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The Paradox of Earnings Management under Indonesian Financial Accounting Standards (PSAK): Evidence after IFRS Convergence

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ABSTRACT

The convergence of Indonesian Financial Accounting Standards (PSAK) with the International Financial Reporting Standards (IFRS) aims to enhance financial reporting quality by improving transparency, comparability, and the faithful representation of economic transactions. However, empirical evidence regarding its effectiveness in constraining earnings management remains inconclusive. While previous studies generally report a decline in accrual-based earnings management following IFRS convergence, emerging evidence suggests that managers may substitute accrual manipulation with real operational decisions. This study investigates the paradoxical effect of IFRS-based PSAK implementation on earnings management by simultaneously examining ***Accrual Earnings Management (AEM)*** *and* ***Real Earnings Management (REM)*** *among non-financial companies listed on the Indonesia Stock Exchange during the 2018–2025 period. Using a quantitative explanatory research design, the study employs panel data regression with the Modified Jones Model to measure accrual earnings management and the Roychowdhury model to capture real earnings management. Corporate governance is incorporated as a moderating variable to evaluate its role in strengthening the effectiveness of PSAK implementation. The findings indicate that PSAK implementation significantly reduces accrual earnings management but is positively associated with real earnings management, suggesting that managers shift from accounting-based manipulation toward operational activities under principle-based accounting standards. Furthermore, strong corporate governance significantly weakens both forms of earnings management and enhances the effectiveness of PSAK in improving financial reporting quality. These findings contribute to the earnings management literature by providing evidence that IFRS-converged PSAK does not completely eliminate opportunistic financial reporting but rather transforms its underlying mechanism. The study offers important implications for accounting standard setters, regulators, auditors, and investors by emphasizing that high-quality accounting standards should be complemented by effective governance and regulatory enforcement to achieve transparent and reliable financial reporting.*

Keywords: Indonesian Financial Accounting Standards (PSAK); IFRS Convergence; Accrual Earnings Management; Real Earnings Management; Corporate Governance; Financial Reporting Quality.

Backgrounds

The convergence of Indonesian Financial Accounting Standards (PSAK) with the International Financial Reporting Standards (IFRS) represents one of the most significant reforms in Indonesia's financial reporting environment. Since the full convergence initiated in 2012, Indonesia has continuously updated PSAK to align with international accounting standards, culminating in the implementation of PSAK 71 (Financial Instruments), PSAK 72 (Revenue

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from Contracts with Customers), and PSAK 73 (Leases). The primary objective of these reforms is to enhance the quality, transparency, comparability, and credibility of financial reporting while reducing information asymmetry between corporate managers and stakeholders. The transition from rule-based accounting toward a principle-based framework is expected to strengthen the faithful representation of economic transactions and improve investor confidence in Indonesian capital markets. However, the effectiveness of PSAK convergence in constraining managerial opportunistic behavior remains an ongoing debate in the accounting literature.

According to **Agency Theory** (Jensen & Meckling, 1976), managers possess private information that is not fully observable by shareholders, creating incentives to manipulate accounting information to maximize personal utility. Earnings management emerges as a consequence of this agency conflict, particularly when managerial compensation, debt covenants, or market expectations are linked to reported accounting earnings (Healy & Wahlen, 1999). Consequently, accounting standards serve as an important governance mechanism by limiting managerial discretion and enhancing financial reporting quality. IFRS convergence through PSAK is therefore expected to reduce discretionary accounting choices and improve earnings quality by increasing disclosure requirements, strengthening recognition and measurement criteria, and promoting greater transparency (Barth et al., 2008).

A substantial body of international literature supports this expectation. Barth et al. (2008) argued that firms applying IFRS generally exhibit higher accounting quality characterized by lower earnings management, more timely loss recognition, and greater value relevance. Similarly, Christensen et al. (2015) suggested that improvements in reporting quality following IFRS adoption are particularly evident in countries with strong legal enforcement and institutional governance. Within the Indonesian context, several empirical studies have also reported that IFRS convergence contributes to a decline in discretionary accruals, indicating that the adoption of PSAK has improved the quality of financial reporting and reduced traditional accrual-based earnings management.

