CHAPTER II

LITERATURE REVIEW

2.1 Prior Research

The study from Kartikasari (2011) proves that good corporate governance influence on earnings management. While Siswantaya (2007), Wisnumurti (2010), Subhan (2012) have not been able to prove that good corporate governance influence on earnings management.

The results of study Zahara and Siregar (2009), and Setiawati (2010), empirically can not prove that there is an indication of Islamic banking earnings management practices. Padmantyo (2010), Syahfandi (2012) proves the banking industry practice of earnings management. The summary of previous study on good corporate governance and earnings management in the following table:

Table 2.1
Prior Research

No	Name, Year, Title	Varible and Indicator	Methods	Results
1	I Gede Siswantaya, 2007, Mechanism of Corporate Governance and Earnings Management Studies on Companies	Dependent variables: Earnings Management Independent variables: Managerial ownership,	Quantitative, multiple linear regression analysis	Corporate governance mechanism which consists of managerial ownership, institutional ownership, independent directors and audit committee are not having significant effect on

	Listed on Bursa Efek Jakarta.	institutional ownership, independent directors, audit committee		earnings management, either partial or simultant. This shows that corporate governance mechanism failed to border of earnings management behavior.
2	Zahara dan Sylvia Veronica Siregar, 2009, Influence of CAMEL Ratio on Earnings Management Practices in Islamic Banking	Dependent variable: Management Earnings (discretionary accrual) Independent variables: CAR ratio, RORA ratio, ROA ratio, NPM ratio, LDR ratio.	Quantitative, multiple linear regression analysis	On average, there is no significant earnings management practice (measured using discretionary accruals) in shariah banks and CAMEL ratios do not have a significant effect on earnings management, except NPM which has positive and significant effect. This indicates that although in average there is no earnings management in shariah banks, bank's profitability encourage management to involve in earnings management activity. This study finds evidence that earnings management in BUS is significantly higher than that UUS.
3	Adhika Wisnumurti, 2010, Analysis of Influence of Corporate Governance on Information Asymmetry Relations with Earnings Management	Dependent variable: Earnings Management (discretionary accruals) Independent variables: Information Asymmetry	Quantitative, multiple linear regression analysis	Audit committee size is able to moderate relation of information asymetry and earnings management, but board of commisioner composition and board of commisioner size are unable to moderate the link between information asymetry

	Practice (Studies in Banking Companies Listed on BEI)	(bid-ask spread) Moderating variable: Corporate Governance (independent board of commissioner composition, board of commissioner size, audit committee size) Control variables: firm size (total assets)		and earnings management. This is possible because every company often formed board of commisioner only obey the regulations which every company should have board of commisioner.
4	Koosrini Setiawati, 2010, Influence of CAMEL Ratio on Earnings Management Practices in Islamic Banking	Dependent variable: Earnings Management (discretionary accruals) Independent variables: CAR, RORA, ROA, NPM, LDR	Quantitative, multiple linear regression analysis	There are negative slope of CAR, ROA, NPM and LDR to earnings management, but their effects are not significant to earnings management in sharia banks.
5	Sri Padmantyo, 2010, Analysis of Earnings Management in the Financial Statements of Islamic Banking (Study in Mandiri Sharia Bank and Muamalat	Research variables and measurement: total accruals, cash changes, current assets changes, current liabilities changes, uncurrent	Quantitative, method of total accrual approach	Positive of total accruals for four years and negative for one year. It means that there are earning management in financial statement of Bank Syariah Mandiri and Bank Muamalat Indonesia for four years.

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	Bank)	liabilities changes included in current liabilities, despresiasi costs, total assets.		
6	Desi Kartikasari, 2011, Influence of Good Corporate Governance on Earnings Management (Empirical Study in Corporate Banking in BEI 2007-2009)	Dependent variables: earnings management Independent variables: good corporate governance (board of commission-ners, institutional ownership, managerial ownership) Control variables: Financial Performance (profitability, leverage)	Quantitative, multiple linear regression analysis	Board of commissioners, managerial ownership, institutional ownership, profitability and leverage have significant effect towards earnings management.
7	Djoko Suhardjanto dan Aryane Dewi, 2011, Disclosure of Financial Risk and Good Corporate Governance: Empirical Study of Banking in Indonesia	Dependent variables: financial risk disclosures in the annual reports of banking companies Independent variables: board of commisioner size, number	Quantitative, multiple linear regression analysis	Good corporate governance influence level of financial risk disclosure. Corporate governance variables that influence the level of disclosure of financial risks such as board size and the number of board meetings. Other variables, is the composition of the independent

		of board of commis-sionners meeting, independent commissioner composition, independent audit committee composition, number of audit committee meetings Control variables: leverage, profitability		commissioner, independent audit committee composition and the number of audit committee meetings do not influence on the disclosure of financial risks.
8	Rizky Syahfandi, 2012, Factors Influence of Income Smoothing Isolation Erasing of Earning Assets: Practice Earning Management on Islamic Banking in Indonesia	Dependent variable: allowance for uncollectible accounts (PPAP) Independent variables: total financing, profitability (earnings before taxes and provisions), and finance risk (non performing financing).	Quantitative, multiple linear regression analysis	Islamic banks do earning management with income smoothing practice. Furthermore, three independent variables significantly and positively affected the dependent variables.
9	Subhan, SE. MA, 2012, Influence of Good Corporate	Dependent variables: earnings management	Quantitative, multiple linear regression	(1) Institutional ownership, composition of independent

	Governance and Financial Leverage on Earnings Management Banking Companies are Listed in BEI	Independent variables: institutional ownership, independent board commissioner composition, board of comissioner size, board of director size, financial leverage	analysis	commissioners, board of director size and financial leverage influence of significant negative on earnings management, while (2) The size of the board commissioner doesn’t influence of significant positive on earnings management. Does not significance because of the relatively low awareness of GCG implementation in Indonesia.

