The Impact of Family Ownership and Political Connections on Earnings Management

Adiarti Apriliani
Universitas Indonesia
adiartia@gmail.com

Vera Diyanty
Universitas Indonesia
veranabila1@gmail.com

1. Abstrak

Penelitian ini bertujuan menginvestigasi pengaruh kepemilikan keluarga terhadap tingkat manajemen laba akrual dan manajemen laba riil dengan mempertimbangkan efek moderasi hubungan politik. Penelitian ini berpendapat bahwa kepemilikan keluarga dapat mempengaruhi tingkat manajemen laba akrual dan manajemen laba riil perusahaan. Penelitian ini juga berpendapat bahwa hubungan politik dapat mempengaruhi hubungan antara kepemilikan keluarga dan tingkat manajemen laba.

Sampel penelitian ini dipilih dengan menggunakan metode purposive sampling, meliputi 265 perusahaan non-keuangan yang terdaftar di Bursa Efek Indonesia dari tahun 2009 sampai 2013. Hasil penelitian ini membuktikan bahwa kepemilikan keluarga memiliki efek positif pada tingkat manajemen laba akrual dan memiliki efek negatif pada tingkat manajemen laba riil. Selanjutnya, penelitian ini membuktikan jika hubungan politik tidak berpengaruh pada hubungan antara kepemilikan keluarga dan kedua tipe manajemen laba.

Kata kunci: Manajemen Laba, Kepemilikan Keluarga, Hubungan Politik

2. Introduction

2.1. Research Motivation

In business practice, the agency relationship is defined as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. The fact shows that the interest of the principal and the agent does not always align which gives rise to a agency conflict (Jensen & Meckling, 1976).

Unlike most companies in the United States and European countries which have a widely-dispersed ownership structure, public companies in East Asia, including Indonesia, have concentrated ownership structure in which control rights and cash flow rights are concentrated in the hand of large shareholders such as family, government, widely-held financial institutions, and widely-held corporations (Claessens et al., 2000). Through a concentrated ownership structure, the controlling shareholder has the greater ability to entrench company's policies (Fan & Wong, 2002). Claessens et al, (2002) finds that more than 50% of managers of the companies which has concentrated ownership came from representatives of the controlling shareholders. The phenomenon of the concentrated structure has led the nature of the agency problem shifts away from manager–shareholder conflicts to conflicts between the controlling owner (who is also the manager) and minority shareholders.

Claessens et al., (2000) found that 66.9% of the publicly – listed companies in Indonesia owned by family. The high level of family ownership tend to led to a higher agency conflict between controlling and non-controlling shareholders. Companies controlled by families through pyramidal ownership structures and business groups of families have the potential to do expropriation against the non-controlling shareholders because this ownership arrangements allow controlling owners to commit low equity investment while maintaining tight control of the firm (Claessens et al., 1999; Diyanty, 2012). These conditions may led to the decreasing of firm's earnings quality along with the higher probability of outright expropriation (Wang, 2006). Therefore, the family owner may also have the potential to steer company's policies align with the interests of other stakeholders (Wang, 2006) in order to protect the company's performance in the long term that may have a potential impact on their personal wealth. These conditions will led to the production of higher earnings quality along with the potential risk of outright expropriation is getting decreased (Wang, 2006; Ali, 2007).

Based on the arguments on the above, family ownership could affect the quality of financial reporting in one of two competing ways: the entrenchment effect and the alignment effect. The entrenchment effect motivates financial state-ment suppliers (firms) to opportunistically manage earnings. It is consistent with the entrenchment view that concentrated ownership creates incentives for controlling shareholders to expropriate wealth from non-controlling shareholders (Shleifer and Vishny,1997). Family members usually hold important positions on both the management team and the board of directors. Thus, these firms may have inferior corporate governance because of ineffective monitoring by the board. Another source of entrenchment is potentially greater information asymmetry between family owners and other shareholders. Fan and Wong (2002) argue that concentrated ownership limits accounting information flows to outside investors, while Wang (2006) and Ali (2007) suggest that information asymmetry lowers the transparency of accounting disclosures. As a result, family members have both the incentive and the opportunity to manipulate accounting earnings for private interests. Therefore, the entrenchment effect predicts that family ownership is associated with the lower earnings quality.

A competing view is the alignment effect, which is based on the argument that family firms have incentives to report earnings in good faith and thus earnings are of higher quality. The alignment effect implies that concentrated ownership creates greater monitoring by controlling owners (Wang, 2006), suggesting that controlling families might monitor firms more effectively. Moreover, because of family members' long-term and sustainable presence in the firm and their intention to preserve the family reputation, families have a greater stake in the firm than nonfamily professional executives. Conversely, managers with short-run objectives may report earnings that maximize their personal wealth at the cost of shareholders (Wang, 2006). Hence, founding families are more likely to forgo short-term benefits from managing earnings because of the incentives to pass on their business to future generations and to protect the family's reputation. Accordingly, the alignment effect implies that founding family firms are less likely to engage in opportunistic behavior in reporting accounting earnings because it potentially could damage the family's reputation, wealth, and long-term firm performance. Thus, family firms are motivated to report earnings of higher quality than nonfamily firms (Wang, 2006; Ali, 2007). Therefore, family ownership can affect positively or negatively on earnings quality.

Morck et al., (2000; 2004) and Chaney et al (2011) suggested that closely held firms (e.g., family firms) may also be more inclined to establish political connections. A company is identified to have a political relationship if at least one of its large shareholders (anyone controlling at least 10 percent of voting shares) or one of its top officers (directors and board comissioners) is a member of parliament, a minister, or is closely related to a top politician or party (Faccio, 2006). The political relationship can affect the relationship of family ownership and earnings management practices by two different perspectives. Fisman (2001) argues that political relations can provide protection from disciplinary sanctions. This condition will cause a greater incentive to take action against the outright expropriation of non controlling shareholders. The second argument suggests that with its political relations, the company will be strictly monitored by a third party, for example, the mass media (Chaney et al, 2011). These conditions may push the controlling shareholders to be more careful in directing policy for protecting their reputation that potentially will give an impact on the value of the company in the long term.

