CHAPTER I
INTRODUCTION

1.1 Background of The Study

Income statement is one of the important parts of financial statements that has been used to report financial performance of an organization for a period. Income statement plays a big role in decision making of the company as it is the basic of financial statements that contain important financial data reports. Financial statement is one of the media for the management of the company to communicate with the investors of the company. Rudinto (2009) stated that the objective of financial statement is to meet the interests of various parties that are interested in the company, it aims to provide financial information about the company at certain periods. The quality of information provided by the income statement is very important as it affects the investor's decision making. The main information that are the most important point in income statement is the information concerning the earnings (profit or loss).

Accounting standard is very important as the globalization has been improving a lot, whereas it promotes on more multinational companies. In this era, business is not limited to only one country, where every business has even more opportunity to grow overseas easily when globalization has taken over the world. Investors also able to invest not only in local business but also international business. The technology has been a great help in providing whatever information needed for the investor to invest in business overseas. This prospect encourages the world to have an accounting standard that can standardized and uniformized every financial statement in the world to provide ease for overseas investors to analyze the financial statements. This is what formed the International Financial Reporting Standard.

International Financial Reporting Standard is the standard set for the financial statements produced to uniformly standardize every financial report for them to be consistent and easily comparable globally. It was released by International Accounting Standard Board (IASB). IFRS was first issued in Europe and was then followed by Australia, Brazil, Canada, Singapore, and some other countries including Indonesia.

A company's financial reports should adopt International Financial Reporting Standard (IFRS) to be able to be accepted internationally. With IFRS, every company globally will be using this standard uniformly. Adopting IFRS will ensure the company has a good quality of information. Producing a good quality of information is very important for a good decision making, but with adopting IFRS, will the quality of earnings decrease or increase.

Indonesia adopted IFRS in accordance with the commitment and their deal with G-20. Indonesia has adopted IFRS fully since 2012, although Indonesia started to adopt IFRS slowly in 2010. IFRS is said to provide a better-quality accounting information, the analysis of the effect of IFRS adoption on the quality of earning has been tested globally and have resulted in different results in some countries. The adoption of IFRS in Indonesia eases the business transactions with other countries as it makes it easier for other countries to compare the financial statements. However, most companies in Indonesia adopted IFRS due to the Indonesian regulation not by their own initiative.

Profitability is very important for the company to ensure their long-term growth and determine their future. Profitability ratio is a ratio that shows how profitability or how large the profit of the company is in a period. This ratio determines the efficiency of the company in producing profits in every sale. Profitability ratios consist of gross profit margin, net profit margin and operating profit margin. Profitability ratio can determine the quality of earning in a period.

Other than that, earnings persistence also can be used to measure quality of earnings. earnings persistence is the time-series parameter that measures the magnitude of the effect of permanent earnings innovations on expected future earnings. This parameter helps to explain the relation between earnings and firm valuation (Komerdi & Lipe, 1987). Persistent earnings have been acknowledged as being valuable for earnings forecasts (Frankel & Litov, 2009) and stock return predictions (Collins & Kothari, 1989).

Earning management is the practice of using the accounting procedures to produce overly optimistic financial statements by manipulating the amounts, it is usually used to present a manipulated amount of earnings to affect the decision making of the investors and creditors. Large fluctuations on company's earnings are a common condition, but management of the company might not want to alert the investors that may change their decision making. Therefore, management of the company might manipulate the earnings to show a good result that has achieve their objective to show the investors and to maintain their company's stock price up.

Scott (2009) explains that earnings management is the managers' action to report earnings that could maximize personal or corporate interests by using the accounting method policy; Earning management is used by the company to manipulate and show a good financial report mostly to investors and creditors. According to Angkoso (2012), in general, one of the benefits of IFRS convergence is to improve the quality of financial statements, one of them is by reducing opportunities for earnings management. The quality of earning is determined by a little earnings management involved, therefore, the less earning management, the better the quality of earning. Sulistyanto (2008) stated that the existence of rules in standard of accounting can be one of the tools to accommodate and facilitate companies to commit fraud. The companies could hide the fraud by using the methods and procedures that contained in the standard of accounting, so the standard of accounting seems to accommodate and provide companies opportunity to regulate and manage company's earnings.