Sources: Various journals, 2013

2.2 Theoretical Studies

2.2.1 Good Corporate Governance

2.2.1.1 Definition of Good Corporate Governance

Cadbury Committee, formed by the Bank of England and the London Stock Exchange, defines good corporate governance as the system of directing and controlling the corporation in order to achieve a balance between the forces of authority necessary company to ensure the company's existence and their stakeholder accountability, with shareholder relations arrangements, directors, managers, creditors, government, employees, and other stakeholders (Abdullah, 2010:25).

Understanding of good corporate governance in the banking sector, there is in provisions in section 1 number 10 of Central Bank Regulation No. 11/33/PBI/2009 on Implementation of Good Corporate Governance for Islamic General Banks and Islamic Business Unit. In this rule states that good corporate governance is the governance of the Bank to apply the principles of transparency, accountability, responsibility, professional, and fairness.

Implementation of good corporate governance is necessary to build trust both community and international as an absolute condition for the banking sector to develop well and healthy (Zarkasyi, 2008:122).

According Idroes (2008) in Subhan (2012:3) Basel II Committee states in enhancing good corporate governance in the baking organization in 1999 about standardization GCG effectively in the banking industry as follows:

a. Banks should decide strategic objectives and corporate values combine into at every level positions in the organization.

b. Banks should decide authority and responsibility at every level of the position in the organization.

c. Bank should determine that board of banks have sufficient competence and integrity and understand its role in the management of healthy banks and independent of influence or control external.

d. Banks should determine the existence of proper oversight by directors.

e. Bank should optimize the effectiveness of the role of the external auditor function (public accounting), and the internal audit unit.

f. Banks should determine that the remuneration policy is consistent with ethical values, objective, strategies, and environmental control of the bank.

g. Banks should implement practices transparency of financial and non-financial to the public.

2.2.1.2. Principles of Good Corporate Governance

Zarkasyi (2008:113-114) suggest that bank as intermediary and trust institutions, in carrying out its business activities banks should follow to the transparency principle, has a measurement of bank performance from all row banks based measures that are consistent with corporate values.

Bank shall defines objective business and bank strategy as a reflecting of accountability, it hold to prudential banking practices and guarantee the implementation of regulations as a form of bank (responsibility), free from any side pressure in decision-making (professional), and always attention the interests of all stakeholders based on the principles of equality and fairness. In relation to the principle of a bank should consider the following:

a. Transparency

Transparency is openness in expressing material and relevant information and transparency in the decision-making process. Banks should disclose information in a timely, adequate, clear, accurate, comparable and accessible to stakeholders in accordance with their rights. The transparency principle adopted by the bank does not reduce the obligation to comply with bank regulation in accordance with the valid legislation, official secret, and personal rights.

b. Accountability

Accountability is clarity of function and implementation of accountability of bank element of bank for effective management. Banks should establish clear responsibilities of each element aligned with the organization's vision, mission, business objectives and strategy of the company. Banks should decide that all element of the bank's organization has competence in accordance with its responsibilities and understand their role in the implementation of GCG.

c. Responsibility

Responsibility is with uniformity the bank management with legislation in force and the principles of healthy bank management. To maintain the continuity of their business, banks should: (1) hold on to prudential banking practices are implemented and ensure it applicable regulations, and (2) the bank should act as a good corporate citizen including care for environment and implement social responsibility.

d. Professional

Professional are competent, be able to act objectively and free from the influence/pressure from any party (independent) and have a strong commitment to developing Islamic banks. Banks should avoid undue dominance by any stakeholder and do not influence of the interests by unilateral and free of conflicts of interest.

e. Fairness

Fairness is justice and equality in fulfilling the rights of stakeholders based on agreements and legislation in force. Banks should always attention the interests of all stakeholders based on the principles of equal treatment. Bank should provide the opportunity for all stakeholders to provide input and express opinions in the interest the bank and have access to information in accordance with the principle of transparency.

Zarkasyi (2008:126) highlights, condusif environment is needed in order to achieve effective implementation of good corporate governance in the bank. For the parties related to the bank needs to provide support, for example:

a. Government and regulatory authorities issued regulations that allow the implementation effective of good corporate governance.

b. The enactment of law enforcement.

c. Application of accounting standards and auditing standards that refer to international standards by the external auditor.

d. Increasing the role of the banking associations in Indonesia to support and promote the principles of good corporate governance.

