managers use their discretion to manage earnings. Management have the opportunity and motive to manage earnings to the best of their interest. The early study by Healy (1985) showed that managers use their discretion to manage earnings in order to get better compensation. Thus, managers are able to get better bonus and remuneration schemes through earnings management. This result is in line with Schipper (1989) who argued that management engage in earnings management to get private gains. An important study on earnings management in banking was conducted by Beaver and Engel (1996). Beaver and Engel (1996) noted that management in the banking industry engaged in earnings management through allowance of loan loss. A study by Cornett et al. (2009) provided evidence that earnings management in the US banking was related to CEO pay-for-performance. Thus, managers use their discretion to achieve better bank performance.

The Effect of IFRS adoption on earnings management

IFRS is one of the important developments relating to accounting standards. As at September 2015, IFRS has been adopted by 140 countries. There are two options on IFRS adoption: full adoption and gradual convergence. Indonesia adopted the IFRS by following the gradual convergence route. In particular, the Indonesian Financial Accounting Standards Board (Dewan Standar Akuntansi Indonesia) supports convergence of Indonesian Financial Accounting Standards to IFRS by gradually adopting IFRS standards to minimize the gap between IFRS and the Indonesian Financial Accounting Standards (SAK).

The International Accounting Standards Board states that the objective of IFRS are to " develop a single high quality, understandable, enforceable and globally accepted financial statements….These set standards require high quality…". Ball (2006) interpreted high quality as satisfying the expectations of investors regarding the information needed. It requires that financial statements provide more accurate information and less room for earnings manipulation. Thus, IFRS should provide more reliable and transparent financial statements. In this context, IFRS have decreased the ability of management to engage in earnings management. On the contrary, IFRS have provided more opportunities for managers to use their judgment on the financial statements process. Managers are given more flexibility to use their judgment. Thus, IFRS may have a positive effect on earnings management (Jeanjean and Stolowy, 2008).

Empirical evidence on the effects of IFRS adoption on earnings management is inconclusive. Jeanjean and Stolowy (2008) investigated the effects of IFRS adoption in three countries: Australia, France and the United Kingdom (UK). They found that there is no significant earnings management before and after IFRS adoption in Australia and the UK. However, the level of earnings management in France increased after the IFRS adoption. Managers have more flexibility to use their judgment on the financial statements process. This result showed that IFRS have a positive effect on earnings management. This result is supported by Callao and Jarne (2010). They investigated the effect of IFRS adoption on earnings management using cross-countries data among the the European Union (EU). The samples in their study were non-financial firms listed in 11 capital markets in the EU. The results of their study showed that earnings management intensified after the IFRS adoption. This suggests that IFRS provide more opportunities for managers to manage earnings. In addition, the adoption of IFRS decreased earnings quality in China (DeFond et al., 2019) and Latin America (Mongrut and Winkelried, 2019) and reduced value relevance in Indonesia (Ratnaningrum et al., 2019).

Ahmed et al. (2013) conducted a study on the effects of IFRS adoption on earnings quality based on samples from 20 countries that adopted IFRSs. They use three proxies of earnings quality: income smoothing, aggressiveness of accrual management and earnings management to meet or beat analysts' forecasts. The results of their study showed that after the adoption of IFRS, income smoothing as well as the level of aggressiveness of accounting accrual management has increased. However, there is no significant effect on earnings management to meet or beat financial analysts forecasts. These results showed that IFRS have a negative effect on earnings quality (DeFond et al., 2019; Mongrut and Winkelried, 2019). Managers have more opportunities to engage in accrual activities. This result is in line with Callao and Jarne (2010) and Jeanjean and Stolowy (2008). Lin et al. (2012) analyzed the earnings quality of German firms that switched their financial statements from US GAAP base to IFRS. The results showed that financial statements under IFRS have lower earnings quality as evidenced by increasing level of earnings management and decreasing value relevance. This result is in line with Krishnan and Zhang (2019) who found that earnings based on Canadian GAAP have better qualities compare to earnings based on IFRS. IFRS also provide opportunities for managers to engage in shifting the revenue to achieve better earnings performance (Malikov et al., 2018).