Based on those two competing- arguments, political connections are able to strengthen (weaken) the positive (negative) effect from family ownership to the earnings management practice. Political connections can strengthen the positive influence from family ownership to the earnings management because the family owners can avoid the potency for competition and social sanctions. Thus, politically connected firms have a greater opportunities to do rent seeking activities that lead to the lower earnings quality. Based on the same argument, political connections can also weaken the negative influence from family ownership to the earnings management because based on the entrenchment argument, political connection would affect the family owners to maximize the self-interest purpose activities instead of aligning their interest with the other stakeholders. Therefore, the negative influence from family ownership on the earnings management will be weaken by the presence of political connection.

In another perspective, political connections can weaken the positive influence from family ownership to the earnings management because political connections give a consequence of higher public scrutiny and subject to more extensive controls and public monitoring than non-connected firms (Chaney *et al.*, 2011). Based on this argument, family owners would likely to align their interest as the same as other stakeholders. Thus, based on the alignment argument, political connections can also strenghten the negative influence from family ownership to the earnings management practices.

2.2. Research Objective

This study aims to investigate the effect of family ownership to quality of earnings considered that the majority of public companies in Indonesia is still dominated by family (Claessens et al., 2000). Further, this study also investigate whether political relations companies can strengthen or weaken the effect of family ownership on the quality of earnings. This research needs to be undertaken to remember that, through the writer's observation, there are many entrepreneurs in Indonesia involves in political world and there are still a few studies that look at the impact of political relations and family ownership simultaneously (Winata, 2014).

3. Theoritical Review and Hypothesis Development

3.1. Family Ownership and Earnings Management

Ownership structure which concentrated in the hand of large shareholder (i.e family) can cause the incentive effect of control. Claessens et al., (2000) found that 66.9% of public companies in Indonesia is owned by a family in majority proportion which is generally enhanced through a pyramid structure. Through the chain of ownership of the pyramid, the controlling shareholder has the potential to enjoy personal benefit without having to bear the cost consequences or disciplinary sanctions arising from the policy that he has made (La Porta et al, 1999; Claessens et al, 2002). With the concentration of ownership and pyramid mechanism, Wang (2006) suggested that family ownership can give different influence on earnings quality that can be viewed through two competing arguments; entrenchment argument and alignment argument. The explanation of each arguments is as follows:

1. *Entrenchment Argument*.

According to Wang (2006) and Chi *et* al., (2014), the entrenchment effect predicts that founding family ownership is associated with the lower earnings quality, because the entrenched controlling owners may opportunistically manage earnings. It is consistent with the agency-theoretic view that concentrated ownership creates incentives for controlling shareholders to expropriate wealth from other shareholders (Chi *et al*, 2014).

Fan and Wong (2002) argued that if the majority ownership of a company is concentrated in the hands of a few shareholders will lead to the ability and incentive to manage financial reporting policies opportunistically and can limit information about the company to the public with the aim of achieving self-interest purposes (Chaney et al 2011; Fan & Wong, 2002). These conditions resulted in the quality of the company's earnings getting decreased as the increasing of potential expropriation of the non-controlling shareholders (Wang, 2006).

Entrenchment argument can be associated with the low quality of earnings on the supply side because of the agency conflict motivated by the second type which suggests that the concentrated ownership, controlling shareholders have an incentive to direct policy that provides personal gain by taking action against the expropriation of non – controlling shareholders which one which is to manage earnings opportunistically (Wang, 2006; Chi et al, 2014). Beside that, In Indonesia, as in many emerging economies, the users of financial statements normally do not trust firm's reported earnings and may have to rely on information from private sources. Chi *et al.,* (2014) find evidence that earnings management is more pervasive in economies with less-developed stock markets, concentrated ownership, and weak investor protection. Given these country-level institutional factors increase insiders' ability to acquire private benefits, they have higher incentives to manage reported earnings.

Chi et al., (2014) found that a company owned by the family has higher accrual earnings management than non-family companies. This influence can be explained through the entrenchment effect and the demand for low-quality earnings (Chi et al, 2014).

2. *Alignment argument*.

The alignment effect is based on the notion that the interests of founding families and other shareholders are better aligned because of the large blocks of stock owned by family members and their long-term presence. Therefore, according to the alignment effect, founding families are less likely to expropriate wealth from other shareholders through managing earnings. Because the wealth of founding families is closely tied to firm value, families have strong incentives to monitor employees (Anderson and Reeb, 2003) and to create long-term loyalty in employees. In addition, long-term orientation and reputation protection dis-courage family firms from opportunistically managing earnings, because earnings management activities are more likely to be short-term oriented and perhaps even detrimental to long-term firm performance.

Basically, the company with the ownership structure dominated by the family can have a more efficient performance due to the smaller monitoring costs (Fama & Jensen, 1983). In line with the research of Fama and Jensen (1983), Anderson and Reeb (2003) suggested that the controlling shareholder who comes from a family would increase their monitoring by selecting individuals that have an affiliation with them to fill the top management positions. It is intended because the family's wealth is so closely linked to firm welfare, families may have strong incentives to monitor managers and minimize the freerider problem inherent with small, atomistic shareholders (Anderson and Reeb, 2003).

Unlike the entrenchment argument, the alignment argument is based on the belief that ideally the interests of the family as the controlling shareholder should be align with the interest of other shareholders because of the alignment of their interest will have an impact on the incidence of benefits for the company in the long term (Anderson & Reeb, 2003). Anderson and Reeb (2003) suggested that the owner of the family has a long-term presence on the company due to the the wealth of family owner is determined by the wealth of the company. By this condition, the family will tend to protect their interests by creating a policy that is aligned with the other stakeholders' interest as known as alignment effect.