2.2.1.3 Board of Commissioners

Central Bank Regulation-2006 determines the number of board members must be at least three and at most equal to the number of members of the board of directors, which is consisting of commissioner and independent commissioner. The existence of independent directors is intended to encourage the creation of climate and work environment thet is more objective, can put fairness and equity among various interests, including the interests of minority shareholders and other stakeholders. Number of independent directors should be at least fifty percent of the members of the board of commissioners. All board members are required to fill all requipment of the capability test, fit and proper test in accordance with Central Bank. In addition, the board of commissioners must also fill with the requirements relating to the appointment procedure, experience, prohibit double function and ban of having a family relationship (with fellow board members and/or the board of commissioners) (Abdullah, 2010:76).

Board of commissioners, as the main element responsible for supervision to ensure good corporate governance principles applied by the company seriously. The commissioners are obliged to develop a monitoring mechanism as well as possible, with the support of an audit committee, monitors risk, remuneration and nomination committees should they form (Abdullah, 2010:83).

In article 14 of the Regulation of Central Bank No. 11/33/PBI/2009 propose about the board of commissioners meeting. In this article propose that the board of commissioners meeting shall be attended by at least 2/3 (two third) of the members of the board of commissioners and led by the top commissioner. If the top commissioner was unable to attend the board commissioners, the meeting can be led by a member of the board of commissioners.

2.2.1.4. Board of Director

Central Bank Regulation-2006 determine board of director must specify at least three people, but not be limited to the greatest number, according to the needs of the bank. Board of directors led by the president of director or top director who had come from a independent party of the controlling shareholder. Independence of the assessment is based on the existence of relationship the parties concerned with the management, ownership and/or financial and family with the controlling shareholder. All members of the board of directors must filler quirements of the capability test, fit and proper test in accordance with Central Bank. In addition, the board of directors must also fill with the requirements relating to the appointment procedure, experience, prohibit double function and ban of having a family relationship (with fellow board members and/or the board of commissioners) (Abdullah, 2010:79).

Board of Directors, which is the main element responsible for the operational management of the bank, do the management to keep it running in accordance with the principles of good corporate governance. For that purpose, the board director should develop policies and mechanisms for managing the company according to the principles of good corporate governance, with the support of Internal Audit Working Unit, Risk Management Working Unit, Risk Management Committee, Compliance Working Unit. All GCG policies adopted by the board of directors must be spell out the process and mechanism of action for all employees (commonly known as enterprise-wide) so that it becomes part of the collective consciousness when interacting with other stakeholders (Abdullah, 2010:83-84).

2.2.1.5. Audit Committee

Banks should determine that the audit committee is well function. For banks whose shares have been listed on the stock exchange and major banks, they must have an audit committee for the bank while others are depended on the needs (Zarkasyi, 2008:120).

In Article 36 Regulation of Central Bank No. 11/33/PBI/2009 propose about the audit committee. Members of the audit committee consist of at least an independent commissioner, an independent party who has expertise in the field of financial accounting, and an independent party who has expertise in the field of Islamic banking. Members of the audit committee must have integrity and good financial reputation. The audit committee is led by an independent commissioner. Board of director are prohibited from becoming members of the audit committee. The majority of commissioners who are members of the audit committee must be independent commissioners.

2.2.1.6. Institutional Ownership

Institutional ownership is ownership of company securities by financial institutions such as insurance companies, banks, pension funds, and investment banking (Kartikasari, 2011:39).

Institutional ownership is another part of mechanisms of corporate governance in company. Institutions have the resources, ability and opportunity to monitor and discipline managers to be more focused on the value of the company (Siswantaya, 2007:21).

The increase in institutional ownership such as banks, insurance companies, investment companies and other institutional ownership is an effective monitoring of agent to reduce the agency conflict in the company, because it can decimate the need for concentration of managerial ownership and debt financing in controlling the agency conflict. The greater institutional ownership, the more efficient utilization of company assets. Institutional ownership generally act as a monitoring party companies in general and the manager as the organizer of the company in particular (Kartikasari, 2011:39).

2.2.1.7 Managerial Ownership

Understanding of the ownership of the company is very important because it relates to the operational control of the company. According to the theory of accounting, earnings management is determined by the motivation of the company manager. Different motivations will result in a different amount of earnings management, as between managers and shareholders and a manager who is not a shareholder. This is consistent with the company's management system in two criteria: (a) the company led by the owner-manager, and (b) the company led by owners of non-manager. These two criteria will influence of earnings management, because manager ownership will determine the policy and decision making on the accounting method applied in the companies they manage. In general it can be said that a certain percentage of stock ownership by management are likely to influence the act earnings management (Kartikasari, 2011:40).

According to Jensen (1993) in Siswantaya (2007:19) interest convergence hypothesis declare that managerial ownership may help unification of interests between shareholders and managers. The greater proportion of managerial ownership, lead to better performance of the company. Concentration of interest can be achieved by giving ownership to the manager. If managers have shares of the company, they will have the same interests as the owner. If the interests of managers and aligned may reduce the agency conflict. If the agency conflict can be reduced, managers are motivated to improve the performance and reduce the company's contractual barriers.

However, a high level of managerial ownership can lead to defenses problems. It means that if a high managerial ownership, they have a strong position to control the company and external parties will find it difficult to control the actions of managers. It occur because the manager has a great voting rights on the high managerial ownership (Siswantaya, 2007:19).