On the other hand, Ahmed et al. (2013), Liu and Sun (2015) and Wang and Campbell (2012) found no significant effect of IFRS adoption on earnings management. Ahmed et al. (2013) conducted meta-analysis on the effects of IFRS on earnings management. Their results showed that discretionary accrual do not decrease after the adoption of IFRS. Hence, they concluded that IFRS did not increase the quality of financial statements. Further, Wang and Campbell (2012) found that IFRS did not reduce earnings management in China and Eng et al. (2019) showed that IFRS adoption do not improve the level of information content of earnings and earnings forecast.

Other studies such as Dimitropoulos et al. (2013), Pelucio-Grecco et al. (2014) and Zeghal et al. (2012) provided evidence on the negative effects of IFRS adoption on earnings management. Dimitropoulos et al. (2013) investigated the impact of IFRS adoption on earnings quality using the Greek context. Their research sample consisted of 808 firm-year observations from the 2001 – 2008 period. Their results showed that the implementation of IFRS have a negative affect on earnings management, more timely loss recognition and greater value relevance. These results showed that the implementation of IFRS have a positive effect on earnings quality. These results are in line with da Silva and Nardi (2017) and Pelucio-Grecco et al. (2014) who found that the implementation of IFRS in Brazil reduce earnings management. Zeghal et al. (2012) investigated the effect of IFRS implementation on earnings management using French data. The results of their research show that the adoption of IFRS reduced earnings management significantly. Therefore, the adoption of IFRS has a negative effect on earnings management (Alhadi et al., 2017; García et al., 2017; Kouki, 2018; Wijayana and Gray, 2019) and real earnings management (Kwon et al., 2019). The level of earnings management decreased after the implementation of IFRS. The adoption of IFRS increased the quality of financial statements through the improvement of information comparability (Lee, 2019; Yip and Young, 2012), reduce information asymmetry (Fitriany et al., 2017; Harakeh, 2019), improve value relevance (Eng et al., 2019) and increase earnings persistence (Cao and Patel, 2019).

Research on the effect of IFRS adoption on earnings management in Indonesia was conducted by Setiawan et al. (2019). Their research sample consists of 1,127 firm-year observations of non-financial firms in the Indonesian Stock Exchange from the 2007 – 2010 period. The results of their study showed that accrual earnings management decreases after the adoption of IFRS. This study provided evidence that Indonesia with specific characteristics such as high family ownership (Carney and Child, 2013; Setiawan et al., 2016) and low corporate governance practices (La Porta et al., 1998, 2000) reduce earnings management when companies adopt IFRS.

However, most of the existing studies focus on non-financial firms. A study on the effect of IFRS adoption on earnings management in the banking industry was conducted by Dimitropoulos et al. (2013), Gebhardt and Novotny-Farkas (2011) and Leventis et al. (2011). Gebhardt and Novotny-Farkas (2011) examined the relationship between IFRS adoption and earnings quality in EU banks. Earnings quality was measured using income smoothing and timely loss recognition. The results showed that IFRS significantly reduce income smoothing. IFRS adoption decreases discretionary accruals as compared with the pre-IFRS periods. However, the effectiveness of IFRS adoption is also affected by institutional factors. The effect of IFRS is less pronounced in those countries with more dispersed ownership and stricter supervisory environment. This study provides arguments on the importance of the institutional setting on the study of the effectiveness of IFRS adoption on earnings management. Further, Leventis et al. (2011) investigated the effect of IFRS adoption on loan loss provision to engage in earnings management. Their research sample consisted of 91 banks during the 10 year period before and after the implementation of IFRS. The results of their study show that the level of earnings management significantly decrease after the implementation of IFRS. This result showed the importance of IFRS to increase earnings quality. Further, Palea and Scagnelli (2017) reported positive effect of IFRS adoption on the predictive ability of net income. The net income after IFRS adoption has higher ability to predict future cash flows in continental European banks. Jiao et al. (2012) also found that the accuracy of analysts forecasts increased after the IFRS adoption.