Using the alignment argument, family owners and managers often act with altruism for the benefit of the entire organization and its stakeholders other than economic self-interest. Indeed, family owners often have a deep emotional investment in their firms because their fortune, personal satisfaction, and even reputation are tied to the firm (Chi *et al*., 2014). Thus, the family owners will tend to not doing the expropriation in order to avoid the threats of their reputation. Families through the management company will tend to produce higher earnings quality by lowering the earnings management (Wang, 2006) as the result of the lower risk of outright. Ali et al., (2007) in his study had proved that family firms are associated with higher earnings quality in which one of the measurements used in the study was the earnings management.

Earnings management practices can be either accrual earnings management (Chi et al, 2014; (Chaney et al, 2011) and real earnings management (Roychowdhury, 2006). Selection of the type of earnings management will be influenced by the underlying purpose of such activities and external conditions. With these two arguments; entrenchment arguments and alignment argument, that describes two different perspectives on the effect of family ownership on earnings management, it can be hypothesized:

H_{1a} : Family ownership has the influence on the accrual earnings management.

H_{1b} : Family ownership has the influence on the real earnings management.

3.2. Moderating effect of political connections on the relation between family ownership and earnings management.

Companies that have a concentrated ownership generally have political ties to maintain the status quo (Morck et al, 2000; Morck and Yeung, 2004). The family owners build political relationships with diverse motivations, for example, is to get protection from disciplinary sanctions or strengthen the company's position among its competitors (Chaney et al, 2011).

Indonesia has a number of examples that illustrate the phenomenon of family businessman who drawn into political world such as Aburizal Bakrie (who owned Bakrie & Brothers group) that have plunged in politics as the Chairman of Golongan Karya Political Party, Surya Paloh as the owner of Metro TV group which has plunged as the Chairman of the *Nasional Demokrat* political party, Hary Tanoesoedibjo with the MNC group, which also served as chairman of the board of supervisors in the *Hati Nurani Rakyat* political party and now serves as Chairman of the *Perindo* political party, and Hashim Djojohadikusomo which known as a palm oil entrepreneur is the younger brother of the Chairman of the Gerindra political party named Prabowo Subianto. Those examples is only represent small part of phenomenon that occur in Indonesia.

Political connections are basically likely to strengthen or weaken the effect of family ownership of the earnings management practices. First, the political connection can lead the family owner to be more freely to do expropriation (Chaney et al, 2011). This is because the benefits arising from political connectioms may provide an incentive for families to maximize their personal gains. Against the background of weak investor rights protection, concentrated ownership structure allows the family as the controlling shareholder of the company to limit the information to be published to external parties. By having political connections, the family owners can avoid the potency for competition and social sanctions (Fan & Wong, 2002). Political connection will lead a greater incentive for family owner to do expropriation more freely against the non-controlling shareholders. This argument is in line with the phenomena of entrenchment effect which argues that the controlling shareholder will entrench the company's policy according to his personal interests. Consequences that come from these phenomena is the controlling shareholder through the management company must hide the expropriation acts and adverse effect by increasing earnings management practices (Chaney et al, 2011; Zhaoming et al, 2010). Thus, based on this theory development, we can argue that political connections can strengthen the positive influence from family ownership to the earnings management because the family owners can avoid the potency for competition and social sanctions. Therefore, the practice of earnings management is potentially will be greater with the presence of political connections. Political connections can also weaken the negative influence from family ownership to the earnings management because based on the entrenchment argument, political connection would affect the family owners to maximize the self-interest purpose activities instead of aligning their interest with the other stakeholders (Braam *et al*, 2015).

Explanation of the second argument is coming from a different perspective. In fact, as the presence of political connections, the company will be monitored more intensively by third parties such as regulators and mass media (Chaney et al, 2011). In accordance with alignment argument, the family as the controlling shareholder would consider the value of the company in the long term so that the family will be directing policy aligned with the interests of other stakeholders. A high monitoring by the media will lead to increase litigation risk. In other words, when the expropriation act by the family has revealed, it will bring a negative effect of the family reputation. This will cause a less incentive fot the family owner to commit acts of expropriation and tend to report higher quality earnings. The lower probability of expropriation acts and public demands for a higher quality of reported earnings led to decrease earnings management practices (Yanzi 2010 in Zhaoming et al, 2010). Therefore political connections can weaken the positive influence from family ownership to the earnings management practices or strenghten the negative influence from family ownership to the earnings management practices.

In summary, political connections can strengthen or weaken the effect of the family ownership against both types of earnings management. Zhaoming et al., (2010) proved that political relations can affect the level of accrual earnings management. Therefore, it can be hypothesized:

H_{2a} : Political connections will strengthen (weaken) the positive (negative) effect from family ownership to the accrual earnings management.

The second argument as described above also applies to the effect on real earnings management. Political connections can be predicted to strengthen (weaken) the positive (negative) effect from the family ownership to the real earnings management. Additional argument comes from the study conducted by Braam et al., (2015) which found that with its political relations on a firm tend to replace their preference from accrual earnings management to real earnings management. This is because the political connections of the company are generally associated with greater scrutiny by regulators and the media. With regard to these reasons, the real earnings management would be chosen because it has a lower detection risk than accrual earnings management. Darrough and Ragan (2005) in Braam et al., (2015) further argued that the use of both types of earnings management (accrual earnings and real earnings) will be carried out simultaneously by the company due to the effect of the resulting combination of both proven to achieve maximum output, Therefore, it can be hypothesized:

H_{2b} : Political connenctions will strengthen (weaken) the positive effect (negative) from the family ownership to the real earnings management.