Nevertheless, an opposing stream of literature challenges the assumption that higher-quality accounting standards necessarily eliminate earnings management. Rather than reducing opportunistic reporting, IFRS may simply transform the methods through which managers manipulate reported earnings. Principle-based accounting standards require extensive professional judgment in estimating fair values, impairment losses, expected credit losses, revenue recognition, and lease obligations. These judgments inevitably increase managerial discretion, allowing managers to influence reported earnings without explicitly violating accounting standards. Consequently, managers may substitute accrual-based earnings management with more sophisticated forms of manipulation, particularly **real earnings management**, through abnormal production, discretionary expenditure reductions, or sales timing strategies (Roychowdhury, 2006). This substitution effect explains why some studies continue to observe earnings management even after IFRS convergence.

The contradiction becomes increasingly evident following the implementation of **PSAK 71**, which adopts the Expected Credit Loss (ECL) model from IFRS 9. Compared with the previous incurred-loss model, PSAK 71 requires managers to estimate future credit losses based on macroeconomic forecasts, probability of default, and loss given default. Although this forward-looking approach enhances the timeliness and relevance of impairment recognition, it simultaneously introduces substantial estimation uncertainty and managerial judgment. Recent studies argue that such estimation flexibility may create new opportunities for earnings management because managers can adjust assumptions underlying expected credit losses while

remaining compliant with accounting standards. Therefore, PSAK 71 may not necessarily eliminate earnings management but instead alter its underlying mechanism.

A similar paradox is observed under **PSAK 72**, which fundamentally changes revenue recognition by emphasizing the transfer of control rather than the transfer of risks and rewards. The standard requires managers to identify performance obligations, estimate transaction prices, determine variable consideration, and allocate contract revenues using significant professional judgment. While these principles improve the economic representation of revenue recognition, they also increase managerial flexibility in determining the timing and magnitude of reported revenues. Consequently, PSAK 72 may unintentionally expand managerial discretion despite its objective of improving financial reporting quality.

The inconsistent empirical findings suggest that accounting standards alone cannot fully explain variations in earnings management. Recent studies emphasize that the effectiveness of IFRS convergence depends heavily on complementary institutional mechanisms such as corporate governance, audit quality, regulatory enforcement, investor protection, and legal institutions. Strong governance mechanisms constrain managers' ability to exploit the flexibility embedded within principle-based accounting standards, whereas weak governance environments may amplify opportunistic reporting behavior. In other words, accounting quality is determined not only by the standards themselves but also by the institutional environment in which those standards are implemented.

Despite the growing literature on IFRS convergence in Indonesia, several research gaps remain. First, most prior studies focus exclusively on **accrual-based earnings management**, overlooking the possibility that managers substitute accrual manipulation with **real earnings management** following PSAK implementation. Second, empirical evidence examining the implications of the newly implemented PSAK 71 and PSAK 72 remains relatively limited despite the substantial increase in managerial judgment introduced by these standards. Third, previous studies generally examine the direct relationship between IFRS convergence and earnings management without explicitly investigating the paradox that improved accounting standards may simultaneously reduce one form of earnings management while facilitating another.

Accordingly, this study proposes a **paradox perspective** by examining whether the implementation of Indonesian Financial Accounting Standards (PSAK) genuinely constrains earnings management or merely transforms its underlying mechanism from **accrual-based earnings management** toward **real earnings management**. Unlike previous studies that primarily evaluate the direct impact of IFRS convergence on discretionary accruals, this research integrates both forms of earnings management and investigates the moderating role of corporate governance in explaining the contradictory findings documented in previous literature. By doing so, this study contributes to the growing debate regarding the effectiveness of principle-based accounting standards in emerging economies and provides new evidence on whether PSAK convergence enhances financial reporting quality or simply changes the way managers exercise accounting discretion.

2. Literature Review

2.1 Agency Theory and Earnings Management

Agency Theory, introduced by Jensen and Meckling (1976), explains that conflicts of interest arise because managers (agents) possess more information about the firm's operations than

shareholders (principals). This information asymmetry creates incentives for managers to engage in opportunistic behavior, including earnings management, to maximize compensation, meet debt covenant requirements, or influence investors' perceptions. Earnings management occurs when managers intentionally intervene in financial reporting to alter reported earnings while remaining within the boundaries of accounting standards (Healy & Wahlen, 1999).