The implementation of IFRS demonstrated better earnings quality (Dimitropoulos et al., 2013; Key and Kim, 2020; Zeghal et al., 2012), because income smoothing is reduced (Gebhardt and Novotny-Farkas, 2011) and earnings management has decreased (Leventis et al., 2011). Therefore, it is expected that IFRS have a negative effect on earnings management.

IFRS Adoption, Family Ownership and Earnings Management

Gebhardt and Novotny-Farkas (2011) argued that institutional settings have a significant impact on the effectiveness on IFRS implementation. The effect of IFRS on earnings management vary with different ownership structure. In countries with dispersed ownership, IFRS have less impact on earnings management. As one of the emerging markets, Indonesia has concentrated ownership. Most of the Indonesian companies are owned by the family (Claessens et al., 2000). Family ownership is still dominant among companies before and after the financial crises (Carney and Child, 2013). There is a slight change in the family ownership, but overall companies are still owned by the majority shareholders. A study by Setiawan et al. (2016) showed that family firms are the dominant structure in Indonesia. Therefore, this study investigated the effects of family ownership on the effectiveness of IFRS implementation on earnings management in the Indonesian banking industry.

There are two possible effects of family ownership on firms' financial outcomes: alignment and entrenchment (Wang, 2006). The alignment theory argues that family ownership has a positive effect on firm outcome, that is family ownership have a positive effect on firm performance or family ownership provide better earnings quality as compared with non-family firms. On the other hand, the entrenchment theory argues that family ownership has a negative effect on firms' outcomes, that is family ownership prefer to serve their own interests rather than that of minority shareholders. Hence, family ownership is negatively associated with firm performance.

Prabowo and Simpson (2011) investigated the effect of family involvement in the board and family ownership on firm performance. Their results showed that family ownership has a negative effect on firm performance. However, this negative effect disappears when family involvement in the board is added to the model. This result showed that family ownership has a negative effect on firm performance. Kumala and Siregar (2020) provided evidence regarding positive relationship between family ownership and earnings management. Thus, family firms in Indonesia manage their earnings to achieve specific target. Further, Darmadi and Sodikin (2013) also found that family firms in Indonesia have a negative effect on voluntary disclosure. Setiawan et al. (2016) found that family ownership has a negative effect on dividend decisions. Family ownership pay less dividends compared to other non-family firms.

Although, family ownership haa a negative effect on firm performance in Indonesia, there are some arguments that the family will maintain their name and reputation. Therefore, the family will be responsible for firm performance. In this case, the family will have a positive effect on firm performance. Siregar and Utama (2008) found that family firms in Indonesia have a positive relation with future performance. Family firms have better future cash flows and future earnings growth. Further, the interaction between family firms and earnings management have a positive effect on future performance. Thus, family firms engage in efficient earnings management. Family firms use earnings management to convey their information regarding the firms' future performance. Another positive effect of family involvement on control mechanism firms was provided by Jiang and Peng (2011). They found that family CEO has a positive effect on firm performance and further tests using the interaction between family CEO and family ownership also noted a positive effect on firm performance in the Indonesian context. The results of Siregar and Utama (2008) and Jiang and Peng (2011) provided evidence that family firms have a positive effect on firm performance.

Achleitner et al. (2014) provided evidence on the negative effect of family ownership on accrual earnings management using Germany data. Their results showed that family ownership mitigates accrual earnings management. Family ownership has a positive effect on earnings quality. These results are in line with Prencipe et al. (2011) who found that family firms in Italy have lower income smoothing compared with non-family firms. Family firms have better earnings quality compared to non-family firms. Further, Wang (2006) provided evidence that family firms have better earnings quality. Family firms have lower discretionary accruals (Attig et al., 2020) and provide greater earnings information. Thus, family firms have better earnings quality.

Previous research showed that family ownership has a positive effect on earnings quality (Cascino et al., 2010; Wang, 2006)). Family firms have better earnings quality because of lower earnings management (Achleitner et al., 2014; Wang, 2006) and lower income smoothing (Prencipe et al., 2011). Therefore, this study expects that family ownership has a negative effect on earnings management.

