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The role of investor protection in corporate governance and accounting harmonization: Cross-country analysis in Asia

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A R T I C L E I N F O

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A B S T R A C T

The purpose of this research is to analyze the effect of law system for investor protection on implementation of corporate governance at company level and degree of convergence of local accounting standards to IFRS (International Financial Reporting Standards). The result shows that investor protection has positive effect on implementation of corporate governance and degree of convergence of local standard to IFRS. The evidence is consistent with the argument that firm can establish law environment well for their own, but the quality of corporate investor protection via implementation of corporate governance mechanisms will depend on efficiency of judicial system of the country where the firm operates; and the quality of accounting standard in one country is a signal of country's commitment to investor protection in order to provide good protection for its investor; a country will tend to adopt higher quality of accounting standard to ensure financial reporting transparency. This indicates that investor protection can be the key to the quality of other governance mechanisms, both at institutional level such as accounting standards, and also at firm level such as corporate governance implementation.

A B S T R A K

Tujuan penelitian ini adalah untuk menganalisis pengaruh sistem hukum untuk perlindungan investor pada pelaksanaan tata kelola perusahaan pada tingkat perusahaan dan tingkat konvergensi standar akuntansi lokal untuk IFRS (International Financial Reporting Standards). Hasil penelitian menunjukkan bahwa perlindungan investor memiliki efek positif pada pelaksanaan tata kelola perusahaan dan tingkat konvergensi standar lokal untuk IFRS. Bukti ini konsisten dengan argumen bahwa perusahaan dapat membangun lingkungan hukum baik bagi mereka sendiri, tetapi kualitas perlindungan investor perusahaan melalui penerapan mekanisme tata kelola perusahaan akan tergantung pada efisiensi sistem peradilan di negara tempat perusahaan beroperasi; dan kualitas standar akuntansi di satu negara adalah sinyal komitmen negara untuk perlindungan investor dalam rangka memberikan perlindungan yang baik kepada investor tersebut; negara akan cenderung mengadopsi kualitas yang lebih tinggi dari standar akuntansi untuk memastikan transparansi pelaporan keuangan. Hal ini menunjukkan bahwa perlindungan investor dapat menjadi kunci untuk kualitas mekanisme pemerintahan lainnya, baik di tingkat kelembagaan seperti standar akuntansi, dan juga di tingkat perusahaan seperti pelaksanaan tata kelola perusahaan.

1. INTRODUCTION

In financing a firm, an investor usually gets rights and particular authority protected by law through law enforcement. If a firm breaches that right, fund provider can charge firm at justice to get right for it (Shleifer and Vishny 1997). There are some differences in corporate governance system across country because of different law and enforcement gives different provision for firm in giving protection to investors. Protection to right of stockholder is very important because in many countries, expropriation of minority shareholders' right by majority is so frequently done.

La Porta et al. (2000) indicate that country jurisdiction approaches to corporate governance is the main key of corporate governance mechanisms

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which is the protection to extern investor (stockholder and creditor) trough law system which cover regulation and its enforcement. Therefore, investor protection is the main key for corporate governance implementation in country level. Previous researches define investor protection in to several elements. La Porta et al. (1997, 1998 and 2006) articulate the basics about how protection for investor is done which is via countries' law tradition, corporate law, and capital market law.

Besides, law system in the country can also affect the quality of standard, particularly accounting standard adopted by that country. Countries that have better law system concerning investor protection tend to make a standard that protects stockholders' rights. Hope et al. (2006) declare that country that gives good protection to its investor tends to adopt higher quality of accounting standard to ensure financial reporting transparency. The level of harmonization of accounting standard in a country is determined by prevailing law system at that country. Hope et al. (2006) also declare that international accountings standard adoption in a country constitutes a signal of commitment to increase protection for investor.