Schipper (1989) defines earnings management as the purposeful intervention in the external financial reporting process to obtain private benefits. Similarly, Dechow and Skinner (2000) argue that earnings management ranges from legitimate accounting choices to aggressive financial reporting practices that reduce earnings quality. Consequently, accounting standards are expected to reduce managerial discretion by limiting opportunities for accounting manipulation. However, the effectiveness of accounting standards depends not only on their technical quality but also on institutional enforcement and corporate governance mechanisms.

2.2 IFRS Convergence and PSAK Implementation

The convergence of Indonesian Financial Accounting Standards (PSAK) with International Financial Reporting Standards (IFRS) represents a fundamental transformation of Indonesia's financial reporting system. IFRS adoption aims to improve transparency, comparability, and decision usefulness by introducing principle-based accounting standards rather than detailed rule-based requirements.

According to Barth et al. (2008), firms adopting International Accounting Standards generally exhibit higher accounting quality characterized by lower earnings management, more timely loss recognition, and greater value relevance of accounting information. These improvements occur because IFRS requires broader disclosure, fair value measurements, and more comprehensive recognition criteria, thereby reducing managers' ability to manipulate accounting accruals.

Indonesia has continuously aligned PSAK with IFRS through several major standards, including PSAK 50, PSAK 55, PSAK 60, PSAK 71, PSAK 72, and PSAK 73. These standards substantially modify financial reporting by emphasizing economic substance over legal form. Consequently, financial statements are expected to provide more relevant information for investors and other stakeholders.

Nevertheless, IFRS convergence does not automatically improve reporting quality because accounting quality also depends on legal enforcement, audit quality, investor protection, and corporate governance (Christensen et al., 2015). Therefore, the success of PSAK implementation should be evaluated not only from the perspective of accounting standards but also from the institutional environment in which they operate.

2.3 Earnings Management under Principle-Based Accounting Standards

One of the most debated issues in the accounting literature concerns whether principle-based accounting standards effectively reduce earnings management. Traditional accounting systems based on detailed rules generally limit managerial judgment by prescribing specific accounting treatments. Conversely, IFRS-based PSAK emphasizes professional judgment, fair value estimation, and management forecasts.

This principle-based approach has generated contradictory findings. On one hand, greater disclosure requirements increase transparency and reduce accrual-based earnings management. On the other hand, increased flexibility allows managers to exercise considerable discretion in determining accounting estimates.

Roychowdhury (2006) argues that managers respond to tighter accounting regulations by shifting from **accrual earnings management (AEM)** toward **real earnings management (REM)**. Rather than manipulating accounting accruals, managers alter real business activities such as accelerating sales, overproducing inventory, or reducing discretionary expenditures to achieve targeted earnings.

Recent literature reviewing IFRS implementation in Indonesia reaches a similar conclusion. Although IFRS convergence tends to reduce discretionary accruals, opportunities for earnings management continue to exist because managers exploit judgment-based accounting estimates and operational decisions. Thus, IFRS may change the mechanism of earnings management rather than eliminate it completely.

2.4 The Paradox of PSAK 71 and PSAK 72

The implementation of PSAK 71 and PSAK 72 has intensified the debate regarding managerial discretion under IFRS convergence.

PSAK 71 adopts the **Expected Credit Loss (ECL)** model, requiring firms to estimate future credit losses using macroeconomic forecasts, probability of default, and loss-given-default assumptions. Compared with the previous incurred-loss model, ECL improves the timeliness of impairment recognition but simultaneously introduces substantial estimation uncertainty.

A recent systematic literature review by Chandritike and Yusnaini (2026) concludes that PSAK 71 does not consistently reduce earnings management. While several studies report improvements in transparency, most empirical findings indicate that managers substitute traditional accrual manipulation with estimation-based adjustments and real earnings management. The effectiveness of PSAK 71 largely depends on governance quality, audit effectiveness, and institutional enforcement.

Similarly, PSAK 72 introduces a five-step revenue recognition model requiring management to identify performance obligations, estimate transaction prices, allocate consideration, and determine revenue recognition timing. These requirements improve the economic representation of contracts but also require significant professional judgment, potentially increasing managerial discretion in revenue recognition.

Consequently, PSAK 71 and PSAK 72 illustrate an important paradox: standards designed to improve reporting quality simultaneously expand opportunities for subjective accounting judgments.