2.2.1.8 Good Corporate Governance in Islamic Perspective

Good corporate governance in Islamic perspective, as also initiated in the western world, is expected to have a very essential role in achieving corporate goals and objectives. But Islam adds deeper the values in elements maqashid al-Shari'ah, is protection against benefit common humanity and universal (Abdullah, 2010:58).

In the development of good corporate governance, according to Dusuki (2008) in Abdullah (2010:58) benefit (as maqashid al-shari'ah) is useful for preventing and managing potential conflicts of interest between the stakeholder groups. The benefit principles reflect how Islam and sharia give importance to the public interest rather than the interests of individuals. In accordance with the Qur'an Surah. An-Nisa' (36) teaches to do good to others:

۞ وَٱعۡبُدُواْ ٱللَّهَ وَلَا تُشۡرِكُواْ بِهِۦ شَيۡـًٔاۖ وَبِٱلۡوَٰلِدَيۡنِ إِحۡسَٰنٗا وَبِذِي ٱلۡقُرۡبَىٰ
وَٱلۡيَتَٰمَىٰ وَٱلۡمَسَٰكِينِ وَٱلۡجَارِ ذِي ٱلۡقُرۡبَىٰ وَٱلۡجَارِ ٱلۡجُنُبِ وَٱلصَّاحِبِ
بِٱلۡجَنۢبِ وَٱبۡنِ ٱلسَّبِيلِ وَمَا مَلَكَتۡ أَيۡمَٰنُكُمۡۗ إِنَّ ٱللَّهَ لَا يُحِبُّ مَن كَانَ
مُخۡتَالٗا فَخُورًا ٣٦

"Worship Allah and associate nothing with Him, and to parents do good, and to relatives, orphans, the needy, the near neighbor, the neighbor farther away, the companion at your side, the traveler, and those whom your right hands possess. Indeed, Allah does not like those who are self-deluding and boastful."

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According to Nienhaus (2006) in Abdullah (2010:57) should be able to truly value-orientation and the principles of honesty and fairness all stakeholders. In terms of the objective function, according to Hasan (2009) and Yusof (2008) in Abdullah (2010:57) Islamic GCG should strive to put maqashid Islami al-Shariah as the ultimate goal, to bring the concept of the protection of the interests and rights of all stakeholders to the Islamic rule. According to Al-Quran Surah. Al Maidah (119) on the honesty:

قَالَ ٱللَّهُ هَٰذَا يَوْمُ يَنفَعُ ٱلصَّٰدِقِينَ صِدْقُهُمْ ۚ لَهُمْ جَنَّٰتٌ تَجْرِى مِن
تَحْتِهَا ٱلْأَنْهَٰرُ خَٰلِدِينَ فِيهَآ أَبَدًا ۚ رَّضِىَ ٱللَّهُ عَنْهُمْ وَرَضُوا۟ عَنْهُ ۚ ذَٰلِكَ
ٱلْفَوْزُ ٱلْعَظِيمُ ﴿١١٩﴾

"Allah will say, "This is the Day when the truthful will benefit from their truthfulness." For them are gardens [in Paradise] beneath which rivers flow, wherein they will abide forever, Allah being pleased with them, and they with Him. That is the great attainment."

2.2.2 The Agency Theory

Agency theory directs to the agency relationship, principal who gave the mandate to the agent. Agency theory explains the agency relationship by using the metamorphosis of a contract (Ikhsan and Suprasto, 2008:76). Wolk et al (2000) in Siswantaya (2007:14) explains that the theory of agency preparing the company as a nexus the agency relationship and seek to understand organizational behavior through testing how the parties related to the agency in company to maximize the utility they have.

Agency theory aims to solve the problem (1) the agency problem that appear when a conflict of objectives between the principal and the agent and the principal difficulty verifying employment agency, (2) risk-sharing problems that appear when the principal and agent have different behavior towards risk. There are problems because of differences in the action, because of the different risk preferences (Ikhsan and Suprasto, 2008:76).

The appearing of earnings management can be explained by the agency theory. In agency theory, the agency relationship appear when principals of the company is unable to manage sis own company, so principal do a contract with agents to carry oout the company. Relationship between principal and agent can aim to asymmetrical information because agent has a lot more information about the company than the principal. The assumption that agent act to maximize own self-interest, the asymmetry information will encourage agents to hide some information was not known to the principal. In these conditions, the agent may do earnings management.

One manner to minimize the earnings management that occur between principal and agent is good corporate governance. Associated with agency problems, good corporate governance is expected to function as a tool to provide confidence to investors that they would receive a return on the funds they have invested. Good corporate governance is directed to reduce the information asymmetry between the principal and the agent, which it can minimize the earnings management. So that the performance reported by the agent can reflect the real economy of the company.

A brief overview of the agency theory is described in the table below:

Table 2.2

The Agency Theory Overview

Main Idea	Principal and agent relationship may reflect organization efficiency related to organizational costs and costs to overcome risks
Analysis unit	Contract between principal and agent
Human assumption	Selfishness, bound rationality, risk averse
Organizations assumption	Conflict between participant, efficiency of the creation of effectiveness, asymmetry of information between principal and agent
Information assumption	Information as a commodity that information held
Contract problems	Moral hazard and adverse selection and risk-sharing
Set of problems	Relationship of difference with principal and agent and risk preferences (compensation regulation, leadership, impression management, whistle blowing, vertical integration, transfer pricing)

Sources: Ikhsan and Suprasto, 2008:77

From the other side, agency theory aims to develop accountability where accountability in this theory emphasizes an accountability of agents (managers / implementers) to the principal (who gave authority). Accountability according to Islamic perspective is mandate, a mandate is a

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part of universal became accountability, a western concept derived from agency theory (http://larispa.or.id, 2013).