This research aims to analyze the effect of law system on the investor protection in implementation of corporate governance and degree convergence of local accounting standard of a country to IFRS (International Financial Reporting Standards). This is motivated by La Porta et al. (2000) and Hope et al. (2006) who conceptually stated that investor protection is the key of institutional mechanisms in a country in the mechanisms related to corporate governance and implementation of international accounting standards. Furthermore, this research extends La Porta et al. (2000) and Hope et al. (2006) by empirically test the relationship between investor protection and corporate governance mechanism in firm level and the convergence of international accounting standards.

This research is expected to provide several contributions. First, it provides evidence how the investor protection can be the key factors to determine the quality of governance in a country and how the quality of financial reporting is reflected in the convergence level of country's accounting standards to international standards, which has not been tested previously. Second, this research gives contribution about the effect of legal system to implementation corporate governance at firm level and accounting standard convergence to international standard in the context of Asian countries. Previous research on investor protection and IFRS adoption usually used perspectives from developed market such as Europe and America. There is only limited research that used Asia as a context.

This research is done in the context of Asian countries consisting of Hong Kong, India, Indonesia, Japan, Korea, Malaysia, Philippine, Singapore, Taiwan, and Thailand. These countries represent the diversity in law and accounting standard in Asian. Empirical evidence of this research will give interesting picture of legal system and accounting standard in Asia. It contributes to a practical implication to the implementation of corporate governance and adoption of international accounting standards.

Third, this research gives methodological contribution by using different measurement of IFRS convergence. Previous research measure the IFRS adoption by using an indicator variable whether a country has fully adopted IFRS or not without considering the level of convergence of the local standards to IFRS. This research measure the IFRS convergence by scoring the degree of convergence of local accounting standards to IFRS based on 32 accounting standards. By using this measurement, this research can capture the different levels of adoption between countries.

There are several reasons why this research is important. Despite of the contributions mention above, there are some benefits in it. First, this research is important in the era of IFRS adoption especially in Asia countries, which used two major approaches in IFRS adoption, big bang approach or convergence process approach. By investigating the effect of investor protection on degree of convergence to IFRS, this research provide evidence how the legal system of a country effect the level of convergence of local standards to IFRS.

Second, this research is also important because it uses Asia as the setting. Asian Economic Crisis that happened in 1997 to the early of 2000 has lowered the economic growth of the countries. The speed of recovery varies between countries. Some previous researchers said that corporate governance play an important role in the recovery process. By investigating the effect of investor protection on corporate governance implementation, this research gives insight to improve the corporate governance implementation quality the regulator must focus on the legal system of investor protection.

Third, this research is also important for countries in Asia that face several free trade agreements, because governance, transparency, and legal protection to investor are the key success to increase

the cross border investment in the free trade era. By using 2004 and 2006 as the year of observation, this study may provide evidence of the effect of investor protection on the CG mechanisms and convergence of IFRS in the early years of IFRS convergence process in the Asia region. IFRS is an international accounting standard that is being adopted in many countries, especially in Asia since 2002. Indonesia itself has started the process of convergence to IFRS in 2004. Therefore, by observing in the period, this study can provide early evidence of how the legal system for the protection against the investor can support the process of convergence of IFRS. As an implication, the results of this study can show how the adoption of the international accounting standards and improvement of the implementation of corporate governance can succeed if supported by the legal system at the country level through the protection of investors.

2. THEORETICAL FRAMEWORK AND HYPOTHESES

Investor Protection

The investors have some right protected by law. These rights, among others, are related to information disclosed by the company, dividend distribution in fair proportion, vote in board elections, participation in meetings of shareholders, the purchase of new securities, and the legal prosecution of insider of the company over alleged expropriation, and call extraordinary shareholders' meeting (La Porta et al. 2000). If companies violate the rights, the funds providers could sue companies to the court to get their rights (Shleifer and Vishny 1997). There are some differences in corporate governance systems in many countries because of differences in legal system which are owned by the company to the funds providers and the differences in interpretation and implementation of laws and regulations of the relevant parties (such as the court, policy, attorney, law maker, etc).