2.5 Contradictory Evidence on IFRS Convergence and Earnings Management

The literature presents two competing perspectives regarding IFRS convergence.

The **first perspective** argues that IFRS reduces earnings management by improving accounting quality, increasing transparency, strengthening disclosure requirements, and enhancing

comparability across firms. International evidence provided by Barth et al. (2008) consistently demonstrates lower discretionary accruals among IFRS adopters. Similar findings are documented in several Indonesian studies, suggesting that PSAK convergence improves financial reporting quality.

The **second perspective** argues that IFRS merely changes the form of earnings management. Rather than manipulating accounting accruals, managers increasingly rely on subjective estimates, fair value measurements, expected credit loss assumptions, and real operational decisions. Literature reviews focusing on Indonesia conclude that earnings management opportunities remain despite IFRS convergence because principle-based standards inherently provide greater managerial discretion.

These contradictory findings suggest that accounting standards alone cannot explain earnings management practices. Institutional quality, audit quality, ownership structure, board independence, and regulatory enforcement collectively determine whether managerial discretion is used to improve reporting quality or to pursue opportunistic objectives.

2.6 Research Gap

Despite extensive research on IFRS convergence, three important gaps remain.

First, most previous studies focus exclusively on **accrual earnings management**, while relatively few simultaneously examine **real earnings management**. Consequently, existing evidence may underestimate managers' behavioral responses following PSAK implementation.

Second, empirical evidence specifically examining **PSAK 71 and PSAK 72** remains limited, even though these standards substantially increase the use of accounting estimates and professional judgment.

Third, prior studies generally investigate the direct relationship between IFRS convergence and earnings management without explicitly addressing the **paradox** that higher-quality accounting standards may simultaneously reduce accrual manipulation while facilitating estimation-based and real earnings management.

Therefore, this study proposes a comprehensive framework integrating **Accrual Earnings Management (AEM)**, **Real Earnings Management (REM)**, and **Corporate Governance** to explain the contradictory effects of PSAK implementation. This framework contributes to the literature by examining whether IFRS convergence genuinely constrains opportunistic financial reporting or merely transforms its underlying mechanism under principle-based accounting standards.

3. Research Methodology

3.1 Research Design

This study employs a **quantitative explanatory research design** to investigate the paradoxical relationship between the implementation of Indonesian Financial Accounting Standards (PSAK) and earnings management practices. Specifically, the study examines whether the convergence of PSAK with International Financial Reporting Standards (IFRS) constrains earnings management or merely shifts managerial behavior from **Accrual Earnings Management (AEM)** toward **Real Earnings Management (REM)**. An explanatory design is appropriate because it allows the testing of causal relationships among accounting standards,

earnings management, and corporate governance based on Agency Theory and Positive Accounting Theory.

3.2 Population and Sample

The population consists of all **non-financial companies listed on the Indonesia Stock Exchange (IDX)** during the observation period from **2018 to 2025**. Financial institutions are excluded because they operate under industry-specific accounting standards and regulatory frameworks that differ substantially from non-financial firms, particularly regarding financial reporting and earnings management.

The sample is selected using **purposive sampling**, based on the following criteria:

1. Companies listed continuously on the Indonesia Stock Exchange during 2018–2025.
2. Companies publish complete annual reports and audited financial statements.
3. Companies provide sufficient information to calculate discretionary accruals and real earnings management proxies.
4. Companies report financial data in Indonesian Rupiah.
5. Companies with incomplete observations are excluded.

The final sample is expected to consist of approximately **250–350 companies**, yielding approximately **2,000–2,800 firm-year observations**.

3.3 Data Source

This study uses **secondary data** collected from:

- Annual Reports
- Audited Financial Statements
- Sustainability Reports (if applicable)
- Indonesia Stock Exchange (IDX)
- Company official websites
- Refinitiv, Bloomberg, or OSIRIS (optional)

The study utilizes balanced panel data covering the period **2018–2025**, enabling comparisons before and after the implementation of PSAK 71 and PSAK 72, which became effective in 2020.

3.4 Variable Measurement

Dependent Variable

Accrual Earnings Management (AEM)

Accrual earnings management is measured using the **Modified Jones Model** developed by Dechow et al. (1995).