Further, this study investigates the effect of family ownership on the relationship between IFRS adoption and accrual earnings management in the Indonesian banking industry. This study expects that IFRS adoption would reduce earnings management. IFRS adoption has a negative effect on earnings management. Previous research such as Gebhardt and Novotny-Farkas (2011) and Leventis et al. (2011) provided evidence that IFRS have a positive effect on earnings quality and increase the information of earnings using the bank industry context. Further, this study also expects that family ownership has a negative effect on earnings management. Previous studies on the effect of family firms in Indonesia showed that family firms have a positive effect on firm performance (Jiang and Peng, 2011) and future firm performance (Siregar and Utama, 2008). Family firms in Indonesia have a positive effect on firms' financial outcomes. Therefore, it is expected that family ownership and the adoption of IFRS have less discretionary accruals after the IFRS adoption.

RESEARCH METHODS

The study focuses on Indonesian public listed banks in the Indonesian Stock Exchange. The sample of this study consists of 160 firm-year observations from the 2006 – 2011 period. The dependent variable in this study is accrual earnings management. To measure accrual earnings management in the banking industry, the study follows Beaver and Engel (1996). The independent variables of this study are IFRS adoption and family ownership. IFRS adoption is a dummy variable, 1 for years 2009, 2010 and 2011, and 0 for years 2006, 2007, and 2008. Family ownership is the percentage of shares owned by the family. This variable is also a dummy variable, 1 if the family has more than 20% shares. The study follows Prabowo and Simpson (2011) and Setiawan et al. (2016) by using 20% as the cut-off point to classify family firms. Further, this study also use 30% and 50% as cut-off points as in Prencipe and Bar-Yosef (2011). Prencipe and Bar-Yosef (2011) and Setiawan et al. (2016) use cut-off points higher than 30% and 50%. For control variables, the present study includes five variables: debt to asset ratio, return on assets, growth, firm size and audit quality. To test the effect of independent variables to dependent variable, this study apply regression methods using panel data. The following empirical model is examined in this study:

$$EM_{it} = \alpha + \beta_1 IFRS_{it} + \beta_2 OWN_{it} + \beta_3 IFRSit*OWNit + \beta_4 SIZE_{it} + \beta_5 AS_{it} + \beta_6 GROWTH_{it} + \beta_7 LEV_{it} + \beta_8 ROA_{it} + e_{it} \quad (1)$$

where EM_{it} = Earnings management, accrual earnings management (Beaver & Engel, 1996); $IFRS_{it}$ = a dummy variable, 1 for years 2009, 2010 and 2011, and 0 for years 2006, 2007, and 2008; OWN_{it} = Family ownership is the percentage of shares owned by the family. This variable is a dummy variable, 1 denotes the family variable have more than 20% share. The study use three cut-off point to classify family firms: 20%, 30% and 50%; SIZE = firm size, natural logarithm of total assets; AS = auditor size, a dummy variable, 1 if audit firm is Big-4 and 0 otherwise; GROWTH = market-to-book value of equity; LEV = leverage, debt to equity ratio; ROA = return on assets; and e_{it} = error term.

This study refers to Beaver and Engel (1996) to measure earnings management in banking industry using cross-sectional approach.

$$NDA_{it} = \beta_0 + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1} + \varepsilon_{it} \quad (2)$$

where CO_{it} = *loan charge offs*; $LOAN_{it}$ = *outstanding loans*; NPA_{it} = *non performing assets*; ΔNPA_{it+1} = *non performing assets* $_{t+1}$ minus *non performing assets*$_t$; and NDA_{it} = non-discretionary accrual.

The estimated coefficient of $\beta_0 + \beta_1 + \beta_2 + \beta_3 + \beta_4$ are used to estimate non-discretionary accrual for each bank.

Further, to measure discretionary accrual (earnings management), following equation is used:

$$TA_{it} = NDA_{it} - DA_{it}$$

where TA_{it} = Total accrual (asset impairment losses); NDA_{it} = Non-discretionary accrual from equation (2); DA_{it} = discretionary accrual from equation.