Protection of shareholders' rights is very important because in many countries, expropriation of minority shareholders by controlling shareholders is very frequent. Expropriation is very detrimental to the company's stakeholders, whether investors, creditors, employees environment, and economy of the country in general. In the end the expropriation could damage the financial system functions.

La Porta et al. (2000) state that the primary key of the corporate governance mechanism is protection to outside investors (both shareholders and creditors) through the legal system which includes aspects of regulation and law enforcement aspects. Investor Protection is a legal system that covers rules, regulation, and enforcement to protect the rights of minority investor. La Porta et al. (1997, 1998 and 2006) articulate basics about how protection for investor that is done via countries' law tradition, corporate law, and capital market law.

Law tradition of a country is a basic legal form of a country in establishing a system of law. Basic law tradition of a country is classified based on country's legal origin. La Porta et al. (1997) classified legal origin into two major groups, namely common law and civil law. The fundamental difference of the two legal traditions lies in the establishment of the legal system. Civil law uses acts and regulation as the primary tools in regulating the legal materials. In civil law the establishment and implementation of laws and regulations was made by the law expert such as law maker, police, attorney, and prosecutor. The common law is created by judges based on the result of a specific legal dispute and it is stipulated by previous judicial decisions.

La Porta et al. (1998) showed a common law country has better protection to minority shareholder than in civil law country. This is due to differences in legal philosophy in the two groups. In common law countries, judges can interpret legal principles are widely available, so it can perform authorization to make regulations that prohibit various forms of expropriation. Judicial explanation of why common law countries provide better protection for investors than civil law countries is explained by Coffee (2000) and Johnson et al. (2000b). The rule of law in common law countries is usually made by judges based on the general principles of justice. In this system the judge can use the principles to make decisions that have not or even prohibited in their statute. In the case of expropriation of investors, the judge can do what is called by Coffee (2000) as the 'smell test' to evaluate whether outside investors aggrieved from expropriation that has never happened before.

Yet, in the state that is based on civil law, because the legal arrangement is under any law, act or regulation, the parties conducting expropriation can use a legal loophole if the law does not address the problems faced by investors. In addition, the law is often formed based on the interests of certain parties who have great power so that the protection of minority investors is less attention. In the legal system, judges are not allowed to act outside the law, so that people in the company can find a way that is not explicitly prohibited in the regulations when making the expropriation of minority investors.

Other Investor Protection mechanism is related to corporate law and its enforcement. This mechanism is measured by anti-director rights and law enforcement. Measurement variable of anti-director rights explained how strong legal system of a country protect minority shareholder from manager or majority shareholder in decision-making process, including in the process of voting. On the other hand, variable law enforcement explained the quality and how law enforcement is done effectively in a country. Law enforcement is part of Investor Protection mechanism which is very important because it can substitute legal weakness of a country.

La Porta et al. (1997 and 1998) measure the anti-director rights by using the index established based on the commercial code, which consists of several aspects of investor protection that includes(i) the ability to vote by mail; (ii) the ability to gain control of shares during investors' meetings; (iii) the possibility of cumulative voting for directors; (iv) the ease of calling an extraordinary investors meeting; (v) the availability of mechanisms allowing minority investors to make legal claims against the directors; and (vi) the presence of shareholders' preemptive rights that can be waived only by a shareholders' vote (La Porta et al. 1997: 1134). On the contrary, law enforcement variable comprises the measurement of four elements, namely:. (I) the efficiency of the judicial system, (ii) the rule of law, (iii) corruption, and (iv) risk of expropriation (La Porta et al. 1998: 1124-1125). Efficiency of judicial system and rule of law reflects the quality of law enforcement that is running in a country, while corruption and expropriation risk reflects the constraint from the government for companies to do business.