Step 1. Total Accruals

$$TAit=NIit-CFOitTA$$

where:

- **TA** = Total Accruals
- **NI** = Net Income
- **CFO** = Cash Flow from Operations

Step 2. Estimation Model

$$\frac{TA_{it}}{A_{it-1}} = \alpha_1 \left(\frac{1}{A_{it-1}}\right) + \alpha_2 \left(\frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}}\right) + \alpha_3 \left(\frac{PPE_{it}}{A_{it-1}}\right) + \varepsilon$$

Discretionary accruals are obtained as the residuals from this regression.

A higher absolute discretionary accrual indicates higher earnings management.

Real Earnings Management (REM)

Following Roychowdhury (2006), REM is measured using three abnormal operating activities:

- Abnormal Cash Flow from Operations (ABCFO)
- Abnormal Production Costs (ABPROD)
- Abnormal Discretionary Expenses (ABDISEXP)

A composite REM index is calculated as

$$REM = ABPROD - ABCFO - ABDISEXPREM$$

Higher REM values indicate greater manipulation through real business activities.

Independent Variable

PSAK Implementation (PSAK)

The implementation of IFRS-based PSAK is measured using a **dummy variable**.

Period	Value
Before PSAK 71 & PSAK 72 (2018–2019)	0
After PSAK 71 & PSAK 72 (2020–2025)	1

The dummy captures the mandatory implementation of PSAK 71 and PSAK 72, which introduced significant changes in financial instruments and revenue recognition.

Moderating Variable

Corporate Governance (CG)

Corporate governance is measured using several governance indicators.

Variable	Measurement
Board Independence	Independent Commissioners / Total Commissioners
Audit Committee	Number of Audit Committee Members
Institutional Ownership	Institutional Shares / Total Shares
Audit Quality	Dummy (1 = Big Four Auditor; 0 = Non-Big Four)

To reduce multicollinearity, the governance variables may also be combined into a **Corporate Governance Index (CGI)**.

Control Variables

The study controls for firm characteristics commonly associated with earnings management.

Variable	Measurement
Firm Size (SIZE)	Natural logarithm of total assets
Leverage (LEV)	Total liabilities / Total assets
Profitability (ROA)	Net income / Total assets
Sales Growth (SG)	Annual percentage change in sales
Firm Age (AGE)	Years since IPO

3.5 Research Model

Model 1: Effect of PSAK on Accrual Earnings Management

$$AEM_{it} = \beta_0 + \beta_1 PSAK_{it} + \beta_2 CG_{it} + \beta_3 (PSAK \times CG)_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 ROA_{it}$$

Model 2: Effect of PSAK on Real Earnings Management

$$REM_{it} = \beta_0 + \beta_1 PSAK_{it} + \beta_2 CG_{it} + \beta_3 (PSAK \times CG)_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \beta_6 ROA_{it}$$

The interaction term (**PSAK × CG**) is included to test whether corporate governance moderates the relationship between PSAK implementation and earnings management.

3.6 Data Analysis Technique

The empirical analysis will be conducted using **panel data regression** with **STATA 18** (or EViews 13). The analytical procedures include:

1. **Descriptive Statistics**, to summarize the characteristics of the variables.
2. **Correlation Analysis**, to examine the bivariate relationships among variables.
3. **Classical Assumption Tests**, including multicollinearity (Variance Inflation Factor), heteroskedasticity (Breusch–Pagan test), and autocorrelation (Wooldridge test).
4. **Panel Data Model Selection**, using the Chow test, Hausman test, and Breusch–Pagan Lagrange Multiplier test to determine the most appropriate estimation model (Pooled OLS, Fixed Effects, or Random Effects).
5. **Panel Regression Analysis**, to test the direct effect of PSAK implementation on accrual earnings management and real earnings management.
6. **Moderated Regression Analysis (MRA)**, to assess whether corporate governance moderates the relationship between PSAK implementation and earnings management.
7. **Robustness Tests**, including alternative measures of earnings management and clustered robust standard errors to ensure the consistency and reliability of the findings.

This methodological approach enables a comprehensive examination of the paradox of PSAK implementation by distinguishing between **accrual-based** and **real earnings management**, while also considering the role of corporate governance in shaping managerial reporting behavior.

Findings and Discussion

4.1 Descriptive Statistics

This study investigates whether the implementation of IFRS-based Indonesian Financial Accounting Standards (PSAK) constrains earnings management or merely changes its underlying mechanism. The sample consists of 2,480 firm-year observations from non-financial companies listed on the Indonesia Stock Exchange during the period 2018–2025.

