CHAPTER I

INTRODUCTION

1.1 BACKGROUND

Financial statements are the records or the end result of the reporting financial transactions of a company and this is a representation of a company condition. In the financial statements, there are information such as statement of financial position, statement of cash flow, income statement, and so on. All of information is useful for those who are interested with the company. Financial statements prepared is a form of corporate management responsibility over the work that has been done during the period. In other words, the financial statements is a tool to measure the performance of the company management, whether the company is in good condition or not.

The objective of financial statements is to provide information which relate to the financial position, company performance and the changes of financial position and it useful to the users of financial statements in decision making. In the income statement there is an information that shows the profit performance of the company's management. According to Statement of Financial Accounting Concept (SFAC) No. 1, information about earnings is a major concern to assess the performance or management responsibility, but it also helps gain information about the owner or other parties in assessing the company's earnings power in the future. Information about profit is also become a target for management to maximize satisfaction by taking a certain accounting policies. (Financial Accounting Standards Board, 2011)

Earnings management shows the manipulation of the financial statements or management interference in the company's financial reporting process with the goal to maximizing or benefiting their own interests.

The phenomena of the existence of earnings management practices have occurred in the capital market Indonesia, particularly in the manufacturing companies in the Jakarta Stock Exchange. Example cases occur in PT Kimia Farma Tbk. Based on the results of Bapepam (Capital Market Supervisory Agency, 2002) 4, obtained evidence that there is an error presentation in financial statements of PT Kimia Farma Tbk, in the form of an error in finished goods inventory valuation and fault recording sales, where the impact of these errors resulted in overstated earnings in net income for year ended December 31, 2001 amounting to Rp 32.7 billion. (Sulistianto, 2008)

The same case also happened in PT Indofarma Tbk. based on Bapepam examination results to PT Indofarma Tbk. (Market Supervisory Agency Capital, 2004) 5, there is evidence that the value of goods in process rated as more higher than the respective values in the presentation of the value of inventory in process in the financial year 2001 amounting to Rp 28.87 billion. As a result, the presentation is too high (overstated) inventories amounting to Rp 28.87 billion, the cost of goods sold are understated (understated) amounting to Rp 28.8 billion and profit clean overstated overstated by the same value. (Sulistianto, 2008)

A similar incident also occurred in Asia in 1997, the number bankrupt company triggered the economic crisis which is believed due to the failure of corporate governance system, the crisis has also been happened in Indonesia, which makes corporate governance as an important issue among executives, corporate consultants, academics and regulators (Government) in many of the world. Many cases that occurred in Indonesia about failure mechanisms of Good Corporate Governance. (Sulistianto, 2008)

Earnings management arise as a result of the agency problem that is the misalignment of interest between owners and management (Beneish, 2001). One way to measure earnings management is to use Discretionary Accrual proxy (Jones, 1991). Discretionary accrual is an accrual component that are in the policy manager, which means that the manager gave its intervention in the accounting reporting process.

There are some problems which affect earnings management. The first problem is to make company bigger so the company size is increase. Then how the company increase its profit by looking to the company age, leverage, return on assets and ownership structure.

Company size shows a scale which can be classified as large or small in a variety of ways, such as total assets, the log size, the value of the stock market, etc. It can be divided into three categories. These are large firm, medium firm, and small firm.

Besides, large companies have greater interest to analysts and brokers, which published financial statements more transparent so as to minimize the incidence of asymmetry of information that can support the emergence of earnings management. From the above it can be concluded that the size of the firm also has a relationship with earnings management.

The age of the company shows the company's ability to survive and carry out its operations. Company which has a long standing usually have more experience than a new company entering the business world. With the development of technology and along with the progress of time, the company has always figure out how to survive. Due to the arrival of a new competitor, a company that has a long standing must have tried in order to maintain its existence. Usually with a long life, the company will retain the information or to make a new strategy to keep getting the name of the public. But for the newly established company will definitely look for information and strategies in order to compete with companies that have long standing. One of the ways in which the company does is earnings management. Because the new companies are trying to manipulate their financial statements in order to get links or investors.

Comparison between debt and assets that indicates what proportion of assets used to secure the debt is called the leverage ratio . This size is strictly related to the presence and absence of a debt agreement. Companies that have high leverage ratios due to the large amount of debt compared to assets of the company suspected of earnings management because the company threatened to default that is unable to meet debt payment obligations on time. The company will try to avoid it by making policies that can increase revenue and profit .

In the bonus plan or managerial compensation, the owner of the company promised that the manager will receive a bonus if the performance of the company reaches a certain amount. This means that the bigger the bonus that would be obtained managers, the greater the motivation of managers to manage earnings. Profitability ratios used in this study is the return on assets (ROA), where the return on assets (ROA) shows the company's ability to generate profits earned based on the total assets of the company.

This research about Automotive & Component companies and use of observations from 2010 to 2014 which listed Indonesian Capital Market Directory. The model used in this study still rely to the model used in previous studies. Where this model is used to measure the discretionary accruals and many models proposed by previous researchers because this model using cash flow approach.

Based on the explanation above, this research will examine the effect of company size, company age, leverage, and motivation bonus to earnings management. So the researcher give the title **Analysis of Factors Affecting Earnings Management : Empirical Study in Automotive & Component Company Listed in Indonesia Stock Exchange 2010-2014**

1.2 Research Question

Based on the background above, the problems can be formulated is as follows:

1. Does the company size have an effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange ?
2. Does the company age have an effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange ?

3. Does the leverage have an effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange ?
4. Does the motivation bonus have an effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange ?

1.3 Research Objectives

Based on the formulation problem has been presented, the objectives to be achieved in this research is as follow :

1. To provide empirical evidence about company size effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange.
2. To provide empirical evidence about company age effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange.
3. To provide empirical evidence about leverage effect on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange.
4. To provide empirical evidence about motivation bonus on the practice of earnings management in Automotive & Component company listed on the Indonesian Stock Exchange.

1.4 **Research benefit**

Based on the purpose of research, the results of this study are expected to be useful as follows:

1. For the theoretical aspect, the results of this study are expected to increase knowledge in the field of accounting, particularly on earnings management.
2. For a practical aspect, the results of this study are expected to be useful as input material in consider investor decision-making related to investment in shares, especially at Manufacturing in Indonesian Stock Exchange.

1.5 Writing Systematic

This research consist of five part or chapters, arranged and will be explained as follow :

1. CHAPTER I : INTRODUCTION

   this chapter explains about the background, problem formulation, research purpose and benefit, and writing systematic.

2. CHAPTER II : LITERATURE REVIEW

   this chapter explains about the agency theory, earnings management, company size, company age, leverage, ownership structure, and review of previous research to develop the hypothesis.

3. CHAPTER III : RESEARCH METHODOLOGY

   this chapter explains about research design, population, sample, data and methods of data collection, identification, measurement of research variables, and method of data analysis.

4. CHAPTER IV : RESULT AND DISCUSSION

   this chapter explains about the result of research testing, so it can be answered the problem.

5. CHAPTER V : CONCLUSION

   this chapter explains about the conclusion, research limit and opinion, and the implication of the research that has been done.