In addition, La Porta et al. (2006) also explain that Investor Protection mechanism work through capital market law (securities law). Fundamental factors from capital market law that form Investor Protection mechanism are disclosure requirements, litigation standards, and public enforcement. Disclosure requirement is about the completeness of disclosure on corporate prospectus. Litigation standard is level of procedural difficulty for litigation of loss due to mistake in firm's prospectus and financial statements. In this case, public enforcement is a power of securities commission, central bank, or other regulatory bodies in capital market. This measure covers characteristics of securities commission, power in law making, and power in doing the investigation, power in giving sanction such as suspending stock trading, and giving criminal sanction if financial statements don't disclosed material information.

Corporate Governance

It is not sufficient to minimizing agency conflicts and the opportunity to expropriate minority shareholders only based on legal system of investor protection at the country level. Various provisions of the law on investor protection in a country are not entirely binding. This is due to the flexibility at company level to choose the adoption level of the provision. A company may adopt at the level or lower level provisions, or may even voluntarily adopt additional provisions which were not mandated by its legal system with the aim to provide value added for its stakeholders (Easterbrook and Fischel 1991; Black-Gilson 1998). Therefore there is a possibility that a company in a country with the same law enforcement would provide different investor protection (Klapper and Love 2004). This shows that the company will implement the corporate governance at a certain level in accordance with the internal conditions. Furthermore, it will affect the quality of reporting of information generated by companies' management.

Corporate governance applied by firm is basically intended to settle agency problem (Jensen and Meckling 1976). Blair (1995) defines corporate governance as overall as structure legal, culture, and institutional which constitute: (i) what can be done by public firm; (ii) who deserved restrains firm; (iii) how firms operate; and (iv) how firms allocate the risk and return (Darmawati 2003, in Siregar 2005). Organization for Economic Co-operation and Development (OECD) has developed principles of corporate governance that being followed by many countries in the world. OECD already publishes and Principles of Corporate Governance that consist of four main pillars which is fairness, transparency, accountability, and responsibility (Darmawati 2003, in Siregar 2005).

Klapper and Love (2004) prove that legal environment related to protection to investor at a country will influence implementation of corporate governance at corporate level. If legal system at country level offers poor protection for its investor, it would be expensive for firm to adopt different provision from corporate law rule. This is because of the firm that must make different contract that non standard (one that not regulated by corporate jurisdictional in that country). Therefore, firm in a country that has poor legal environment will have limited ability to increase protection for its investor, and hence will have low score of corporate governance.

Based upon above argument, it can be summarized that legal environment and law enforcement

at a country level will influence firm decision in implementation of corporate governance. The better law environment at a country level, the more demand in applying corporate governance principles will excelsior. Thus, in this research it is preconceived that investor protection has positive effect to implementation corporate governance on corporate level.

Hypothesis that is proposed is as follows:
Hypothesis 1: Country's investor protection score has a positive effect on corporate governance index.
Hypothesis 1 is built by considering other factors that influence the implementation of corporate governance on corporate level. Other factors which are chosen as control variables in the test are: (i) Logarithm of Total Asset (LTA); (ii) Sales Growth (GROWTH); (iii.) Ratio of Property, Plant, and Equipment to sales (PPESALES); (iv.) standard deviation of stock return (STDRET); (v) previous period performances (PRIORROE); (vi) dummy variable for regulated industry (DREG); (vii) dummy year (DYEAR); and (viii) dummy country (DCOUNTRY).

LTA is used to control the impact of company size on the level of implementation of corporate governance. The argument is that large companies tend to have a more complex agency problem, so that the mechanisms tend to require more stringent corporate governance (Klapper and Love 2004). GROWTH reflects the company's growth opportunities in the future. The company that is experiencing high growth tends to require external financing for expansion purposes. For that reason, the company will seek to create mechanisms for optimal corporate governance to facilitate in obtaining financing (Klapper and Love 2004). Several previous studies use *Price to Book Value* or *Price Earnings Multiple* as a proxy for growth opportunities. This study did not use that proxy measure because it has consequences of sample deletion for sample with negative income or a negative book value. In addition, Price Book Value ratio or Price Earnings Multiple is a noisy measurement because of many factors that affect this measurement. For this reason, a growth opportunity is proxy by growth in sales.