4. Research Method

4.1. Data and Sample

This empirical analysis is conducted using secondary data of non - financial by Jakarta Stock Industrial Classification (JASICA) listed in the Indonesia Stock Exchange (BEI) from 2009 to 2013. Data were obtained from the company's Annual Report obtained from the Indonesia Stock Exchange website and the Thomson Reuters Eikon. Data of structure of ownership is obtained from The Ministry of Justice and Human Rights of the Republic of Indonesia. Data on political relations review of information obtained from annual reports and public information on internet. Summary of sample selection can be seen through the following table:

Table 4.1 Sample Selection of Research

Sample selection	Number of companies
The number of publicly listed companies on the Indonesian Stock Exchange	507
The number of companies which do inital public offering after January 1, 2009	(137)
The number of public company which categorized in financial sector who do inital	(73)

public offering since January 1, 2009 - 31 December	
Crossholding companies	(6)
The number of companies which has negative equity	(26)
Total observation	265
Multiple by the year of observation	x 5
Total Observation (*Balanced Panel*)	**1.325**

4.2. Research Model

The first and second regression model is used to test the first and second hypothesis that family ownership has a influence to accrual and real earnings management. The third and fourth regression model is used to test the third and fourth hypothesis that political connection can be strengthen (weaken) the positive (negative) influence of family ownership to the accrual and real earnings management. The regression models and the description of variables is summarized as follows:

Table 4.2 Empirical Models

1a	$DACCR_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GWTH_{it} + \beta_6 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i$
1b.	$REM_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GWTH_{it} + \beta_6 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i$
2a.	$DACCR_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 FAMOWN_{it}{*}POLCON_{it}\ \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 GWTH_{it} + \beta_7 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i.$
2b.	$REM_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 FAMOWN_{it}{*}POLCON_{it}\ \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 GWTH_{it} + \beta_7 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i.$

Table 4.3 Definition and calculation of variables used in the analysis and data sources.

Variables	Definition and Calculations
$DACCR_{it}$	Absolute abnormal accruals which estimated using the combination of Kothari (2005) et al., and Kasznik (1999) model on a cross-sectional basis (Diyanty, 2012)
REM_{it}	Total real earnings management which estimated by using Roychowdhury (2006) model.
$POLCON_{it}$	A dummy variable, coded one if a company has a political connection and zero for otherwise
$FAMOWN_{it}$	The total of ultimate percentage of comapany's stock

	which owned by family group.
$SIZE_{it}$	Natural log of total assets
LEV_{it}	The proportion of total debts to total assets
$GWTH_{it}$	Company's growth percentage which is calculated by divided the difference of current year's net sales and the preceeding year's net sales.
$LAGLOSS_{i,t-1}$	A dummy variable, coded one if *net income before extraordinary items* is negative, zero for otherwise

4.3. Variable Operationalizations

Dependent Variables.

The dependent variables in this research are accrual and real earnings management. Abnormal accruals which estimated using the combination of Kothari (2005) et al., and Kasznik (1999) (Diyanty, 2012). This measurement is chosen by the consideration of the prior study conducted by Diyanty (2012) as it is proven that this model strongly represent[1] the abnormal accruals than others measurements. The model is illustrated as follows:

$$\frac{TACCRit}{Asset\ i,t-1} = \beta 1 \frac{1}{Asset\ i,t-1} + \beta 2 \frac{\Delta SALESit - \Delta ARit}{Asset\ i,t-1} + \beta 3 \frac{PPEit}{Asset\ i,t-1} + \beta 4\mathrm{ROAit} + \beta 5 \frac{\Delta CFOit}{Asset\ i,t-1} + \varepsilon i, t$$

$TACCR_{it}$	: Total accruals for firm i in year t, defined as earnings before extraordinary items minus operating cash flows
$Asset_{i,t-1}$	: Lagged total aset
$\Delta SALES_{i,t-1}$	: The change in revenue for firm i in year t
ΔAR_{it}	: The change in receivables for firm i in year t
PPE_{it}	: The gross level of property, plant, and equipment for firm i in year t
ROA_{it}	: Return on asset perusahaan for firm i in year t
ΔCFO_{it}	: The change of operational cash flow for firm i in year t
ε_{it}	:The residual level/abnormal accruals for firm i in year t

Following the prior study about the measurement of real earnings management that developed by Roychowdhury (2006), we consider three metrics to study the level of real activities manipulations: the abnormal levels of cashflow from operations (CFO), discretionary expenses, and production costs (Roychowdhury, 2006).

1. Abnormal levels of CFO.

[1] The combination of Kothari (2005) et al., and Kasznik (1999) has the highest R^2 among the others measurement model (Diyanty, 2012)

$$\frac{CFOit}{Asset\ i,t-1} = \beta 1 \frac{1}{Asset\ i,t-1} \beta 2 \frac{SALESit}{Asset\ i,t-1} + \beta 3 \frac{\Delta SALESit}{Asset\ i,t-1} + \varepsilon i,t$$

2. Production Costs.

$$\frac{PRODit}{Asset\ i,t-1} = \beta 1 \frac{1}{Asset\ i,t-1} + \beta 2 \frac{SALESit}{Asset\ i,t-1} + \beta 3 \frac{\Delta SALESit}{Asset\ i,t-1} + \beta 3 \frac{\Delta SALESit-1}{Asset\ i,t-1} + \varepsilon i,t$$