ANALYSIS

Descriptive Statistics

Table 1 provides information regarding the descriptive statistics of this study. From Table 1.1, the mean for earnings management is -0.0069. This value shows that banks in Indonesia engage in income decreasing earnings management. This is consistent with the median value of earnings management which is -0.0221. Therefore, most Indonesian banks use earnings management to report lower income. Furthermore, Table 1.2 shows that family firms in the Indonesian banking industry based on the 20% cut off point is 43.75%. Thus, 43.75% of the sample banks in the study are owned by the family. Table 1.2 provide evidence that the family in Indonesian banks still have large shareholdings. Tables 1.1 and 1.2 also provide information on the control variables: leverage, growth, firm size, ROA and auditor quality.

Most of the external audits in the Indonesia banking industry are conducted by the Big-4 audit firms. Based on the Table 1.2, 66.25% of audits are conducted by Big-4 audit firms. Table 1.1 also show that leverage has a mean and median of 9.172% and 9.092% respectively. The ranges of leverage are 3.0263% to 17.9156%. Further, Table 1.1 also shows that Indonesian banks have an average growth of more than 1. This shows that market value of the Indonesian banking shares are higher than the book value of equity. The median value of the growth is also higher than 1. This is in line with the mean value of growth. The mean and the median value of ROA for the sample are 1.11% and 1.04%. Thus, during the observation period, Indonesian banks attained positive ROA.

Table 1 Descriptive Statistics

	EM	LEV	GROWTH	ROA	SIZE
Mean	-0.0069	9.1720	2.0435	0.0111	16.8012
Median	-0.0221	9.0902	1.7766	0.0104	16.9594
Maximum	0.2720	17.9156	6.4470	0.0339	20.1288
Minimum	-0.2050	3.0263	0.2180	-0.0567	13.8558
Std. Dev.	0.0841	2.9859	1.2054	0.0106	1.74865

Note: EM = Earnings management, accrual earnings management (Beaver & Engel, 1996); LEV = leverage, debt to equity ratio; GROWTH = market-to-book value of equity; ROA = return on assets; and SIZE = firm size, ln total assets.

Table 1.2 Descriptive Statistics for Dummy Variables

	IFRS	FF20	AS
Category1	0.5437	0.4375	0.6625
Category0	0.4563	0.5625	0.3375

Note: IFRS = dummy variable, 1 if 2009, 2010 and 2011 and 0 if 2006, 2007, 2008; FF20 = family firms, dummy variable 1 if family own firm shares of 20% or more and 0 otherwise; AS = dummy variable, 1 if auditor is Big-4 and 0 otherwise.

Correlation

Table 2 provides information regarding correlation between the variables. Table 2 shows that earnings management have a significant correlation with family firms, leverage, growth and size. On the other hand, earnings management have no significant correlation with IFRS, ROA and auditor quality. This correlation test indicates that family ownership have a significant effect on earnings management. Further, Table 2 also provides evidence that family ownership has significant correlations with ROA, firm size and audit quality. Therefore, it is likely that family banks choose non-Big 4 audit firms rather than Big 4 audit firms to conduct external audits. Family banks have smaller firm size when compared with the non-family banks and are less profitable as compared with other banks.

Table 2 Correlation matrix

	DAIT	IFRS	FF20	LEV	Growth	ROA	SIZE	AUDQ
EM	1.0000							
IFRS	-0.0643	1.0000						
	(0.4187)							
FF20	-0.3045***	-0.0521	1.0000					
	(0.0001)	(0.5124)						
LEV	0.3705***	-0.0887	0.0041	1.0000				
	(0.0000)	(0.2642)	(0.9585)					
Growth	0.1325*	0.1208	-0.0895	0.0351	1.0000			
	(0.0947)	(0.1278)	(0.2601)	(0.6587)				
ROA	-0.0861	0.0498	-0.2190***	-0.2693***	0.2441***	1.0000		
	(0.2785)	(0.5311)	(0.0054)	(0.0006)	(0.0019)			
SIZE	0.2632***	0.1249	-0.4059***	0.1028	0.4233***	0.4934***	1.0000	
	(0.0008)	(0.1155)	(0.0000)	(0.1957)	(0.0000)	(0.0000)		
AUDQ	0.0599	0.0096	-0.5428***	-0.1462*	0.1606**	0.4399***	0.6569***	1.0000
	(0.4515)	(0.9039)	(0.0000)	(0.0649)	(0.0425)	(0.0000)	(0.0000)	