(Cai *et al*., 2008) stated that one of the issues in IASB is that the international standard aimed to simplify various alternative of accounting policies that are permitted and expected to limit management's discretion towards earnings manipulation, so that earning quality can be improved. In Roychowdhury (2006) explains that earning management can be done with pure accrual earning management and real earning management; Pure accrual management such as discretionary accrual which does not affect cash flow directly. Pure accrual management usually done at the end of the period when the manager knows the earnings before manipulating to identify the amount of earning manipulated to achieve the earning target. On the other hand, real earning management can happen throughout the accounting period. Real accounting management started from normal operational activities, which are motivated by managers who wish to mislead at least some stakeholders to believe that the objective has been achieved in normal operations.

According to (Trisnawati *et al.* 2012), companies stated in Islamic index and conventional index in Indonesia in the period of 2004-2010 carried out real earning management and accrual earning management with the purpose of increasing earnings amounts.

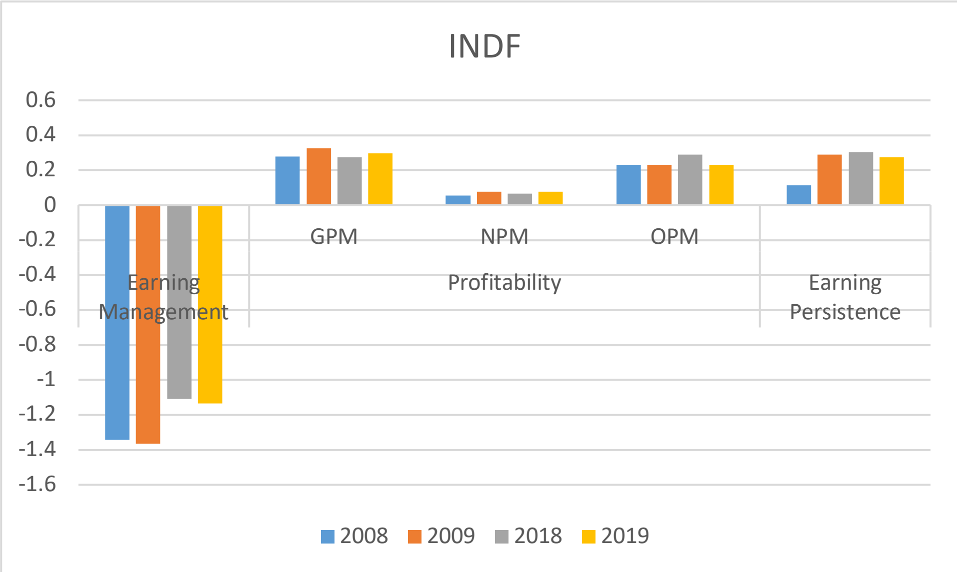
There are contradicting results of research for the IFRS effect on earning management in which Santy (2011) stated that the adoption of IFRS in Indonesia does not affect the earning management according to the companies stated in Indonesia Stock Exchange. The result of the analysis shows that the different in earning management before and after adopting IFRS cannot be shown statistically. On the other hand, from the analysis, it shows that for the company who adopt IFRS by their own initiative has lower earning management after adopting IFRS compared to companies who adopt IFRS due to regulations. However, a different result of research is shown in the research done by Idris (2014), as they have done research on the difference of income smoothing before and after adopting IFRS in Indonesia and the result is positive, in which there is decrease on income smoothing after adopting IFRS.

Earning management has been practiced by most of the companies in the world, it has become a culture to practice earning management. This practice has been a great problem for the country, as it involves in manipulating the earning, it may cause is a great drawback to the economy and affect the moral and ethics of doing business.