Accountability or mandate is not really a new concept in Islam but needs to be developed that includes responsibility to the giver of mandate and receiver of mandate (http://larispa.or.id, 2013). Giver a mandate in this case is that Allah has created human as Allah's representative on earth (khalifatullah fill ard) as in Al-Quran Surah. 35: 39, namely:

هُوَ ٱلَّذِي جَعَلَكُمْ خَلَٰٓئِفَ فِي ٱلْأَرْضِ

"It is He who has made you successors upon the earth."

Meaning receiver a mandate (caliph) must perform their duties on earth responsibly and in carrying out the mandate should be fair and make it as a mercy (useful for others) as in Qur'an Surah 21:107, namely:

وَمَآ أَرْسَلْنَٰكَ إِلَّا رَحْمَةً لِّلْعَٰلَمِينَ ١٠٧

"And We have not sent you, [O Muhammad], expect as a mercy to the worlds."

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2.2.3 Earnings Management

2.2.3.1 Definition of Earnings Management

Humans inclined to avoid risk and try to minimize the losses that may be experienced in carrying out their business activities. The efforts is done sometimes harm others, such as stock market prices of company are influenced by earnings, risk and speculation. Therefore companies whose profits always increase consistently will result risk in this company decreased greater than the percentage increase in earnings. This makes a lot of companies involve in earning management as an effort to reduce risk (Sulistyanto, 2008 in Syahfandi, 2012:24).

However, there are the different views on whether earnings management is a legal activity or not. Some parties evaluated earnings management are against the principles of accounting, while others evaluated earnings management as a reasonable practice in preparing the financial statements, especially if earnings management is done within the limits of the scope of accounting principles. The different view of earnings management resulted in the emergence of several different definitions of the earnings management (Syahfandi, 2012:24).

Copeland (1968) in Kartikasari (2011:29) defines earnings management as "some ability to increase of reported net income or decrease at will". This means that earnings management include the businesses management to maximize, or minimize income, including income smoothing in accordance with the wishes of management.

According to Schipper (1989) in Kartikasari (2011:29) earnings management is intervention in the external financial reporting process with purpose to personal gain. Earnings management occurs when managers use judgment in financial report and in the structure of transactions to alter financial report to mislead shareholders about the company's economic performance or influence of agreement consequences with the figures reported in the financial report.

2.2.3.2. Patterns of Earnings Management

According to Scott (2012:425) the management of earnings to do some patterns of earnings management in the manner intended, among others:

1. Taking a bath

This can take place during periods of organizational stress or restructuring. If a firm must report aloss, management may feel it might as well report a large one-it has little to lose at this point. Consequently, it will write off assets, provide for expected future costs, and generally “clear the decks.” The accrual reversal, will enhances the probability of future reported profits. As the results, the recording of large writeoffs puts earnings “in the bank.”

2. Income minimization

    This is similar to taking a bath, but less extreme. Such a patern may be chosen by a politically visible firm during periods of high profitability. Policies that suggest income minimization include rapid writeoffs of capital assets and intangibles, and expensing of advertising and R&D expenditures. Income tax considerations, such as provide another set of motivations for this pattern, as does enhancement of arguments for relief from foreign competition.

3. Income maximization

    From positive accounting theory, managers may engage in a pattern of maximization of reported net income for bonus purposes, providing this does not put them above the cap. Firms that are close to debt covenant violations may also maximize income.

4. Income smoothing

    This is perhaps the most interesting earnings management pattern. From a contracting perspective, risk-averse managers prefer a less variable bonus stream, other things aqual. Consequently, managers may smooth reported earnings over time so as to receive relatively constant compensation. Efficient compensation contracting may exploit this effect, and condone some income smoothing as a low cost way to attain the manager's reservation utility.

2.2.3.3 Earnings Management Motivation

According to Scott (2001) in Kartikasari (2011:31) the motivation of earnings management include:

a. Bonus Purposes

Company managers get bonus plans will choose accounting policies which slight conservative compared with the company's managers without bonus plans. Managers with bonus plans will avoid the accounting method may to report lower net income, managers use accounting income to determine the amount of the bonus and tend to choose accounting policies that can maximize bonus.

b. Political Motivations

Political aspects can not be avoided from the company. Especially big company and strategic industries, because the activity involves the lives of many people. Company splash around in the provision of facilities for the benefit of many people such as electricity, water, telecommunications and infrastructure, political will receive attention from the government and society. Earnings management is used to reduce earnings which reported of public company. Companies inclined to reduce the earnings on the report because of the public pressure result the government draw up a firm regulation.

c. Taxation Motivations

The amount of income tax expense on the carried to make tax should be one of main reasons for reducing the company's reported earnings. A tax savings motivation become motivational most real earnings management. Various methods of accounting used for the purpose of income tax savings.