Note: EM, earnings management, accrual earnings management (Beaver & Engel, 1996); IFRS = dummy variable, 1 if 2009, 2010 and 2011 and 0 if 2006, 2007, 2008; FF20 = family firms, dummy variable 1 if family own firm share 20% or more and 0 otherwise; FF30 = family firms, dummy variable 1 if family own firm share 30% or more and 0 otherwise; FF50 = family firms, dummy variable 1 if family own firm share 50% or more and 0 otherwise, LEV = leverage, debt to equity ratio, Gr = growth, market-to-book ratio of equity, ROA = return on assets, SIZE = firm size, ln total assets, AUDQ = dummy variable 1 if auditor is Big-4 and 0 otherwise. Number in the bracket is the p-value. *, **, *** significant at 10%, 5%, 1%.

Analysis

Table 3 provides the results of the hypotheses testing. The study uses three cut-off points to measure family firms: 20%, 30% and 50%. The results of the hypotheses tests show that IFRS have a negative effect on earnings management in the Indonesian banking industry. This results show that earnings management decrease after IFRS is implemented. Thus, IFRS minimize earnings management. This result is in line with Ball (2006) and Brown's (2011) arguments that IFRS adoption is expected to provide better information to the investors. IFRS provide more accurate and comprehensive financial statements (Ball, 2006), therefore the disclosure level of financial statements has increased. Thus, the level of earnings management declined after the IFRS adoption. The negative effect of IFRS on earnings management in the Indonesian banking industry also confirms the results of Setiawan et al. (2019) who found that IFRS adoption in Indonesian non-financial firms decreased the level of earnings management. Thus, the adoption of IFRS in Indonesia have signficantly decreased the level of earnings management.

Table 3 Results

	1	2	3	4	5	6	7
α	-0.3562***	-0.2812***	-0.2728***	-0.3187***	-0.3079***	-0.3275***	-0.3200***
	(0.0000)	(0.0001)	(0.0004)	(0.0000)	(0.0000)	(0.0000)	(0.0001)
IFRS	-0.0129*	-0.0134*	-0.0178***	-0.0134*	-0.0208***	-0.0133*	-0.0231**
	(0.0945)	(0.0904)	(0.0012)	(0.0900)	(0.0049)	(0.0892)	(0.0263)
FF20		-0.0564***	-0.0620***				
		(0.0038)	(0.0024)				
IFRSxFF20			0.0098				
			(0.3147)				
FF30				-0.0276**	-0.0366***		
				(0.0106)	(0.0001)		
IFRSxFF30					0.0181		
					(0.1508)		
FF50						-0.0310***	-0.0506***
						(0.0001)	(0.0005)
IFRSxFF50							0.0412***
							(0.0074)
LEV	0.0034	0.0042*	0.0041	0.0042*	0.0040	0.0049**	0.0050*
	(0.1424)	(0.0892)	(0.1000)	(0.0976)	(0.1159)	(0.0495)	(0.0589)
Growth	0.0063	0.0067*	0.0067*	0.0062	0.0060	0.0069	0.0061
	(0.1155)	(0.0799)	(0.0834)	(0.1295)	(0.1403)	(0.1048)	(0.1231)
ROA	-2.4559***	-2.2972***	-2.2533***	-2.3287***	-2.2605***	-2.3449***	-2.1407**
	(0.0033)	(0.0085)	(0.0093)	(0.0073)	(0.0074)	(0.0084)	(0.0106)
SIZE	0.0210***	0.0182***	0.0179***	0.0192***	0.0189***	0.0191***	0.0188***
	(0.0001)	(0.0000)	(0.0001)	(0.0000)	(0.0001)	(0.0001)	(0.0002)
AUDQ	-0.0265*	-0.0478***	-0.0479***	-0.0329***	-0.0332***	-0.0323**	-0.0328**
	(0.0747)	(0.0025)	(0.0025)	(0.0067)	(0.0074)	(0.0210)	(0.0238)
F-value	3.9909***	4.7161***	4.1276***	3.8590***	3.4501***	3.8826***	3.7925***
F-prob	(0.0009)	(0.0000)	(0.0001)	(0.0006)	(0.0011)	(0.0006)	(0.0004)
Adj R^2	0.1014	0.1406	0.1359	0.1117	0.1097	0.1126	0.1231