3. Discretionary expenses.

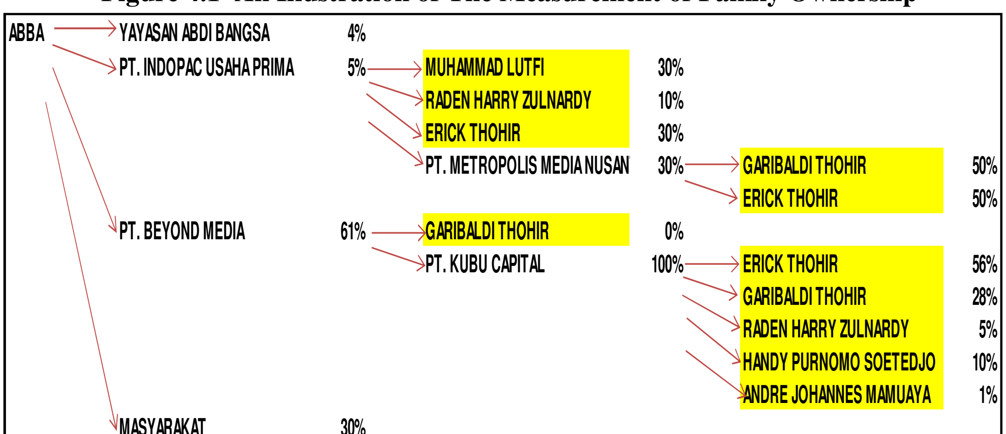
$$\frac{DISCEit}{Asset\ i,t-1} = \beta 1 \frac{1}{Asset\ i,t-1} + \beta 2 \frac{\Delta SALESit-1}{Asset\ i,t-1} + \varepsilon i,t$$

In the above equations, CFO is cash flow from operations for firm i in year t; PROD represents the production costs for firm i in year t, defined as the sum of COGS and the change in inventories; DISCE represents the discretionary expenditures for firm i in year t, defined as the sum of advertising expenses,R&D expenses, and SG&A.

Independent Variable

The literature on the definition of family firm is quite extensive (Chi *et al*, 2014). In this study, family ownership proxy that is used is measured by calculating the percentage of ultimate ownership of a company and considering the family relation that linking between the large shareholders (Diyanty, 2012). This measurement have to be more able to describe the magnitude of family ownership. We use the information from annual report published by Indonesian Stock Exchange to identify ownership structure on the first layer and information published internally by the Indonesia Ministry of Justice and Human Rights to identify ownership on the next layer. This study also uses family- identification database from the research of Diyanty (2012) to identify family relation/non – family relation that linking between the large shareholders. Illustrations of family ownership measurement is as follows:

Figure 4.1 An Illustration of The Measurement of Family Ownership



Source: The writer’s analysis based on the data from Indonesia Ministry of Justice and Human Rights of Mahaka Media Tbk. (2015)

Figure 4.1 shows that the share ownership Family Thohir against PT Mahaka Media Tbk through PT Indopac Enterprises Prima is 5% (30% * 5% + 10% * 5% + 30% * 5% + 0% * 61% + 50% * 30% * 5% + 50% * 30% * 5%), through PT Beyond Media is equal to 61% (28% * 61% + 56% * 61% + 5% * 61% + 10% * 61% + 1% * 61%). Identification of the relationship between individuals who are detected as large shareholders obtained from research Diyanty (2012). Furthermore, the further review of the history of the company's ownership would have be done if there is found the proportion of foreign ownership in the ownership structure. If the history of the company is controlled by the family, but in a year turned into a foreign ownership, the assumptions used in this study are these companies still controlled by the family.

Moderating Variable.

Variable political relations is a dummy variable that is, coded one if the company has a political relationship, and 0 for otherwise. The criteria used to define political relations refers to research Faccio (2006) and Chaney et al, (2011) which is desribe below:

1. If there is one of the directors and / or board of commissioners concurrent positions as members of the state parliament, high state officials (are in a cabinet government), officials of state institutions, and members of political parties.
2. If there is one of the directors and / or commissioner is a former high-ranking officials or politicians.
3. If there is one of the owners of the company or its controlling shareholder are politicians, government officials, or former government officials.
4. If there is one of the directors, commissioners, and the owner of the company or the shareholder has a close relationship with politicians / political parties, government officials, and former government officials. To give a limitation of subjectivity, a close relationship in this study defined as a family relationship as well as cases where a politician's close relative (e.g., the son or daughter) holds such positions.

Control Variables.

Control variables used in the study were (1) the size of the company (SIZE) as measured by the natural logarithm of the total assets of the company (Watts and Zimmerman, 1990) This variable is predicted to have a positive effect on earnings management, (2) The company's debt ratio (LEV) is measured by dividing total debt with total assets of the company (Houqe et al., 2012) This variable is predicted to have a positive effect on earnings management, (3) the growth of the company (GWTH) as measured by the percentage change in revenue or sales from the previous year (t- 1) to year test period (t) (Houqe et al., 2012)) This variable is predicted to have a positive effect on earnings management, (4) loss the year before (LAGLOSS) where a dummy that is worth 1 if net income before extraordinary items of the company in before (t-1) at a disadvantage, and 0 for the others (Houqe et al., 2012) is predicted to have a positive coefficient, and (5) Political relations Company

(POLCON) which is a dummy variable equal to 1 if the company has a political relationship and 0 for otherwise (Zhaoming et al., 2012; Braam et al., 2015) is predicted that political connection can influence positively or negatively on earnings management.

4.4. Data Analysis Method.

Data analysis methods to be used in this research is panel regression method. To be able to know what statistical model should be used in the research model, we conducted three tests before analyzing the result; Chow Test, Hausman Test, and Breusch Pagan - LM Test.

