CHAPTER I
INTRODUCTION

1.1 Research Background

The company must have clear objectives in carrying out business activities. Financial statements are important things that must be completed by companies. Financial statements are records the financial information of the company in an accounting period that can be used to describe the performance of the firm. The firm management performance is reflected in the profits contained in one of the financial statements, called income statement. The process of preparing an income statement influenced by several factors that can affect the quality report. Profit becomes one of the measuring tools for companies to do their operations.

To find the amount of profit owned by a company can be seen the revenue from business activities reduced with operational costs incurred in the company. Earnings as one of the important components of firm performance, and also illustrate the increase or decrease in the wealth of a company (Tabassum, Kaleem, & Nazir, 2013). The action of earnings management causes financial statements not reflect the actual state of financial statements. This allows shareholders and investors to make inaccurate judgments on the company (Rahman & Ali, 2006). Various factors that encourage the emergence of earnings management are to stabilize the market prices, avoid payment of dividends, management positions, equal income, fulfill regulations and contract requirements (Naz et al., 2011).
To prevent earnings management, the application of corporate governance is very necessary. Corporate governance is a mechanism to regulate and manage the business to improve corporate accountability (Roodposhti & Chashmi, 2011). It has been proven that the level of company performance depends on the governance mechanism that has been implemented in the company (Obradovich & Gill, 2013). Good corporate governance can increase investors' trust to invest their funds and get results that are appropriate for their investments (Itan, 2015).

Corporate governance has received much attention after the collapse of giant companies such as Adelphia, Enron, WorldCom and the majority of other companies in the United States (Cornett et al., 2006). As in the case of Enron which is a company jointly with Inter North and the Houston Natural Gas company, one of Enron's executives questioned the company's accounting practices that were declared unhealthy and expressed concern about the CEO and KAP partner Andersen in mid 2001. Have same cases occurred in Indonesia regarding poor corporate governance resulting in audit failure at Kimia Farma and Lippo Bank companies in Indonesia (Boediono, 2005). In the Kimia Farma company, there were a markup the profits in 2001, while Bank Lippo had double bookkeeping in 2002. From the cases, it shows that corporate governance is very influential in making earnings management. Especially for Indonesia, there are several cases of earnings management that have occurred. In general, large companies have a broader important role, this will have an impact on the public interest compared to small companies. Large companies must be careful in
carrying out their financial statements, because they will become a concern for the community (Ningsaptiti, 2010). Large companies have a large incentive to do earnings management, one reason being that companies must be able to meet the expectations of shareholders.

This is the reason why this study focuses on the important role of good corporate governance and earnings management in the company. The several good corporate governance mechanisms consist of board independence, board gender diversity, managerial ownership, audit committee, and audit quality.

Based on the background above, researchers are interested in researching about “Corporate Governance and Earnings Management in Indonesia: A Study of Manufacturing Company”.

1.2 Problem Statement

The sample used in this study are all manufacturing companies listed on the Indonesia Stock Exchange. The reason the authors chose manufacturing companies as research objects was because manufacturing companies listed on the Indonesia Stock Exchange consisted of various industrial sub-sectors so that they could reflect the reaction of the capital market as a whole. Manufacturing companies also have the largest number of companies on the Indonesia Stock Exchange. In addition, the selection of manufacturing companies is the object of research because, in accordance with the facts explained, cases involving manufacturing companies are more or more dominant compared to other companies. With that the author intends to conduct research on the presence or
absence of the influence of these factors on the quality of earnings.

The financial fraud committed by Kimia Farma has an effect on the reputation of the external auditor, Hans Tuanakotta and Mustofa (HTM). Because of the failure to detect fraud in the financial statements, HTM suffers from 100 million which needs to be deposited into the state treasury because this is a state regulation. Problems made by one party can have an impact on related parties as well, therefore, it is expected that the company will provide accurate and transparent information to the public, not to manipulate the value of its financial reporting.

1.3 Research Question

From the background above, there is several question in this research:
1. Does board independence has relationship to earnings management?
2. Does board gender diversity has relationship to earnings management?
3. Does managerial ownership has relationship to earnings management?
4. Does audit committee has relationship to earnings management?
5. Does audit quality has relationship to earnings management?

1.4 Research Objectives

The purpose of this study is to provide empirical evidence as follows:
1. To test board independence has a significant effect on earnings management.
2. To test board gender diversity has a significant effect on earnings management.

3. To test managerial ownership has a significant effect on earnings management.

4. To test the audit committee has a significant effect on earnings management.

5. To test audit quality has a significant effect on earnings management.

1.5 Research Contribution

Based on the formulation of the problem above, the benefits that can be taken from this research are:

1. Management, the result can be a references for management company to making decision. They can understand about impact of good corporate governance and earnings management for companies before make the decision.

2. Company, this study can help company to understand how to improve the good corporate governance on the company and also what factors impact the manager to do the earnings management. So, company can do their operation more better and can generate more profit.

3. Investor, By recognizing the company's revenue management factors, it can provide investors to analyze which companies are better to invest. Although most investors only focus on financial statements, but to find
out and understand the quality of financial statements needed for investors.

1.6 Systematic Discussions

Systematics discussion aims to provide a general description of the parts of the research report arranged in five chapters namely:

CHAPTER I: INTRODUCTION

In this chapter explains the background of research, problem of the research, research objective and systematic discussions of this research.

CHAPTER II: THEORITIES AND HYPOTHESIS DEVELOPMENT

This chapter contains the theoretical framework, explanation of previous research, the model underlying the research, and the formulation of hypotheses.

CHAPTER III: RESEARCH METHODOLOGY

This chapter is an explanation about research design, objective of the research, definition of each operational variable and measurements, technique for collecting data and which methods suitable to analyzing research data.

CHAPTER IV: RESULTS AND DISCUSSIONS

This chapter shows the results of testing the data from descriptive statistic analysis, outlier results, regression analysis results and conclusion about the hypotesis results.
CHAPTER V: CONCLUSION, LIMITATION, AND RECOMMENDATION

This chapter explains about the conclusion of the result from this research, limitations and recommendation to provide benefits for researchers in the future.