PPESALES used to control the impact of asset composition. This variable measures the relative importance of fixed capital in the firm's output. Companies that have a composition of intangible assets greater than the tangible assets will require governance mechanisms more stringently. This is due to the ease of controlling the tangible assets compared to intangible assets (Klapper and Love 2004). STDRET is a variable that measures the volatility of the company's stock price. Demsetz and Lehn (1985), in Bushman et al. (2004), state that the magnitude of stock price volatility will increase monitoring costs. Increasingly high cost of their monitoring, implementation of corporate governance will be increasingly needed. PRIORROE control the impact of past performance on the mechanisms of corporate governance. Hermalin and Weisbach (2002), Himmelberg et al. (1999), and Kole (1996), in Bushman et al. (2004), states that the board composition and managerial ownership as part of corporate governance mechanism is influenced by the performance of companies in the past. Companies who have good past performance will strive to maintain the performance and communicate their performance, through the implementation of good corporate governance.

DREG is the classification of regulated and unregulated industries which reflect differences in the implementation of corporate governance in regulated and unregulated industries. Companies operating in regulated industries that are bound by government regulations that govern the mechanisms of corporate governance that must be met by the company. Therefore, the implementation of corporate governance in companies that should be better regulated than unregulated firms. In this case, DYEAR is a dummy variable for year, with 2006 as reference year. Then, to control the heterogeneity of corporate governance throughout the country then used dummy variables for countries (DCOUNTRY). DCOUNTRY is a dummy variable for each country in the sample, with the Indonesian state as reference state.

Degree of Convergence of Local Accounting Standard with IFRS

With the higher demand of international trading and capital market growth, the need of international accounting practices also increases (Abu-Ghazaleh 1986). International accountings standard will increase comparability of financial statement and it will be more reliable (Aljifri and Khasharmeh 2006). Therefore, the requirement of accounting harmonization gets bigger. To answer the need of international accounting standard, on year 2000 International Accounting Standards Committee (IASC), one that on year 2001 was changed to International Accounting Standards Board (IASB), for harmonization to standard by published International Accounting Standards (IASs), which now is International Financial Reporting Standards (IFRSs).

IFRS has been applied by a number of coun-

tries around the world, with different level of adoption. Adopting IFRS can be done in five levels which are: (i) *full adoption*, where a country adopts all IFRS and translates it with word by word; (ii) *adapted*, where a country adopts all IFRS with several adjustment by condition a state; (iii) *piecemeal*, where a state adopts several IFRS for a certain number of standard and chooses paragraph most indeed; (iv) *referenced*, where a state makes IFRS as reference information standard which is made by local standard maker; and (v) *not adoption at all*, where a state not at all adopts IFRS (Accounting media (2005), in Panggabean (2007)).

The process of financial information reporting is much determined by the applicable accounting standards. Accounting standards in a country will determine the quality of financial information, particularly related to income information produced by companies. Adoption of IFRS as reporting standards ensures high quality of financial reporting, because it is based on international standards supported by the IASB as standard setter with world-class competence. But on the other hand, the adoption of IFRS may not be able to accommodate the special characteristics of a country. This occurs because the IASB as standard setter IFRS has members that are mostly well-developed countries. Therefore, IFRS are not always entirely appropriate when applied in countries that have different characteristics with well-developed countries, so the adoption of IFRS should be tailored to the characteristics of the country for the harmonization process to accommodate different characteristic across countries.

IFRS is basically a principles based on standards. The excellence of principles-based standards over rule-based standards is that company able to implement corporate accounting standards in accordance with the special characteristics so that the resulting financial reporting will better reflect the economic value of the company. Ashbaugh and Pincus (2001) showed that with increasing convergence of local GAAP against the international standard, the disclosure requirements will be higher and restrictions in choices of accounting methods will also get larger. Additionally, Barth et al. (2007) stated that by using IFRS, accounting quality can be improved by eliminating alternative accounting method that is less to reflect the company's performance and that can be used to manage earnings.