d. Substitution of Directors

Various motivations appear around the time of change of the directors. For example, directors who are nearing the end of the assignment or retire will be do a strategy of maximizing earnings to increase his bonus. Likewise, the directors are less able to improve corporate performance will inclined to maximize earnings in order to prevent discharge by shareholders.

e. Initial Public Offering (IPO)

Basically the first company to offer shares in the stock market do not have a market price, so it has the problem of how to decide the value of the shares on offer. Information net income can be used as a signal to candidate investors about the company's value. Manager of a company that will go public do earnings management to get a higher value on the shares.

f. The importance of giving information to investors

Information about the company's performance to be delivered to investors that earnings reporting needs to be presented so that investors still appraise that the company is in a good performance.

g. Contract long term debt

For the funding of the company, management will carry on credit from a third party. Management together with the creditors will sign a debt contract. This contract purpose to protect the creditors from management actions which contradicted the interests of creditors. Violation of the contract debt will bring to surface a big cost, because it is the company will try to avoid conditions that be concidered breaking the contract. Earnings management can be used to reduce the possibility company in the condition which break debt contract and reduce the possibility company technical default.

In Islam, earnings management is not justified. Islam teaches people to say the right thing, according Qur'an Surah. An-Nisa' (9) :

وَلْيَخْشَ ٱلَّذِينَ لَوْ تَرَكُوا۟ مِنْ خَلْفِهِمْ ذُرِّيَّةً ضِعَٰفًا
خَافُوا۟ عَلَيْهِمْ فَلْيَتَّقُوا۟ ٱللَّهَ وَلْيَقُولُوا۟ قَوْلًا سَدِيدًا ﴿٩﴾

"And let those [executors and guardians] fear [injustice] as if they [themselves] had left weak offspring behind and feared for them. So let them fear Allah and speak words of appropriate justice."

2.2.4. Accounting Practice for Islamic Banking

Based on law No. 21 of 2008 about Islamic Banking chapter 1 article 1, Islamic Banking is everything related to Islamic Banking and Islamic Business Unit, covering institutional, business activities, and the manner and process in conducting its business. While the Banks Islamic is the bank run its business activities based on Syariah principles and by type consists of Islamic General Banks and Islamic Financing Bank (Setiawati, 2010:24).

The main basis to establish Islamic banks in Indonesia is trying as much as possible to operate as a bank of commerce based on the Islamic law to provide ease and bank services to all Muslims and people in this country, by achieving persistence and efforts to develop forward from time to time (Parmudi 2005 in Syahfandi, 2012:14).

Philosophically, Islamic bank is bank whose activity left the problem "riba". Thus, avoidance interest which is considered usury constitute one of the challenges who facing the Islam world adult this. Lately the Muslim economists have devoted great attention to finding ways to replace the system

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of interest in banking and finance are more in line with Islamic ethics. This work is done in an effort to build a model of economic theory-free interest and the test of economic growth, allocation, and distribution of income (Machmud and Rukmana, 2010:4).

Islamic banking was established based on the philosophical and practical reasons. Reason philosophical is banning of “riba” within financial transactions or nonfinancial. According to QS. Al-Baqarah: 275, namely:

ٱلَّذِينَ يَأۡكُلُونَ ٱلرِّبَوٰاْ لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ ٱلَّذِي يَتَخَبَّطُهُ ٱلشَّيۡطَٰنُ
مِنَ ٱلۡمَسِّۚ ذَٰلِكَ بِأَنَّهُمۡ قَالُوٓاْ إِنَّمَا ٱلۡبَيۡعُ مِثۡلُ ٱلرِّبَوٰاْۗ وَأَحَلَّ ٱللَّهُ ٱلۡبَيۡعَ
وَحَرَّمَ ٱلرِّبَوٰاْۚ فَمَن جَآءَهُۥ مَوۡعِظَةٞ مِّن رَّبِّهِۦ فَٱنتَهَىٰ فَلَهُۥ مَا سَلَفَ وَأَمۡرُهُۥٓ
إِلَى ٱللَّهِۖ وَمَنۡ عَادَ فَأُوْلَٰٓئِكَ أَصۡحَٰبُ ٱلنَّارِۖ هُمۡ فِيهَا خَٰلِدُونَ ٢٧٥

“Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah . But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein.”

Practice reasoning is a conventional banking with the interest system contains several weaknesses (Zainul Arifin, 2002 in Machmud and Rukmana, 2010:5), as follows:

a. Interest-based transactions violate justice or fairness of the business.

b. Unflexibility interest-based transaction systems cause to bankruptcy.

c. Bank commitment to the security of depositor money with interest make banks anxious to return the principal and interest.
d. Systems interest-based transactions blocking the emergence of innovation by small businesses.
e. In system of interest, bank not will interested in partnership of business, except when there is a guarantee of certainty return on capital and interest income them.

Based on several weaknesses system conventional banking, so the islamic banking are expected get a freedom in developing own product in accordance with the theory islamic banking (Machmud and Rukmana, 2010:6).