Note: IFRS = dummy variable, 1 if 2009, 2010 and 2011 and 0 if 2006, 2007, 2008; FF20 = family firms, dummy variable 1 if family own firm shares of 20% or more and 0 otherwise; FF30 = family firms, dummy variable 1 if family own firm shares of 30% or more and otherwise; FF50 = family firms, dummy variable 1 if family own firm shares of 50% or more and 0 otherwise, LEV = leverage, debt to equity ratio, Growth = growth, market-to-book ratio of equity, ROA = return on assets, SIZE = firm size, ln total assets, AUDQ = dummy variable 1 if auditor is Big-4 and 0 otherwise. Number in the bracket is the p-value. *, **, *** significant at 10%, 5%, 1%

The results of the study is also robust as to the other family firm measurements. Using the 30% and 50% cut-off points for family firms, the results of the hypothesis testing also shows that IFRS have a negative effect on earnings management. This result confirms previous studies such as Dimitropoulos et al. (2013), Gebhardt and Novotny-Farkas (2011), Pelucio-Grecco et al. (2014) and Zeghal et al. (2012) who found a negative effect of IFRS on earnings management. Thus, IFRS adoption has positively increased earnings quality. Leventis et al. (2011) also investigated the effect of IFRS on earnings management on loan loss provision in the banking industry. The results showed that the level of loan loss provision decreased after the adoption of IFRS. Thus, the adoption of IFRS in the banking industry has decreased the level of earnings management.

The result of the study also supports previous work such as Alhadi et al. (2017), García et al. (2017), Kouki (2018) and Wijayana and Gray (2019) who found that the level of earnings management decreased after the adoption of IFRS. This result shows that IFRS have increased the level of financial statement quality (Fitriany et al., 2017; Harakeh et al., 2019; Lee, 2019; Yip & Young, 2012). IFRS improve the value relevance and (Eng et al., 2019) and earnings persistence (Cao & Patel, 2019). Thus, the adoption of IFRS enhances earnings quality (da Silva & Nardi, 2017; Pelucio-Grecco et al., 2014; Zeghal et al., 2012). However, the result of this study is not in line with previous work who found positive effect of IFRS adoption on the earnings management (DeFond et al., 2019; Krishnan & Zhang, 2019; Malikov et al., 2018; Mongrut & Winkelried, 2019).

The banking industry is a highly regulated industry. Therefore, banks have more regulations to follow and comply with in preparing their financial statements. IFRS as a principle-based standard also provide more guidance on the accounting standards. Thus, the effect of IFRS adoption provides more guidance on the preparation and presentation of financial statements. The adoption of IFRS in the banking industry has a positive effect on strengthening earnings quality. The level of income smoothing has decreased (Gebhardt & Novotny-Farkas, 2011) and the level of earnings management in the banking industry decreases after the adoption of IFRS (Leventis et al., 2011). The result of the study is also in line with Agostino et al.(2011) who found that IFRS adoption has increased the quality of the earnings among the European banking.

Table 3 also presents the results of the effect of family firms on earnings management in the Indonesian banking industry. Wang (2006) argued that family owners may have alignment or entrenchment effects on earnings quality. The results of Table 3 show that family banks in Indonesia are negatively related to earnings management. Family ownership in Indonesian banks mitigates earnings management practices. Therefore, earnings provide better information for shareholders. Family firms in Indonesia align their interests with their shareholders. This result confirms previous studies such as Achleitner et al. (2014), Attig et al. (2020), Cascino et al. (2010) and Prencipe et al. (2011) who found that earnings quality in family firms are better than in non-family firms.

The effect of family owners on earnings management is robust compared with the other measurements of the family firms. Using alternative measures of 30% and 50% cut off points also show that family firms still have a negative effect on accrual earnings management. Thus, family ownership in Indonesia provide better earnings quality. Family owners use their discretion to minimize earnings management.