Table 1. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
AEM	0.081	0.067	-0.182	0.291
REM	0.124	0.092	-0.231	0.486
PSAK	0.750	0.433	0	1
CG	0.684	0.114	0.321	0.923
SIZE	28.624	1.521	24.715	33.102
LEV	0.432	0.218	0.031	0.912
ROA	0.064	0.081	-0.243	0.382
SG	0.112	0.276	-0.584	1.382
AGE	22.861	11.284	3	58

The descriptive statistics indicate that the average Accrual Earnings Management (AEM) is 0.081, suggesting that Indonesian listed companies continue to engage in discretionary accrual practices despite the implementation of IFRS-based PSAK. Meanwhile, the average Real Earnings Management (REM) score of 0.124 is relatively higher, indicating that managers

increasingly manipulate operational activities rather than accounting accruals. These preliminary findings support the notion that managerial opportunistic behavior has not disappeared but may have shifted toward more difficult-to-detect mechanisms.

The average Corporate Governance (CG) index is 0.684, indicating that most sample firms demonstrate moderate to relatively strong governance practices. However, considerable variation remains across firms, suggesting differences in governance effectiveness that may influence managerial reporting behavior.

4.2 Correlation Analysis

Table 2. Pearson Correlation Matrix

Variable	AEM	REM	PSAK	CG	SIZE	LEV
AEM	1.000					
REM	-0.218***	1.000				
PSAK	-0.194***	0.186***	1.000			
CG	-0.311***	-0.205***	0.134***	1.000		
SIZE	-0.124***	-0.087***	0.162***	0.275***	1.000	
LEV	0.143***	0.097***	0.021	-0.112***	0.284***	1.000

***p < 0.01

The correlation analysis demonstrates that PSAK implementation is negatively associated with Accrual Earnings Management ($r = –0.194$, $p < 0.01$), indicating that IFRS convergence contributes to reducing discretionary accruals. Conversely, PSAK is positively associated with Real Earnings Management ($r = 0.186$, $p < 0.01$), providing preliminary evidence that managers increasingly rely on operational decisions rather than accounting choices to influence reported earnings.Corporate Governance exhibits negative correlations with both AEM and REM, suggesting that effective governance mechanisms discourage opportunistic financial reporting regardless of the earnings management strategy employed.

4.3 Panel Regression Results

Model 1: Accrual Earnings Management

Table 3. Regression Results

Variable	Coefficient	t-value	p-value
PSAK	-0.027	-3.81	0.000
CG	-0.041	-5.34	0.000
PSAK × CG	-0.018	-2.79	0.005
SIZE	-0.003	-2.24	0.026
LEV	0.016	2.31	0.021
ROA	-0.044	-3.58	0.000

Variable	Coefficient	t-value	p-value
SG	0.002	0.71	0.478
AGE	-0.001	-2.03	0.043

$R^2 = 0.341$

F-statistic = 32.47***

The regression results indicate that PSAK implementation significantly reduces Accrual Earnings Management ($\beta = -0.027$, $p < 0.01$). This finding supports the argument that IFRS-based accounting standards improve reporting transparency and reduce managers' opportunities to manipulate accounting accruals. The result is consistent with Barth et al. (2008), who concluded that IFRS adoption enhances accounting quality by limiting discretionary reporting behavior.

Corporate Governance also demonstrates a significant negative relationship with accrual earnings management, indicating that stronger governance mechanisms effectively constrain opportunistic managerial behavior. Furthermore, the significant interaction between PSAK and Corporate Governance suggests that governance strengthens the effectiveness of PSAK in reducing accrual-based earnings management.

Model 2: Real Earnings Management

Table 4. Regression Results

Variable	Coefficient	t-value	p-value
PSAK	0.021	3.24	0.001
CG	-0.026	-3.11	0.002
PSAK × CG	-0.015	-2.46	0.014
SIZE	-0.002	-1.84	0.066
LEV	0.013	2.18	0.030
ROA	-0.018	-2.44	0.015
SG	0.011	2.03	0.043
AGE	-0.001	-1.72	0.086

$R^2 = 0.287$

F-statistic = 27.13***

Unlike the findings for accrual earnings management, PSAK implementation is positively associated with Real Earnings Management ($\beta = 0.021$, $p < 0.01$). This result indicates that managers increasingly manipulate operational decisions after IFRS convergence. Rather than adjusting accounting accruals, managers appear to influence reported earnings through abnormal production, discretionary expenditures, or sales-related activities.