The fact is that a better legal system in investor protection tends to make a standard and it can still provide a better protection to investor. IFRS constitutes international accounting standard that more reputed superior as compared to another accounting standard (Ashbaugh and Pincus 2001; Gassen and Sellhorn 2006; Barth et al. 2007; Meulen, Gaeremynck, and Willekens 2007). Beatty et al. (1996) declare that purpose IFRS will increase financial reporting transparency, so investor will react positively.

Daske et al. (2007) examined the economic consequences of the use of IFRS that is mandatory for companies around the world. Their research proved that the use of IFRS is useful for countries that have strict enforcement regimes and well institutional environment that provide incentives for good reporting. In addition, their study also showed that the positive impact is weakening in conditions where local GAAP in some countries have approached the IFRS. In general, they conclude that the capital market economically beneficial with the mandatory implementation of IFRS. However, these results may be affected by improvements in law enforcement and governance in this country to support the implementation of IFRS in financial reporting. Thus, this study concludes that the quality of financial reporting formed by many factors is related to the institutional environment in a country specifically factors that related to reporting incentive, law enforcement, and accounting standard.

Meanwhile Hope et al. (2006) declare that states that have high commitment to investor protection will tend to adopt IFRS. They stated that the adoption of IFRS in a country is a signal of commitment to improve protection for investors. Therefore, the protection of investors will affect the quality of earnings indirectly through the process of establishing accounting standards.

Argument that is proposed in this research is that a state that have good law environment and gives better investor protection will encourage the convergence of international accounting standard to establish the better standard, which is via convergence with IFRS. Base on that argument, therefore investor protection will positively affect degree of convergence of GAAP local with IFRS. Hypothesis that is proposed is as follows:

Hypothesis 2: Country's investor protection score has a positive effect on index degree of convergence of local GAAP with IFRS at one particular state.

Hypothesis 1 is built by considering other factors that influence the degree of convergence of local GAAP with IFRS at one particular state. Other factors that are chosen as control variables are: (i) Country Earnings Management (CEM); (ii) Coun-

try Market Capitalization (CMCAP); (iii) Gross Domestic Product per capita (GDPCAP); (iv) dummy year (DYEAR); and (v) dummy country (DCOUNTRY).

CEM is the average value of the absolute value of discretionary accruals for all companies listed on the stock in a country (outside the companies included in the financial industry, real estate, and property). This variable is a proxy of the extent to which people can behave in an opportunist in a country. If the level of earnings management is high, then people in to take personal advantage without being noticed. To limit the personal benefit, from the perspective of the country, high levels of earnings management will encourage countries to adopt better accounting standards through convergence of IFRS as a mechanism to limit earnings management (Renders and Gaeremynck 2005).

The use of CEM variable in estimating the effect of protection for investors against the level of convergence of local GAAP to IFRS is assumed that the CEM is an exogenous variable. Use of this assumption contains a weakness that is the possibility that the CEM is influenced by the quality of corporate governance in both state and corporate level. This study did not consider the possible problems of bias on this variable, and suggested this problem to be investigated in further research.

The second control variable is the scale CMCAP to GDP. These variables are selected based on the view that capital markets are developed (well-developed) usually require a high level of disclosure (Jaggi and Low 2000, Renders and Gaeremynck 2005), so the level of convergence with IFRS tends to be higher. The third control variable is GDPCAP which reflects the level of welfare or a country's economic growth. Countries with advanced economies will seek to attract foreign investment and encourage domestic companies to seek funds from foreign parties. Therefore, the more advanced a country, the higher the level of convergence with international standards (Jaggi and Low 2000, Renders and Gaeremynck 2005). In addition, DYEAR is a dummy variable for this year, with 2006 as reference year. Then, it is to control the heterogeneity of corporate governance throughout the country by using dummy variables for countries (DCOUNTRY). DCOUNTRY is a dummy variable for each country in the sample, with the Indonesian state as reference.