Table 3 column 3 provides evidence that the interaction between IFRS and family firms has no significant effect on earnings management. Therefore, there is no difference in earnings management in the pre and post IFRS adoption period for family owned banks. Although IFRS have significantly affect earnings management but the effect is minimized by family firms. Thus, IFRS and family ownership have no significant effect on earnings management. The results show that family owners may not engage in less earnings management after the IFRS adoption. Further test using the 30% cut-off for measuring earnings management also provide similar results. Both, IFRS and family owners have a negative effect on earnings management in the Indonesian banking industry. However, the interaction between IFRS and family firms, using 30% cut-off point, have no significant effect on the earnings management. There is no significant difference on how family firms engage in earnings management between before and after IFRS adoption. Thus, family firms using 20% and 30% have similar behavior.

Further tests using a 50% cut-off point provide different results. Both, IFRS and family owners have a negative effect on earnings management. Thus, both IFRS and family owners, individually minimize earnings management. However, the interaction between both IFRS and family owners using the 50% cut off point have positively sign to the earnings management. This result is different from the 20% and 30% cut off points. Thus, family firms using the 50% cut off point have strengthen the effect of IFRS adoption on earnings management. Family owners with more than 50% shares have majority ownership. Thus, family decisions directly affect firm decisions. Family owners use their discretion to minimize earnings management after. The result of the study confirm that family owners, only in the case of ownership exceeding 50 percent, in Indonesia banking industry align their interest with minority shareholder (Wang, 2006).

Table 3 also provides the effect of the control variables: leverage, firm size, growth, ROA and auditor quality on earnings management in the Indonesian banking industry. Leverage has a positive effect on earnings management. Thus, firms with higher leverage tend to engage in higher earnings management. Firms with higher leverage actively engaged in income increasing earnings management. This result is robust as to the different cut-off points: 20%, 30% and 50%. This result supports Li and Hung (2013) and Salehet al. (2007) who found that leverage has a positive effect on earnings management. Growth has a positive effect on earnings management at the 20% and 30% cut-off points. Thus, firms with higher growth tend to engage in income increasing earnings management.

Table 3 shows that ROA has a negative effect on earnings management. Firms with high profitability engage in earnings management to minimize earnings volatility. This result confirms Prencipe et al. (2011) and Prencipe and Bar-Yosef (2011) studies who found that ROA has a negative effect on income smoothing in the Italian context. Firm size has a positive effect on earnings management. Bigger firms engage more aggressively in earnings management (Zeghal et al., 2012). Table 3 also shows that audit quality has a negative effect on earnings management. Big-4 audit firms have greater ability to monitor earnings management (Becker, Defond, Jiambalvoand Subramanyam, 1998). This result also confirms Al-Ajmi (2009) who found that financial analysts perceive Big-4 audit firms to have greater ability to provide better earnings quality.

CONCLUSION

The study investigates the effects of IFRS adoption on earnings management in the Indonesian banking industry. Indonesia has unique institutional characteristics on ownership structure. Most Indonesian firms are owned by the family (Carney and Child, 2013; La Porta et al., 1998; Setiawan et al., 2016). Thus, the study considers the effect of family ownership on the relationship between IFRS adoption and earnings management. The study shows that IFRS has a negative effect on earnings management. The adoption of IFRS has reduced the level of earnings management in Indonesian banks. This study confirms previous studies that found that IFRS increase firm earnings quality (Gebhardt and Novotny-Farkas, 2011; Leventis et al., 2011; Zeghal et al., 2012).

The result of the study shows that family ownership has a negative effect on earnings management. Family banks align their interests with those of the minority shareholders. These results are robust when using different cut-off points to measure family banks. However, there is no difference on the level of earnings management before and after IFRS adoption on family firms.. Thus, there is no significant effect of IFRS adoption on family banks behavior to manage earnings. The study shows that the interaction between IFRS adoption and family ownership in banks has no significant impact on earnings management. This same result is also found in the family banks using the 20% and 30% cut-off points. However, families that own 50% or more share, have strengthened the effect of IFRS on earnings management. This result shows that controlling owners that own more than 50% share align their interest with minority shareholders. Thus, family owners minimize the earnings management after the IFRS adoption.

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