Characteristics of Islamic accounting has many similarities with the concept of accounting in general. Besides having the same purpose, Islamic accounting has also qualitative characteristics of information with the public accounting. The main principle which distinguishes are both is the presence of the rules syariah which must in Islamic accounting. Another difference can be seen in the table as follows:

Table 2.3

Differences Postulate between Conventional and Islamic Accounting

Postulate / Principles	Conventional Accounting	Islamic Accounting
Entities	Separation between business and owner	Entity based on the division profit firm, no duty separate
Going concern	Business continues to operate until the goal is	The viability of business depends on contractual

	achieved	agreement between the parties involved in activities for result
Period	Accounting can not be wait until the end company life for measuring the success of the company	Hijri year for calculation tithe exception agricultural sector based harvest season
Unit	Monetary value measuring	Quantity or price of the market for livestock, agricultural thing and gold to fulfill the duty of tithe
Full Disclousure	For purposes of take decision	To indicate duty God, social, and individual
Objectivity	Confidence in the measuring, that is free of any subjective bias	Such as compassionate characteristic is consciousness that we fill the duty financial and non-financial for blessings God
Materiality	Associated with interest information to take decision	Associated with the measure fair, the fulfillment of the duty to God, Social and Individual
Consistency	Record and report in accordance GAAP	Record and report in consistently based on the principle of sharia
Conservatism	Have accounting techniques most influence small to owner	Have accounting techniques most benefit the community, for example, choosing a lower number great for the payment of tithe

Source: Harahap (2001) in Syahfandi (2012:17-18)

In recent years, the development of Islamic banking shows very rapid progress, both from the aspect of asset growth and diversity of products. At the beginning of the entry of Islamic banking in the country, the development of products that may not be too varied to focus on a contract that was used, is murabaha. Along with the development of Islamic banking today, the variety of products developed by Islamic banking (Bahrul, 2011).

As it is known, banks as financial institutions that perform the intermediation function is required to present the financial reporting are accurate, comprehensive, and reflects the performance of the bank as a whole. One of the requirements in the context of the presentation of the financial reporting are accurate and comprehensive, the financial reporting referred to must be presented in accordance with the applicable financial accounting standards (http://www.bi.go.id, 2013). Similarly, Islamic banking, the financial statements must be prepared in accordance with the applicable accounting standards is PSAK. PSAK governing financial reporting of Islamic banking is that PSAK No. 59, 101-108.

Set of PSAK Sharia latest revision is prepared by the Board of Standards of IAI consisting of the Framework for the Preparation and Presentation of Financial Reporting Sharia, and PSAK 101-108. Versions of PSAK Syariah previous including the PSAK 59 who regulate financial statements Islamic banking has been appear in 2002, according to several analysts, still many reflects the value of-values capitalist which oriented on revenue for interests of owners (Ismail, 2008). Content of PSAK 101-108 Framework for the Preparation and Presentation of Financial Statements Sharia:

Table 2.4

Content of PSAK 101-108

No	PSAK	Description
1	**PSAK 101**	Presentation of Financial Statements Sharia
2	**PSAK 102**	Murabahah Accounting
3	**PSAK 103**	Salam Accounting
4	**PSAK 104**	Istishna' Accounting
5	**PSAK 105**	Mudharabah Accounting
6	**PSAK 106**	Musyarakah Accounting
7	**PSAK 107**	Ijarah Accounting
8	**PSAK 108**	Islamic Insurance Transactions Accounting

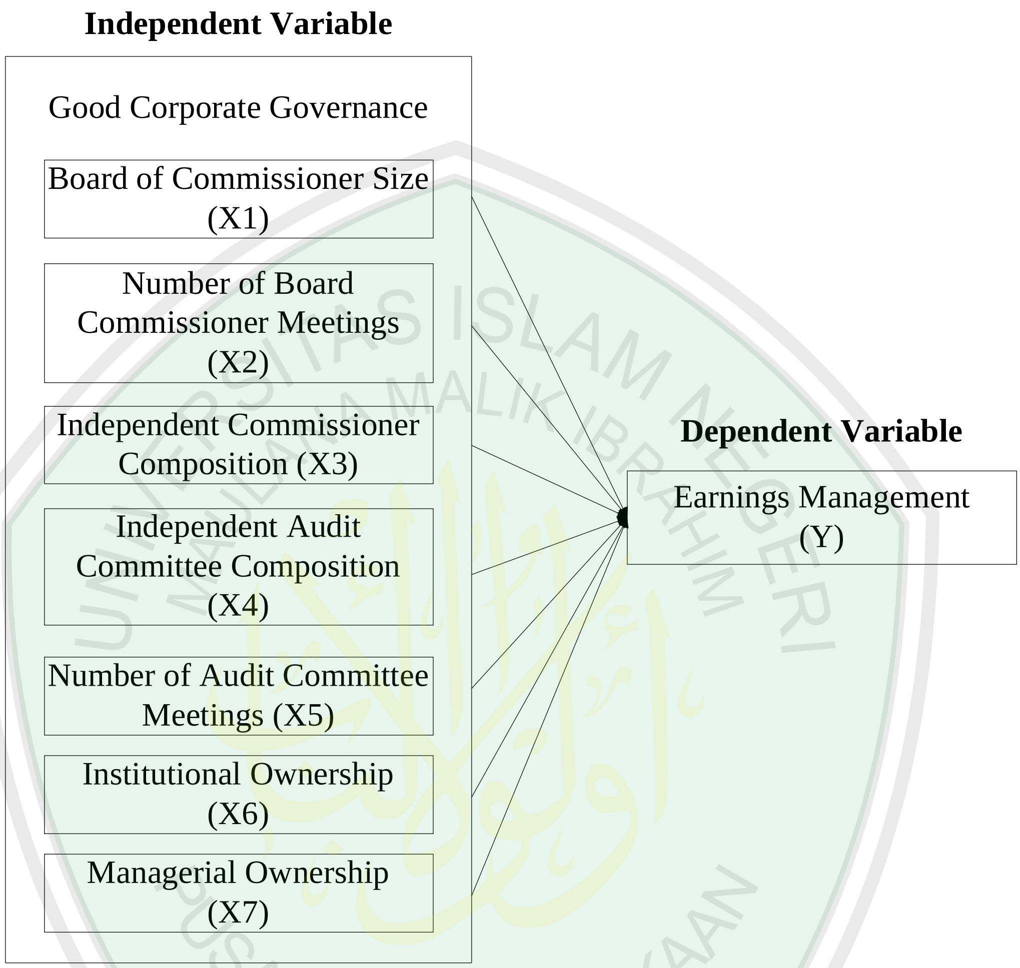
Source: Financial Accounting Standards Board, 2009

