CHAPTER I

INTRODUCTION

1.1. Research Background

Jensen and Meckling (1976) defines agency relationship as a contract of one or more principals by benefiting other people or agent (in this case, manager) to run company operations. Within theory of agency relationship, principal refers to shareholder or owner, while agent refers to management who manage wealth of owner. Principal provides fund and facility for sake of company's operations. On the other hand, agents plays his or her role as the one who is in charge of managing owner's wealth that has been trusted to him or to her, in order to increase principal's wealth through company's value improvement. In return, agent will receive payment, bonus and other compensations.

Earning is an indicator that can be used for measuring the company's operational performance. Manager uses financial report for justifying what he or she has done when he or she operates the company. On the other hand, financial report is benefited by investor to see, to evaluate and to ask about policy that manager has made while operating company. As the party who has entrusted authority to company, investor has a right to control, monitor and demand any clarification from manager. Investor also has a right to attain profit from invested fund (Sulistyanto, 2008).

In order to motivate manager to perform better, investor or owner promises a bonus that manager will receive according to his or her performance.

However, by existence of bonus, manager will only prioritize his or her personal interest without paying attention to investor interest. Therefore, there is a probability of earnings management to be occurred (Scott, 2000).

Earnings management is act of a manager that report earnings which can maximize personal interest or company interest by using accounting policy method (Scott, 2000). Act of earnings management has raised several popular scandals of accounting report namely Enron, Merck, World Com and other companies in the United States of America (Cornett, Marcuss, Saunders dan Tehranian, 2006). Some of cases that took place in Indonesia, such as the one experienced by PT. Lippo Tbk and PT. Kimia Farma Tbk, also involves the financial reporting; these cases is detected from existence of manipulation (Gideon, 2005). Case of Kimia Farma took place in 2001. In this case, company marked up earning from Rp 99.594 billion to Rp 132 billion. On the other hand, Lippo Bank commited a double-booking incident in 2002.Within that year, Bapepam found three version of financial statement. First, financial statement was for public and it was published through advertisement on November 28th, 2002. Second, it was for Jakarta stock exchange (Bursa Efek Jakarta) and it was published on December 27th , 2002.Third, it was for public accountant, in this case public accountant was Prasetio, Sarwoko & Sandjaja with Ruchjat Kosasih as auditor; statement was reported to Lippo Bank management on January 6th, 2003. From all of versions, statement that had been really audited and had delivered "common-sense opinion without any exception" is the one that reported on January 6th, 2003. (Luggiatno, 2008).

Manipulative behavior done by manager emerged from interest conflict and it can be minimized through a monitoring mechanism which aims to align considerable interests. Monitoring mechanism can be in form of independent commissioner board and audit committee. Commissioner board can consist of unaffiliated party known as independent commissioner and affiliated party which can be person having family relationship and business relationship with stakeholder, board member, other commissioner board, and with company itself (KNKG, 2006). Commissioner board has a task to ensure implementation of company's strategy, to monitor management in operating company, and to make accountability compulsory under any circumstance. With existence of monitoring done by unaffiliated party, management will think twice about conducting earnings management. Size of commissioner board influences monitoring function. Number of board of commissioner affects effective or ineffective monitoring toward manager performance (Ujiyantho and Pramuka, 2007).

Audit committee has a task to monitor management in order to increase effectivity in terms of creating fair and well-qualified financial reporting, obedience toward governing regulations and sufficient internal monitoring. By existence of audit committee, company is expected to decrease action of earnings management done by management.

Another factor that has impacts on earnings management is ownership structure. Dispersed ownership structure is generally found only in England and United States of America. In the other advanced countries as well as in developed countries, company is still generally run by family. Anderson et al. (2002) says that company run by family has a structure that cause decrease of agency conflicts between creditor and shareholder, where creditor that family ownership is more to protect creditor's interest.

In addition, other factor that can affect earnings management is culture. A research that analyses cultural factor in Indonesia is rarely done. Cultural inheritance affects attitude toward business-related tampering Watson in Rahman and Ali, 2006) and culture of an organization can affect a company in considering fraudulent financial reporting (Geriesh in Rahman and Ali 2006). Therefore, based on this aspect, research aims to analyse effect of independent commissioner board proportion, size of the commissioner board, audit committee, concentrated ownership and culture toward earnings management. This purpose is poured into following title **"The Effect of Independent Commisioner Board Member, Commisioner Board Size, Audit Comittee, Concentrated Ownership, and Culture toward Earning Management."**

1.2. Research Problem

Based on research background above, research proposes following problem formulations:

1. Does proportion of independent commissioner board affect earnings management?
2. Does size of commissioner board affect earnings management?
3. Does audit committee affect earnings management?
4. Does concentrated ownership affect earnings management?

5. Does culture affect earnings management?

1.3. Research Objective

The research aims to test effect of independent commissioner board proportion, size of commissioner board, audit committee, concentrated ownership and culture toward the earnings management.

1.4. Research Benefit

The research is expected to give following benefits:

1. For the researcher

   The research is a means for implementing theory that researcher have learned through course especially in field of financial accounting.

2. For the other party

   The result of research can be benefited as reading material and knowledge-increasing means by demanding parties especially ones in field of financial accounting.

1.5. Content

CHAPTER I Introduction

This chapter contains research background, research problem, research objective, research benefits and content.

CHAPTER II Theoretical Reviews and Hypotheses Development.

This chapter contains theories that support research, framework and hypotheses development.

CHAPTER III Research Methodology

This chapter contains method that is used within research and it consists of population and sample, data gathering technique, measurement variable and data analysis.

CHAPTER IV Analysis

This chapter discusses analysis that is done and then result will be interpreted in both quantitave and qualitative way.

CHAPTER V Conclusion, Suggestion, and Limitation

This chapter contains conclusion of the research that has been done, limitation that researcher found and suggestion for the next research.