5. Result and Analysis

5.1. Descriptive Statistics

Table 5.1 Descriptive Statistics

Variabel	N	Mean	Median	Std. Dev	Min	Max	Skewness
DACCR	1325	0,0323	0,0123	0,0477	0,0008	0,1868	2,1925
REM	1325	0,0208	0,0444	0,3005	-0,6440	0,5575	-0.3816
SIZE	1325	5.728.482	1.485.581	14.415.993	10247,44	213.994.000	7,2135
LEV	1325	0,2121	0,1846	0,1795	0,0002	0,7507	0,6268
GWTH	1325	0,1443	0,1144	0,2859	-0,3474	0,8873	0,7888
FAMOWN	1325	0,5012	0,5600	0,3114	0	0,9801	-0,3851

Variabel	N	%Value 1	%Value 0	Total %
POLCON	1325	38,26%	61,74%	100%
LAGLOSS	1325	14,42%	85,58%	100%

DACCR = Absolute abnormal accruals which estimated using the combination of Kothari (2005) et al., and Kasznik (1999) (Diyanty, 2012); **REM =** Total real earnings management which estimated by using Roychowdhury (2006) model; **FAMOWN** = The total of ultimate percentage of comapany's stock which owned by family group (Diyanty, 2012) ; **SIZE =** Natural log of total assets (in million of rupiahs). **LEV** = The proportion of total debts to total assets ; **GWTH =** Company's growth percentage which is calculated by divided the difference of current year's net sales and the preceeding year's net sales; **LAGLOSS =** A dummy variable, coded one if *net income before extraordinary items* is negative, zero for otherwise;**POLCON =** A dummy variable, coded one if a company has a political connection and zero for otherwise

Table 5.1 summarizes descriptive statistics of the sample data. It can be seen that the average of accrual management in this study are relatively low, which means earnings management practices in companies in Indonesia did not show an aggressive level. Variations in the level of discretionary accruals company is also relatively low that means during the five-year study of accrual earnings management companies in Indonesia are relatively unchanged. The average of real earnings management also shows a low level. However, the real earnings management has a greater variation than the accrual earnings management, which means over five years of research, the real earnings management companies in Indonesia are relatively likely to undergo a change compared to the accrual earnings management.

The average amount of family ownership in Indonesian company reaches more than 50%. This condition affects the urge to put the family at a management position and commissioners who will ultimately have an impact on the determination of the strategic policy of the company in which one example is the accounting policies. The level of volatility of family ownership for 5 years of observation are relatively low that means the percentage of family ownership has not undergo a significant changes.

From the table above, we can conclude that the number of politically connected companies is less than 50% from the total sample. This result shows that companies which established political connections in Indonesia is still statistically unmassive. The low number of companies that have political connections is predicted because of the specific definition of political connections in this study and the lack of availability of reliable data of political connections.

5.2. Regression analysis

The influence of family ownership on accrual earnings management and the moderating influence of political connection.

The first hypothesis (1a) is used to test the influence of family ownership on accrual earnings management. The next hypothetical model (hypothesis 2a) aims to test the moderating influence of the political connections on the relation between family ownership and accrual earnings management. From the regression result (see table 5.2) it is proven that family ownership is has a positive influence on accrual earnings management. This phenomenon is possible to occur due to by owning majority ownership, family members has an incentive and abilit to do expropriation against non controlling shareholders in which one form of the expropriation is to manage earnings opportunistically that lead a massive practices in accrual earnings management. These results consistent with the study conducted by Chi *et al*., (2014) in Taiwanese companies. In his research, Chi *et al*., (2014) provides an explanation about the reason why family ownership has a posiive influence to accrual earnings management. The first point is the entrenchment effect arising from the control of the owner's family against company policy. The second point is the low demand on the quality of earnings. This is due to the legal protection of investors is still relatively weak and the implementation of governance mechanisms are not yet effective. The positive influence of family ownership on accrual earnings management can also be explained by the argument proprietary information. Concentrated ownership structure will benefit the rent - seekers to centralized company policy so that the specific information concerning the activities of rent - seeking can be hide from the public. Based on this argument, it can be predicted that the concentrated ownership tend to have low earnings quality (Fan & Wong, 2002).

The positive influence from family ownership to the accrual earnings management can be explained by determining the ownership mechanism in Indonesia. Most of family owners in Indonesia have achieved their control through the pyramidal structure. Thus, family as the controlling shareholder has the potential to enjoy personal benefit without having to bear the cost consequences or disciplinary sanctions arising from the policy that he has made (La Porta et al, 1999; Claessens et al, 2002). Gaining effective control of a corporation enables family to act opportunistically against non-controlling shareholders i.e. the family as controlling shareholder benefits from self-dealing transactions in which profits are transferred to other companies he/she controls. Thus, the accrual earnings management tend to be higher in family firms than non – family firms in the reasons of to hide the adverse effects of related party transactions or to facilitate family members' entrenchment in management positions.

The next hypothetical model (hypothesis 2a) aims to examine the impact of moderating effect of political connections on the relation between family ownership and accrual earnings management. The interaction effect between political connections and family ownership is not proven to have an influence on the effect of family ownership on the accrual earnings management (see table 4.2). This phenomenon is likely to occur because that the objectives to be achieved in the presence of political connections is not to manage earnings opportunistically but for achieve other purposes, for example to facilitate the process of firm's lobbying in winning a bid. In addition, when analyzed statistically, the data also shows that not many family firms with political connections who conduct earnings management activities above the average level.

The influence of family ownership on real earnings management and the moderating influence of political connection

The second hypothesis (1b) is used to investigate the influence of family ownership on real earnings management. The next hypothetical model (hypothesis 2b) aims to test the moderating influence of the political relations on the relation between family ownership and the real earnings management. Based on the regression results (see Table 4.3), it was found that the family ownership (FAMOWN) has a negative influence on real earnings management. The results are consistent with research conducted by Achleitner et al., (2012) who conduct research on family ownership of both types of earnings management (accrual and real) in German as well as Goh and Lee (2012), which proved that family ownership has a negative influence on real earnings management. The tendency of companies to lower real earnings management practices is predicted because the practice had a negative impact on the future performance of the company (Achleitner et al, 2012).