2.3. Mindset

Earnings management is a phenomenon that has added to the discourse of the development of accounting theory. Earnings management appear as a direct consequence of the efforts of manager or a maker financial reporting to manage the accounting information, particularly earnings for personal and or company (Kartikasari, 2011:43).

Many of the methods used by management to influence reported earnings that are possible. Empirical evidence indicate that earnings management found in many contexts. This case indicated that the events or certain economic variables related to earnings management (Kartikasari, 2011:43).

Image 2.1
Hypothesis Model



Sources: Figure processed, 2013

2.4. Study Hypothesises

The Board of Commissioners is the core of the implementation of Good Corporate Governance (FGCI, 2001 in Suhardjanto and Dewi, 2010:108). According to Subhan (2012:22), the board of commissioners size influence of no significant positive on earnings management. Wedari (2004) in Kartikasari (2011:44) in her study found that an independent commissioner will limit earnings management activities. The number of large commissioners are expected to minimize the practice of earnings management at the bank, the hypothesis 1 in this study is:

H_1: The board of commissioner size has an influence to the earnings management practices

The Board of Commissioners held a meeting the board of commissioner in carrying out their duties. The more the frequency of meetings held by the board of commissioner will increase the performance of the company (Vafeas, 2003, Brick and Chidambaram, 2007 and Ettredge, et al, 2010 in Suhardjanto and Dewi 2010:109). In Central Bank Regulation. 11/33/PBI/2009 on Implementation of Good Corporate Governance for Islamic General Banks and Islamic Business Units, the board of commissioner shall be held at least 1 (one) time in 2 (two) months. Based on the above, the second hypothesis:

H_2: The number of the board of commissioners meetings have an influence to the earnings management practices

Xie, et al (2001) in Siswantaya (2007:30) finds that independent commissioner and active audit committee and have the financial knowledge may be an important factor in the prevention of the tendency for managers conduct earnings management. In study of Siswantaya (2007:58), concluded that an independent commissioner has no influence significane on earnings management. The more independent the board of commissioner is expected to minimize the practice of earnings management. Based on the above, the hypothesis 3:

H_3: The independent commissioners composition has an influence to the earnings management practices

Central Bank Regulation No. 11/33/PBI/2009 on Implementation of Good Corporate Governance for Islamic General Banks and Islamic Business Unit, audit committees formed by the Board of Commissioners in order to support the effective implementation of the duties and responsibilities in supervising banks. Siswantaya (2007:58), disclose to the audit committee did not influence of earnings management. Nasution and Setiawan (2010) in Suhardjanto and Dewi (2010:109) revealed that the independent audit committee has a positive influence on company performance. The more independent audit committee, is expected to effect of the earnings management practice. Based on the description, this research formulate hypothesis 4:

H_4: The independent audit committee composition has an influence to the earnings management practices

In carrying out the duties, the audit committee do committee meeting three to four times a year (FCGI, 2001 in Suhardjanto and Dewi, 2010:109). According to Li, et al (2008) and Ettredge, et al (2010) in Suhardjanto and Dewi (2010:109), the frequency of audit committee meetings has a positive influence on disclosure. The more frequent audit committee meetings are expected to influence the earnings management practice. Based on the description, this research formulate hypothesis 5, stated as follows.

H_5: The number of the audit committee meetings has an influence to the earnings management practices

Jiambalvo et al (1996) in Kartikasari (2011:44) found that the absolute value of discretionary accruals is negatively related to institutional investor ownership. According Siswantaya (2007:57), institutional ownership influence of no significant on earnings management. This means that the mechanisms of institutional ownership fails to limit the practice of earnings management. Thus hypothesis 6 in this study is:

H_6: Institutional ownership has an influence to earnings management practices

Midiastuty and Mahfoedz (2003) in Kartikasari (2011:45) declare that managerial ownership is one of the mechanisms that can be applied to limit opportunistic behavior of managers in the form of earnings management. However, Siswantaya (2007:57) concludes that managerial ownership has no significant influence to the earnings management. This means that the mechanism of managerial ownership fails to limit earnings management practices conducted management. Based on the theory hypotheses 7 is formulated as follows.

H_7: Managerial ownership has an influence to the earnings management practices