CHAPTER I

INTRODUCTION

1.1 Background of the Study

External parties use financial statements to obtain information about the financial conditions of the company, decision making for an investor, and the achievement of the performance of a company. In *PSAK* No. 1 Year 2015, the function of financial statements is to provide information about financial statements, income, and comprehensive income statements, and bookkeeping of financial statements when making investment decisions.

Earnings information is a major concern for assessing the performance or responsibility of management. It also helps owners or other parties to estimate the company's future profitability. The management has realized the trend of paying more attention to income, especially the managers who measure performance based on earnings information, thus encouraging the managers in performing towards the profit maximization behaviour. One of the forms is earnings management (Medyawati & Dayanti, 2016).

Earnings management is a method used in accounting policies and specific accounting procedures adopted by company's management, which systematically and deliberately affects earnings figures to maximize management utility and stock prices. Earnings management is carried out by deliberately modifying financial statements, using changes in tax legislation, standards, or accounting methods to save costs or minimize tax burdens, or maximize the company's performance by accelerating recognition of profitability and recording of revenue to see the company's financial performance.

The application of earnings management can be carried out through the recognition and recording of income. Recognition and recording of income are the process of recording cash inflows when delivering goods, providing services, or other activities. The revenue can be recognized when the transaction occurs and after the transaction is completed (Musadi et al., 2017).

The application of earnings management through recognition and recording of income can affect revenue and corporate income tax. This is because the company's efforts to accelerate the cash inflows will result in a large number of company cash profits, and more significant company profits will increase the company's income tax. Inaccurate revenue recognition and recording will lead to inaccurate financial performance information provided by the company that will affect the company's profits and corporate income tax (Sutadipraja et al., 2019).

Fiscal reconciliation refers to the process of adjusting commercial profits. This process is different from the fiscal provisions that taxpayers must be carried out before calculating the income tax of a company or individual taxpayer to generate income or profits under tax regulations. Appendix of annual corporate income tax returns is working papers containing adjustments between commercial income before tax and income based on tax provisions. To calculate the amount of income tax levied is based on net income. According to the Income Tax Law, the calculation of income tax is based on commercial net income that has been adjusted to the provisions of the Income Tax Law.

There are two types of fiscal corrections, which are positive fiscal correction and negative fiscal correction. A positive fiscal correction will result an increase in taxable profits and will increase the income tax payable. Meanwhile, a negative fiscal correction will result in lower taxable profits and will reduce the income tax payable (Rismawani & Nurchayati, 2016).

There are permanent and temporary differences that result in a positive or negative corrections. The time difference is caused by the difference in the recognition of revenue and cost when calculating profit. The revenue or cost is recognized according to commercial accounting not certainly recognized under fiscal terms or vice versa. This difference is temporary because it will be closed in the next period. Contrary to permanent differences, permanent differences occur because revenue and cost transactions are recognized in commercial accounting but not in fiscal terms, which results in profit or loss and taxable income (profit) based on fiscal term.

In taxation, accountant of the company uses earnings management strategies in reporting earnings. With a small profit, it can minimize the payment of corporate taxes and it can improve management performance. Management will use differences in taxation treatment to get a fiscal correction that can reduce profits, and the result will minimize the company's tax liability.

In May 2015, Toshiba stated that the company was investigating an internal accounting scandal and had to revise earnings calculations in the last 3 years. Based on this information, it is known that the company's management sets unrealistic profit targets so when the target is not reached, the company's management do manipulating financial statement data. Based on earnings management, Toshiba implements income maximization where this action is carried out when profits are fall. In this way, it can protect the company when dealing with debt activities. In addition, companies get a greater profits by manipulating data so the income tax payable is also getting higher (S. Kartika, 2017).

PT. Terusan Indah Perkasa is a company engaged in general importers, such as chairs, non-woven, staples, steel file cabinets, airport chairs, and steel wardrobe. The application of earnings management in companies is through the recognition and recording of income. Sources of company income include operating income and non-operating income. The company's operating income comes from the sale of imported goods and the company's non-operating revenue comes from the rental of a warehouse in Komplek Pergudangan Fujiayama Blok C no 10 Medan. In the recognition and recording of income, the company uses the accrual basis method. In this method, revenue is recognized and recorded during the service activities and profits are calculated in proportion to the settlement of obligations.

Companies use the Income Minimization system in earnings management to reduce tax burdens by increasing costs in financial reports. For example, the utilization of declining balance method to accelerate the depreciation expense of fixed assets, so that the non-cash expense could be higher and resulting in the tax benefits for the company. In addition, earnings management is applied by companies because companies need to avoid implement fraud or loss of company profit forecasts to regularly see the company's financial health.

In this company, there are several problems in implementing earnings management due to the unclear earnings management on the firm value and the incorrect implementation of taxation regulations. Due to those problems, the writer of this research would like to provide detailed analysis regarding the company's earnings management and how to apply the correct tax provisions in this company and the impact after the research is conducted.

Based on the description above, the author is interested in conducting research at this company and writing it in a paper entitled" **Analysis on The Application of Earnings Management, Fiscal Correction through The Recognition and Recording of Income and Expenses on The Profit Tax of PT. Terusan Indah Perkasa**".

1.2 Problem Limitation

Limitation problems in this research are:

1. Data on company revenue and expense in 2019 will be analyzed by the writer.
2. The writer will analyze acquisition cost and useful life of fixed asset from company data in 2019.
3. The writer will analyze income statements from the company in 2019.
4. Calculation of Article 22 Import tax from the company data in 2019.
5. Calculation of entity income tax used Corporate Income Tax Article 29 of 2019.

1.3 Problem Formulation

Based on the problems identified by the author and the problem restrictions that have been described above, then the problems can be formulated as follows:

1. How to implement earnings management and fiscal correction through the recognition and recording of income towards corporate profits and income tax at PT. Terusan Indah Perkasa?
2. What is the result of the analysis on earnings management and fiscal correction on corporate income and income tax at PT. Terusan Indah Perkasa?

1.4 Objective of the Research

The purposes of this research are to:

1. Understand the application of earnings management and fiscal correction through the recognition and recording of income in the company.
2. Understand the impact of earnings management and fiscal correction through recognition and recording of corporate profits and corporate income tax.

1.5 Benefit of the Research

The benefits of this research for the writer are:

1. The author can find out the application of earnings management and fiscal correction through the recognition and recording of income in the company.
2. The author can understand the impact of earnings management and fiscal correction by recognizing and recording corporate profits and corporate income tax.

1.5.1 Theoretical Benefit

The benefits of this research for academics or other prospective researchers are:

1. As research material for other future researchers in similar companies.
2. For future academicians, this research is expected to be guidance for academicians in their future research, to complement with existing research, and to expand academic knowledge.

1.5.2 Practical Benefit

The benefits of this research for the company are:

1. As a basis for improving the implementation of earnings management and fiscal correction through the company's recognition and recording of income.
2. As a basis for generating realistic and accurate corporate profits and income tax.