Basically, the real earnings management has different characteristics with accrual earnings management (Roychowdhury, 2006). Accrual earnings management (AEM) practices is based on pure accounting choices and, therefore, has no cash flow consequences, this does not hold to be true for real earnings management (REM). By definition, REM implies a deviation from normal business practices with the goal to avoid the reporting of a loss or to smooth earnings. Roychowdhury (2006) shows that this effect is obtained by boosting earnings through increased price discounts, overproduction in order to allocate less overhead costs to the cost of goods sold and aggressively reducing discretionary expenses such as R&D, advertising and SG&A expenses. Therefore, it is not surprising , that REM has a negative impact on future performance (Gunny, 2010). Anderson and Reeb (2003) suggests that the assets of companies owned by the family reflects the wealth of its family in the long term. Therefore, the owner of the family will consider the implications of each policy on its influence on such property (Anderson & Reeb, 2003). Assuming that the familes will always protect the value of their wealth, the family will avoid real earnings management practices since the latter is associated with negative performance consequences (Gunny, 2010). This phenomenon may be a reason why family ownership has a negative effect on real earnings management.

Selection of earnings management practices are also motivated by external factors such as investor protection. The higher investor protection rights should set a limit to the degree of AEM put in place by the management. In fact, as far as AEM is concerned, it is well known that it is confined by the level of investor protection (Achleitner et al, 2012). Therefore, we can expect that this influences the level of REM. As a consequence, it could be that in countries with higher investor protection rights, the management of widely-held firms has less discretion in implementing AEM making REM relatively more attractive.

The negative influence of the family ownership of real earnings management practices can be caused by the protection of investors in Indonesia are still relatively weak (Claessens et al, 2002). Weak investor protection in Indonesia is associated with the lower detection risk of earnings management practices so that companies will tend to choose the accrual earnings management rather than real earnings management that are more costly.

Hypothesis 2b aims to investigate the moderating impact of the political connections on the relation between family ownership and real earnings management. The regression results (see Table 4.3) shows that the interaction between family ownership and political connections do not have a influence on real earnings management. These results are not consistent with the predictions in the development of hypotheses. No influential political ties to family ownership and management of real earnings is predicted because the family firm has a tendency to do the accrual earnings management rather than real earnings management.

Control Variable Analysis

Political connections (POLCON) are not proven to have an influence on accrual earnings management and real earnings management. This is evidenced by the p value greater than 1%, 5%, and 10% (see table 5.2 and 5.3).

Regression result shows that the size of the company (SIZE) has a positive effect on accrual earnings management (see table 5.2) these results are consistent with research Watts and Zimmerman (1990) and Dechow (2010). In addition, the regression results show that the size of the company (SIZE) has a negative effect on real earnings management. This phenomenon occurs because it is possible to invest in companies of small size are generally more risky than investing in larger companies. To minimize these risks, smaller companies tend to be exposed to set the high targets (i.e. the minimum level of sales target). Real earnings management is predicted to increase along with the achievement of these targets (Roychowdhury, 2006).

The next analysis is a leverage variable (LEV). The result showed that the level of debt is not proven to have an influence on accrual earnings management but has a positive influence to real earnings management (see table 5.2 and 5.3). Empirically, a condition that occurs in Indonesia is the increasing levels of debt will lead to the higher risk of the company to violate the debt covenants. Real earnings management is a mechanism that can be used to reduce the risk due to its characteristcs that tend to be more difficult to detect by outsiders (Roychowdhury, 2006).

Company's growth variable (GWTH) is proven to have a positive influence on accrual earnings management (see table 5.2) these results are consistent with research Dechow (2010). Besides this, the company's growth are found have a negative effect on real earnings management (see table 5.3). This shows that companies with higher growth would tend to perform accrual earnings management rather than real earnings management.

Bankruptcy risk variable (LAGLOSS) is proven to have positive influence on accrual earnings management and negatively affect the real earnings management (see table 5.2 and 5.3). This phenomenon is possible to occur due to the activity of real earnings management tends to be costly compared to the accrual earnings management (Braam et al, 2015). Therefore, companies that suffer a loss in the preceeding year are going to see the real earnings management practices as less favorable alternatives. Therefore, the company experienced a loss in the preceeding year will tend to increase the accrual earnings management practices and decrease real earnings management practices.

Table 5.2 Regression Result (Hypothesis 1a and 2a)

Hypothesis 1a : Family ownership has the influence on the accrual earnings management.

Empirical model 1a: $DACCR_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GWTH_{it} + \beta_6 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i$

Hypothesis 2a: Political connections will strengthen (weaken) the positive (negative) effect from family ownership to the accrual earnings management.

Empirical model 2a. $DACCR_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 POLCON_{it}{*}FAMOWN_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 GWTH_{it} + \beta_7 LAGLOSS_{it-1} + \text{fixed effects} + \varepsilon_i$

		Hypothesis 1a				**Hypothesis 2a**			
Variable	**Predicted sign**	**Coefficient**	**Prob**	**Sig**	**VIF**	**Coefficient**	**Prob**	**Sig**	**VIF**
C		-0,2034	0,000			-0,2054	0,000		
$FAMOWN_{it}$	(+/-)	0,0535	0,007	***	3,44	0,0581	0,006	***	5,81
$POLCON_{it}$	(+/-)	0,0018	0,771		1,78	0,0062	0,519		5,95
POLCON*FAMOWN						-0,0094	0,551		5,23
$SIZE_{it}$	(+)	0,0118	0,000	***	5,93	0,0116	0,000	***	8,46
LEV_{it}	(+)	-0,0160	0,135		2,57	-0,0161	0,133		2,60
$GWTH_{it}$	(+)	0,0135	0,000	***	1,29	0,0136	0,000	***	1,31
$LAGLOSS_{it-1}$	(+)	0,0097	0,013	**	1,21	0,0099	0,012	**	1,21
R-squared (within)	0,0393	**F-Statistic**	7,19			**R-squared (within)**	0,0396	**F-Statistic**	6,20
No. Obs	1325	**Prob (F-Statistic)**	0,000			**Total Observation**	1325	**Prob (F-Statistic)**	1325

DACCR = Absolute abnormal accruals which estimated using the combination of Kothari (2005) et al., and Kasznik (1999) (Diyanty, 2012); **REM =** Total real earnings management which estimated by using Roychowdhury (2006) model; **FAMOWN** = The total of ultimate percentage of comapany's stock which owned by family group (Diyanty, 2012) ; **SIZE =** Natural log of total assets (in million of rupiahs). **LEV =** The proportion of total debts to total assets ; **GWTH =** Company's growth percentage which is calculated by divided the difference of current year's net sales and the preceeding year's net sales; **LAGLOSS =** A dummy variable, coded one if *net income before extraordinary items* is negative, zero for otherwise;**POLCON =** A dummy variable, coded one if a company has a political connection and zero for otherwise.* *significant in 10% level of α, ** significant in 5% level of α, *** significant in 1% level of α*

Table 5.3 Regression Result (Hypothesis 1b and 2b)

Hypothesis 1b: Family ownership has the influence on the real earnings management.

