

CHAPTER I

INTRODUCTION

1.1 Research Background

Subprime mortgage crisis that began in 2007 hit not only US but also Japan and European countries. United States and Japan both are the biggest Indonesia's export targets. During the October-December 2008 period, Indonesia's quarterly economic growth fell from 6.1% to 5.2% on a yearly basis and export growth was at only 1.82%, the slowest since 1986 (Atje, Soesastro, and Titiheruw. 2009).

Besides that, global financial crisis also caused price increasing of raw imported materials. For manufacturing companies, price increasing of raw imported materials will lead into the rise of production costs; whereas for the declining of export level, will increase stock accumulation. As a result, it is expected to have an effect in company's earnings, namely decrease in earnings.

During financial crisis where company's earnings decreased, managers tend to engage in income decreasing earnings management. Earnings management performed by manager because they expect benefit from actions taken. Earnings management could describe about manager's behavior in order to report their business activities in certain period of time. In which there is possibility of particular motivation that push managers to manage or set financial data reported (Gumanti, 2000). According to Scott (2011) earnings management is the choice by a manager of accounting policies,

or actions affecting earnings, so as to achieve some specific reported earnings objective. Earnings management can include both accounting policy choice and real actions. Earnings management could be measured by using discretionary accrual proxy. The definition of discretionary accrual is accrual item in financial statement that could be controlled by managers, which mean managers can make intervention in those items.

Next, the reason behind managers engage in income decreasing earnings management is known as political motivation, especially in case of taxation motivation. In a profit condition, company usually has to pay tax. The amount of the tax also depends on the amount of profit, the greater the profit the bigger the tax. But during loss condition company will get different treatment. According to Government Act No. 17 Year 2000 chapter 17 about Income Tax and the revision version of it, Government Act No. 36 Year 2008 chapter 17 about Income Tax, "If the gross profit after deductions provided in paragraph (1) result in a loss, the loss is compensated by the gross profit starting next year in a row up to 5 years". So, in a loss condition, company does not have to pay tax. Then, in the next following year, if company earns some profits then it does not have to pay tax due to the compensation of last year's loss. By engaging in income decreasing earnings management, company expects to pay less tax in the future.

Based on that argument about taxation motivation, it is expected that during global financial crisis 2008-2009 engage in income decreasing earnings management.

From some previous researches, it can be known that firms engage in income decreasing during difficult times (i.e. during crisis period). Han and Wang (1995) said that during Persian Gulf crisis, oil companies have tendencies to minimize earnings. The result of this research indicated that petroleum refining firms used income-decreasing accruals in the third and fourth quarters of 1990 to reduce unusually large earnings increases. Sanjaya and Raharjo (2006) used the sample of listed manufacturing companies in Indonesia during Asian financial crisis 1997/1998. The research shows that management has tendency to minimize income during the crisis. Chia, Lapsley, and Lee (2007) also found that in general service-oriented public-listed companies in Singapore during the Asian financial crisis engaged in managing their earnings downward. Moreover, using the sample of 15.000 publicly listed firms from 31 countries, Spring (2011) found that in the year of the crisis, there was a significant positive relation between the years of crisis and big bath proxy. Then, Bachtiar, Shauki, and Harahap (2011) is conducted a research using descriptive statistics and statistical test on mean differences. By examining 316 Australian manufacturing listed companies during 2005 and 2009, this paper finds that firms that are expected to have lower profit due to crisis used accruals to increase their reported earnings during the global financial crisis did not engage in income increasing earnings management.

This research uses two previous researches as references, by Rahardjo and Sanjaya (2006) and by Bachtiar, Shauki, and Harahap (2011). Researcher will use the

combination from two previous researches, from Indonesian listed manufacturing companies during 2008-2009. Earnings management here will be measured by using Modified Jones Model. This research use two years observation period during financial crisis to see whether firms engage in income decreasing earnings management during financial crisis or not.

Based on the background, researcher finds some interests to do a research about earnings management with the title “Earnings Management during Global Financial Crisis 2008-2009: Evidence from Listed Manufacturing Companies in Indonesia”.

1.2 Problem Statement

According to the explanation of the research background, the main problem of this paper is:

Do managers in listed manufacturing companies engage in income decreasing earnings management during global financial crisis 2008-2009 ?

1.3 Research Scope

In order to answering the existing problems and not deviating for the problems, then the Research Scope should be made:

1. Companies which become sample in this research are listed manufacturing companies in Indonesian Stock Exchange in 2008 - 2009.

2. Financial statement that being used is audited financial statement ended in December.
3. Earnings management will be measured by using Modified Jones Model (1991). This model is chosen according to Dechow et al. (1995) which explained the negative side of Jones model, namely the implicit assumption of nondiscretionary revenues. This means, revenues in Jones Model, might not be manipulated by management.

1.4 Research Objectives

The intention of this research is to know the existing of income decreasing earnings management in listed manufacturing companies during global financial crisis 2008-2009.

1.5 Research Benefits

Potential contribution:

1. Academic

This research is a device for the implementing of theories that have been gotten in college. Also further expectation; this research can acknowledge researcher more.

2. Reader

This research is expected to give suggestions and more insights about earnings management during global financial crisis 2008 in listed manufacturing companies in Indonesia.

1.6 Thesis Structure

This research is divided into 5 chapters, which are:

CHAPTER 1 INTRODUCTION

This chapter consists of the background of the research, problem statement scope and objectives of the research, and the benefit of the research.

CHAPTER 2 THEORITICAL BACKGROUND AND PREVIOUS RESEARCHES

This chapter further explains theoretically about the origin of global financial crisis 2008-2009, the impact of crisis to the whole world and Indonesia, earnings management, motivations and patterns of earnings management, the relation between global financial crisis and earnings management, positive accounting theory, and also previous researches and hypothesis development.

CHAPTER 3 RESEARCH METHODOLOGY

This chapter consists of sample, data, sources of data and research method, and method of data analysis that used in this research.

CHAPTER 4 DATA ANALYSIS

This chapter consists of analysis data that has been calculated at the previous chapter, and being observed to find the conclusion.

CHAPTER 5 CONCLUSIONS AND IMPLICATIONS

This chapter consists of conclusion, managerial implication, limitation of the research, and suggestion for further research.