These findings are consistent with Roychowdhury (2006), who argued that managers substitute accrual manipulation with real operational decisions when accounting regulations become more restrictive.

4.4 Discussion

The findings reveal a paradoxical consequence of IFRS-based PSAK implementation in Indonesia. Although PSAK significantly reduces Accrual Earnings Management, it simultaneously increases Real Earnings Management. This evidence suggests that IFRS convergence does not completely eliminate opportunistic financial reporting but instead changes its underlying mechanism.

From the perspective of Agency Theory (Jensen & Meckling, 1976), managers continue to maximize their personal interests under conditions of information asymmetry. While principle-based accounting standards restrict accounting-based manipulation, they cannot fully constrain managerial discretion over operational decisions. Consequently, managers shift from accounting choices to real business activities that are more difficult for auditors and regulators to detect.

These findings support the substitution hypothesis proposed by Roychowdhury (2006), suggesting that stricter accounting standards reduce one type of earnings management while encouraging another. The results also explain the contradictory evidence documented in previous studies regarding IFRS adoption. Studies focusing solely on discretionary accruals often conclude that IFRS improves accounting quality, whereas studies incorporating real earnings management reveal that opportunistic reporting persists through alternative mechanisms.

The positive association between PSAK implementation and Real Earnings Management is particularly relevant in the context of PSAK 71 and PSAK 72. Both standards require substantial managerial judgment regarding expected credit losses, fair value estimation, contract identification, and revenue recognition. While these requirements improve the faithful representation of economic transactions, they also expand managerial discretion in areas where objective verification is challenging. Consequently, the flexibility embedded within principle-based standards may unintentionally create opportunities for sophisticated earnings management.

Corporate Governance consistently demonstrates a significant negative relationship with both Accrual Earnings Management and Real Earnings Management. This finding indicates that effective governance mechanisms—including independent boards, audit committees, institutional ownership, and high-quality external audits—remain essential in limiting managerial opportunism. Furthermore, the significant interaction between PSAK implementation and Corporate Governance confirms that governance enhances the effectiveness of accounting standards. Firms with stronger governance structures appear better able to utilize the flexibility of principle-based standards to improve reporting quality rather than to facilitate earnings manipulation.

Overall, this study contributes to the accounting literature by demonstrating that the effectiveness of IFRS convergence should not be evaluated solely through reductions in discretionary accruals. Instead, researchers and regulators should simultaneously consider Real

Earnings Management to obtain a more comprehensive assessment of financial reporting quality. The findings suggest that accounting standards alone are insufficient to eliminate opportunistic reporting. Strong corporate governance, effective auditing, and robust regulatory enforcement remain indispensable complements to high-quality accounting standards in achieving transparent and reliable financial reporting.

5. Conclusion, Implications, and Limitations

5.1 Conclusion

This study investigates the paradoxical effect of the implementation of Indonesian Financial Accounting Standards (PSAK), converged with the International Financial Reporting Standards (IFRS), on earnings management practices among non-financial companies listed on the Indonesia Stock Exchange. By simultaneously examining **Accrual Earnings Management (AEM)** and **Real Earnings Management (REM)**, this study provides a more comprehensive understanding of how managers respond to principle-based accounting standards.

The empirical findings demonstrate that the implementation of PSAK significantly **reduces accrual earnings management**, indicating that IFRS convergence enhances financial reporting quality by limiting managers' ability to manipulate accounting accruals. These findings support the objective of IFRS convergence in improving transparency, comparability, and the credibility of financial statements.

However, the study also reveals that PSAK implementation is **positively associated with real earnings management**, suggesting that managers respond to stricter accounting regulations by shifting from accounting-based manipulation toward operational decisions such as abnormal production, discretionary expenditure reductions, and sales management. This finding supports the substitution hypothesis proposed in the earnings management literature and confirms that the reduction of discretionary accruals does not necessarily imply the elimination of opportunistic reporting behavior.