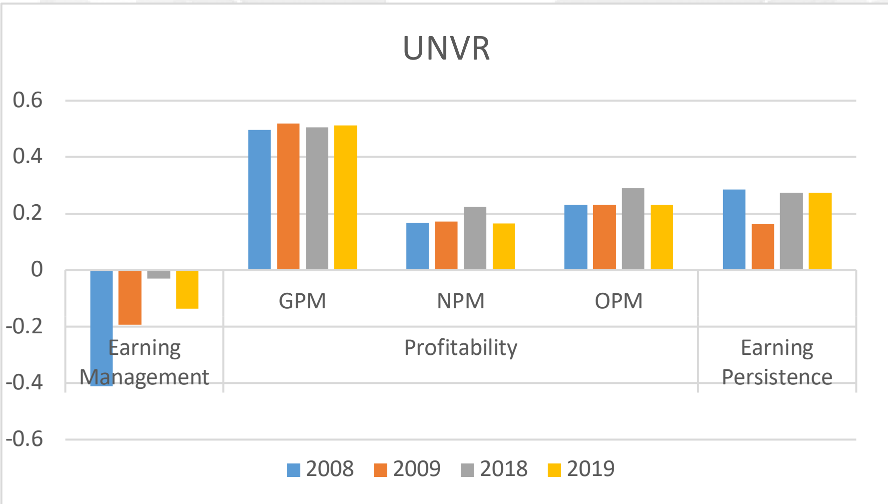
Table 1.1 Phenomena Table

Company	Year	Earning Management	Profitability			Earning Persistence
			GPM	NPM	OPM	
INDF	2008	-1,34448758	0,279207421	0,055508284	0,230992523	0,11391823
	2009	-1,36408345	0,324722941	0,076890616	0,230704411	0,28912813
	2018	-1,10940362	0,275367851	0,067606857	0,290609679	0,30323871
	2019	-1,13268907	0,296585515	0,077066213	0,230689207	0,27457420
ADRO	2008	-0,3321817	0,51186947	0,16212223	0,36856632	0,12893924
	2009	-0,8861007	0,32323058	0,08809437	0,27036301	0,11373292
	2018	-0,5967139	0,33433432	0,12945946	0,24640148	0,16272823
	2019	-0,7087571	0,30302671	0,11208873	0,17862728	0,21858402
UNVR	2008	-0,4103258	0,495522794	0,166828978	0,230992523	0,28629382
	2009	-0,19283486	0,518275324	0,17201264	0,230704411	0,16283292
	2018	-0,03060820	0,504875129	0,224538984	0,290609679	0,27393223
	2019	-0,13568687	0,513219423	0,165184847	0,230689207	0,27394734

Source: Prepared by writer (2020)



Source : www. IDX.co.id



Source : www. IDX.co.id

There are still a lot of questions in whether IFRS really affect in increasing the quality of earning, therefore, in this journal, writer will conduct further research on the effect of IFRS on the quality of earnings for the company of LQ-45 listed in Indonesia Stock Exchange. Therefore, the title of this research is **"The Quality of Earning Before and After Adopting IFRS On LQ-45 Companies Listed in Indonesia Stock**

Exchange" with the sample of before adopting IFRS 2009-2010, and after adopting IFRS 2018-2019.

1.2 Problem Limitation

Adopting IFRS has become compulsory in Indonesia since 2012, it has several benefits for the country when the companies are adopting this standard, one of them is a better quality of information provided. In this research, the limitation is to identify the quality of earning before and after adopting IFRS for the LQ-45 companies listed in Indonesia Stock Exchange for the year 2009-2010 as before the adoption of IFRS and 2018-2019 as after the adoption of IFRS.

1.3 Problem Formulation

There are 3 aspects that needs to be questioned and identified which is the earning management, profitability, and earnings persistence.

1. Is there any difference in earnings management before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange?
2. Is there any difference in profitability before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange?
3. Is there any difference in earnings persistence before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange?

1.4 Objective of The Research

The objective of this research is to test empirically whether there is difference in quality of earning before and after adopting IFRS. The quality of earning identified by the decrease of earning management, increase of profitability and increase of earning persistence.

1. To analyze the difference in earnings management before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange
2. To analyze the difference in earnings management before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange
3. To analyze the difference in earnings persistence before and after IFRS adoption in in LQ-45 companies listed in the Indonesia Stock Exchange

1.5 The Benefit of This Research

1.5.1 Theoretical Benefit

This research provides information and knowledge more on IFRS, quality of earning, earning management, profitability and earning persistence

1.5.2 Practical Benefit

This research can be used as practical benefit, one of them is making investors and creditors aware of the financial statements fraudulent and pay more attention to the management action to avoid fraudulent on financial statements provided for the investors and for them to provide a good quality of financial statements