CHAPTER 1

INTRODUCTION

1.1 Background

Globalization is becoming the common issued now. Many countries have begun mandatory adoption of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) to adopt a common language for financial reporting to develop international comparability. IFRS removes many allowable accounting alternatives, and some initial evidences show that IFRS limit managerial discretion to manipulate earnings, improving the earning quality (Callao and Jarne, 2010). Callao and Jarne (2010) found that IFRS implementation in England reduce earnings management measured by accrual discretionary. Researcher investigated the usefulness of IFRS adoption has shown that countries that adopt IFRS have lower earning management (Jeanjean and Stolowy, 2008).

In general practitioners, the economic actor, government, association profession and other regulators, found that earnings management is essentially an opportunistic behavior of a manager for varying number in financial statements in accordance with the objectives to be achieved (i.e. increase the earnings by reducing the expense costs). It made by the manager in order for affected investors to invest. The researcher found that essentially earnings management arise the impact of the manager's freedom to select and use a particular accounting method when recording the information in the financial statements.

Earnings management arise because there are various methods of accounting are recognized and accepted in its standard (Callao and Jarne, 2010).

Previous studies found the relationship between the changes of the standard accounting in this context of the mandatory IFRS to the earning management in their countries such us U.S., China, India, Sweden, Australia, Germany, etc. (Zhou et al., 2009; Zeghal et al., 2011; Bhattacharjee, 2012; Callao and Jarne, 2010; Sun et al., 2011; Elias, 2011; Jeanjean and Stolowy, 2008). The earnings quality is getting higher in common law countries after the adoption of the financial reporting system while it can be measure from the low of the earnings management (Leuz et al., 2008). Leuz (2008) found that is a strong (negative) correlation between the aggregate earnings management through the adaption of IFRS in his country. However, there are only few studies that test the relationship between the mandatory IFRS to earnings management in Indonesia.

Daske et al. (2011) point out that a challenge in examining the effects toward mandatory IFRS adoption is that all firms in a country adopt in the same period in the foreign country, making it difficult to identify an appropriate benchmark. It depends of the regulatory and law in a country while not all company can adopt the IFRS. Basically it can be differ to the non-listed company or the listed company that going public.

In this research, we investigate the impact of mandatory IFRS to earnings management in Indonesia. We focus our research on public company in Indonesia. The mandatory of IFRS for all companies especially public companies in Indonesia start from 2011 while the period of time can be divided into two

periods, i.e. pre-mandatory IFRS from 2006 – 2010 and at the mandatory of IFRS period in 2011. This research will specifically test whether there is less earnings management in the mandatory of IFRS period compare to the period before the adoption.

1.2 Problem Formulation

Based on the overview discussion on the background, this research will test how the mandatory IFRS gives impact to the earnings management. The problem is specifically formulated as follow :

1) Does the accrual based earnings management have the negative impact at the mandatory IFRS period?

2) Does the real transaction based earnings management have the negative impact at the mandatory IFRS period?

1.3 Purpose of the Research

The objective to be achieved in doing this research is to give empirical evidence related :

1) The impact of accrual based earnings management at the mandatory IFRS period.

2) The impact of real transaction based earnings management at the mandatory IFRS period.

1.4 Advantage of the Research

1) For the development of the research

     This research is expected to give contributions for further research which will investigate about the impact of the IFRS to the earnings quality which is measured from the earnings management perspective. Previous research are more focus in foreign countries such us U.S., China, India, Sweden, Australia, and Germany (Zhou et al., 2009; Zeghal et al., 2011; Bhattacharjee, 2012; Callao and Jarne, 2010; Sun et al., 2011; Elias, 2011; Jeanjean and Stolowy, 2008), this research is further discuss about the impact in Indonesia. We hope that this research would give some new contribution by giving new empirical evidence and be able to become references for other parties to do similar researches in the future.

2) For the standard setter

     This research gives contribution for the standard setter to know the effectiveness of the new standard of reporting system in Indonesia and also gives the empirical evidence that compares the result of the IFRS to the earnings management before and after the adoption.

1.5 Writing Scheme

Chapter 1   Introduction

     In this chapter, we will discuss about the background of the research, problem formulation, purpose of the research, advantage of the research, and writing scheme.

Chapter 2   Literature Review and Hypothesis Development

In this chapter, we will explain about the theories related to this topic, such us concept of relations between IFRS and accounting quality, earnings management, and previous research related to the topic and hypothesis development.

Chapter 3   Research Methodology

This chapter discuss about population, determination of sample, and sources of data. It is also discuss in detail about empirical research models and operational variables used in empirical testing model.

Chapter 4   Research Result Analysis and Discussion

This chapter includes the analysis and discussion of the results obtained from the research done that includes about the result of each hypothesis testing model and the analysis of the research result, to know the impact of mandatory IFRS to earnings management.

Chapter 5   Conclusion, Implication, and Recommendation

The final chapter contains the conclusion from this research as a whole, implication, theoretical and practical limitation of the research, as well as recommendation for the next research.