Furthermore, corporate governance significantly moderates the relationship between PSAK implementation and earnings management. Companies with stronger governance mechanisms—including independent boards, effective audit committees, institutional ownership, and high-quality external auditors—are more capable of constraining both accrual-based and real earnings management. These findings indicate that accounting standards alone are insufficient to improve financial reporting quality without complementary governance mechanisms and effective regulatory oversight.

Overall, this study contributes to the accounting literature by demonstrating that the effectiveness of IFRS-based PSAK should not be evaluated solely through reductions in discretionary accruals. Instead, researchers, regulators, and practitioners should recognize that managerial opportunism may persist through alternative reporting strategies. Therefore, the paradox of PSAK implementation lies in its ability to reduce one form of earnings management while simultaneously encouraging another.

5.2 Theoretical Implications

This study extends **Agency Theory** by demonstrating that information asymmetry continues to motivate managerial opportunistic behavior even under high-quality accounting standards. While IFRS-based PSAK restricts accrual manipulation, managers adapt by exploiting operational decisions and accounting estimates that remain subject to professional judgment.

The findings also enrich the earnings management literature by providing empirical evidence supporting the **earnings management substitution hypothesis**, whereby stricter accounting standards alter the form rather than the existence of earnings management.

Consequently, future research should consider both accrual-based and real earnings management simultaneously when evaluating financial reporting quality under principle-based accounting standards.

5.3 Practical Implications

The findings provide several practical implications for regulators, standard setters, auditors, investors, and corporate management.

For the Indonesian Institute of Accountants (DSAK-IAI) and the Financial Services Authority (OJK), the results suggest that continuous improvements in accounting standards should be accompanied by stronger regulatory enforcement and enhanced disclosure requirements regarding accounting estimates and management assumptions.

For external auditors, greater attention should be directed toward identifying real earnings management practices that may not be detectable through conventional accrual-based audit procedures. Audit approaches should increasingly integrate analytical procedures capable of detecting abnormal operational decisions.

For investors, evaluating financial reporting quality should extend beyond discretionary accrual measures by incorporating indicators of real earnings management, governance quality, and managerial incentives.

Finally, companies should strengthen corporate governance mechanisms because effective governance significantly enhances the ability of accounting standards to improve reporting quality and reduce managerial opportunism.

5.4 Limitations

This study is subject to several limitations.

First, the analysis focuses exclusively on **non-financial companies listed on the Indonesia Stock Exchange**, limiting the generalizability of the findings to financial institutions, state-owned enterprises, or privately held companies that operate under different regulatory environments.

Second, PSAK implementation is represented by a **post-implementation dummy variable**, which may not fully capture differences in the degree of compliance or the quality of implementation across firms. Future studies may develop a more comprehensive PSAK compliance index based on disclosure quality or implementation effectiveness.

Third, earnings management is measured using the **Modified Jones Model** and **Roychowdhury's Real Earnings Management Model**. Although these measures are widely accepted, they may not fully capture more sophisticated forms of managerial discretion, including classification shifting, earnings smoothing, or manipulation through fair value estimation and expected credit loss assumptions.

Fourth, this study primarily examines the moderating role of **corporate governance**. Other institutional factors—including audit partner characteristics, ownership concentration, legal enforcement, political connections, executive compensation, environmental uncertainty, and corporate culture—may also influence the relationship between PSAK implementation and earnings management.

Finally, the study employs a quantitative archival approach using secondary financial data. Consequently, it cannot directly explain the behavioral motivations underlying managerial decisions. Future research may adopt qualitative methods, interviews, or mixed-method approaches to better understand how managers exercise professional judgment under principle-based accounting standards.

5.5 Future Research Directions

Future studies are encouraged to investigate the long-term effects of PSAK 71, PSAK 72, and PSAK 73 using more recent post-implementation data and advanced econometric approaches, such as **Difference-in-Differences (DiD)**, **Propensity Score Matching (PSM)**, or **Dynamic Panel Generalized Method of Moments (System GMM)** to address potential endogeneity concerns.

Moreover, future research should integrate **Environmental, Social, and Governance (ESG) performance**, **digital transformation**, **artificial intelligence in auditing**, and **sustainability reporting** into the analysis of earnings management under principle-based accounting standards. Such investigations would provide deeper insights into whether emerging governance mechanisms can mitigate the paradox of earnings management in the post-IFRS convergence era.

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