Empirical model 1b: $REM_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 GWTH_{it} + \beta_6 LAGLOSS_{it-1}$ + fixed effects + ε_i

Hypothesis 2b: : Political connections will strengthen (weaken) the positive (negative) effect from family ownership to the accrual earnings management.

Empirical model 2b : $REM_{it} = \beta_0 + \beta_1 FAMOWN_{it} + \beta_2 POLCON_{it} + \beta_3 POLCON_{it}{*}FAMOWN_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 GWTH_{it} + \beta_7 LAGLOSS_{it-1}$ + fixed effects + ε_i.

		Hypothesis 1b				**Hypothesis 2b**			
Variable	**Predicted sign**	**Coefficient**	**Prob**	**Sig**	**VIF**	**Coefficient**	**Prob**	**Sig**	**VIF**
C		0,3849	0,032			0,2950	0,099		
$FAMOWN_{it}$	(+/-)	-0,2124	0,013	**	3,44	-0,1782	0,051	*	5,81
$POLCON_{it}$	(+/-)	0,0273	0,365		1,78	0,0566	0,167		5,95
$POLCON_{it}{*}FAMOWN_{it}$						-0,0710	0,298		5,23
$SIZE_{it}$	(+)	-0,0381	0,000	***	5,93	-0,0384	0,000	***	8,46
LEV_{it}	(+)	0,3045	0,000	***	2,57	0,3035	0,000	***	2,60
$GWTH_{it}$	(+)	-0,0273	0,060	*	1,29	-0,0262	0,074	*	1,31
$LAGLOSS_{it-1}$	(+)	0,0178	0,169		1,21	0,0194	0,152		1,21
R-squared (within)	0,0381	**F-Statistic**	6,95			**R-squared (within)**	0,0389	**F-Statistic**	6,08
No. Obs	1325	**Prob (F-Statistic)**	0,000			**Total Observation**	1325	**Prob (F-Statistic)**	0,000

DACCR = Absolute abnormal accruals which estimated using the combination of Kothari (2005) et al., and Kasznik (1999) (Diyanty, 2012); **REM =** Total real earnings management which estimated by using Roychowdhury (2006) model; **FAMOWN** = The total of ultimate percentage of comapany's stock which owned by family group (Diyanty, 2012) ; **SIZE =** Natural log of total assets (in million of rupiahs). **LEV =** The proportion of total debts to total assets ; **GWTH =** Company's growth percentage which is calculated by divided the difference of current year's net sales and the preceeding year's net sales; **LAGLOSS =** A dummy variable, coded one if *net income before extraordinary items* is negative, zero for otherwise;**POLCON =** A dummy variable, coded one if a company has a political connection and zero for otherwise.** significant in 10% level of α, ** significant in 5% level of α, *** significant in 1% level of α*

6. Conclusions, limitations, and implications of the study

Conclusions

This study aimed to analyze the influence of family ownership on accrual earnings management and real earnings management. Based on the results of hypothesis testing found that family ownership has a positive effect on accruals earnings management. This result may well stem from the entrenchment effects by family owners,or it may be that the demand for earnings quality is low from family firms due to weak legal systems. This study also found that family ownership has negative influence on real earnings management. This is because the family is prefer to do accrual earnings management rather than real earnings management. Thus, a family shareholders tends to increase the accrual earnings management since it haven't a direct impact on cash flow and family shareholders tend to dislike REM because of its negative performance impact in the long term that can potentially harm the wealth of family shareholders (Achleitner et al, 2012). The next goal of this study is to see the moderation effect of the influence of the political connection between the relation of family ownership and earnings management. Political relations are not empirically proven to affect the influence of family ownership on accrual earnings management and real earnings management. These results is predicted because the phenomena that might occur in Indonesia is political connections could be established not on purpose to manage earnings opportunistically but rather to achieve other objectives, such as to facilitate the process of lobbying firms in winning a bid.

Limitations

This study contains several limitations that need to be observed and need to be developed for further research. The first limitation of the study is the assumption on the measurement of family ownership when the structures are contain with the ownership of foreigners. This limitation is due to the unavailability of sources of information about foreign control. Therefore, further research is expected to find ways to identify the control of foreign shareholder. The second limitation of the latter is the measurement of political relations still contains a number of subjectivity and limitations of reliable information. Definition of political relations that are used in research that is Faccio (2006) and Chaney et al., (2011) still contains a lot of subjectivity. In addition, information on political relations is only obtained through the published information on the annual reports and the Internet. For further research, it is suggested to reformulate the criteria of political connection adapted to the conditions in Indonesia by combining various references.

Implications

With the present study, the regulator is expected to evaluate the regulations on ultimate ownership disclosure of the company and provides information on foreign shareholders in the company in Indonesia. In addition, the regulator is also expected to require company to disclose about the background of the directors and commissioners, for example, by revealing whether the directors / commissioners have/ do not have positions in the government or political parties. The results of this study are also expected to provide empirical recommendations for investors in making investment decisions. By the results of this study, investors can consider the structure of corporate ownership and description of the ultimate owner to find out the potential agency conflicts.

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