3. RESEARCH METHOD

Data Source and Sample Selection

This study observes the effect of investor protection on the corporate governance and IFRS convergence within the period of 2004 and 2006. This period provides early evidence on how the relationships arise in the period of early adoption and convergence process of IFRS in many countries in Asia. Some countries started to fully adopt or partially adopt IFRS in this period, and many others are still in the early process of convergence, such as Indonesia. Data and data source in this research is as follows: (1) firm's financial data taken from ORISIS data based, stock exchange web site and firm web site for the period of 2004 and 2006; (2) investor protection data that consisting of: legal tradition, corporate law & enforcement, and securities law; (3) Data corporate governance index from Credit Lyonnaise Securities Asia (CLSA) corporate governance survey report (CG Watch Report 2005 and 2007, to capture the CG condition of 2004 and 2006); (4) data on degree of convergence of local GAAP with IFRS, measured level of convergence among local accounting standard a state with IFRS based on similarities and differences of local GAAP to IFRS in 2004 and 2006 publish by Big 4 Accounting Firms.

Data are still relevant nowadays because the legal system of investor protection, corporate governance implementation, and level of convergence of local standards to IFRS did not change significantly from period used in this study to the date. If there are changes in these variables, these changes tend to be in line together. Based on this fact, the finding from this research which based on the estimation using this period of data will be still relevant to the date. This time frame is used by this research because many countries in Asia that used the convergence process approach in adopting IFRS starts to change the local standards and converge to IFRS. By using this time frame we can capture the varieties among countries in adopting IFRS.

Sample criteria are: (1) companies listed in stock exchange at ten states in Asian which is: Hong Kong, India, Indonesia, Japan, Korea, Malaysia, Philippine, Singapore, Taiwan, and Thailand; (2) firm that is covered by CLSA CG Watch 2005 and 2007; (3) Excluding financial industrial (bank, leasing, and insurance), real estate, and property; (4) there are data completeness for period 2004 and 2006.

Research Model

The Model to test the effect of investor protection on corporate governance implementation is presented in Model 1 and Model 2 and the description of variables in Table 1.

Table 1
Variable Description

Variables	Description
IP	Score of investor protection which consist of legal origin, corporate law & enforcement, and securities law.
GOV	Corporate governance index
IFRS	Score of degree of convergence of local GAAP with IFRS
LTA	Natural Logarithm of Total Assets
GROWTH	percentage of sales growth from previous year
PPESALES	Ratio of total property, plan, & equipment, divided by total net sales
STDRET	Standard Deviation of monthly return in one year
PRIORROE	Income before extraordinary items and discontinued operation divided by total equity in the year of t-1
DREG	Industry Dummy with value of 1 if company is included in regulated industry and 0 if other. Included as regulated industry are oil and gas, telecommunication, and utilities. This industry classification based on two digit of SEC Code.
CEM	Country Earnings Management, The average value of all corporate earnings management in a country
CMCAP	Total value of market capitalization on the stock of a country divided by the value of GDP
Log GDPCAP	Natural Logarithm of level of GDP per capita in one country
DYEAR	Dummy variable which stands 1 for observation of year 2006 and 0 for other
DCOUNTRY	Dummy variable which stands 1 for country related to the observation and 0 for other, Indonesia as reference

Model 1

$$GOV_{i,t} = \gamma_0 + \gamma_1 IP_{i,t} + \gamma_2 LTA_{i,t} + \gamma_3 GROWTH_{i,t} + \gamma_4 PPESALES_{i,t} + \gamma_5 STDRET_{i,t} + \gamma_6 PRIORROE_{i,t} + \gamma_7 DREG_{i,t} + \gamma_8 DYEAR_{i,t} + \gamma_9 DCOUNTRY_{i,t} + \varepsilon_{i,t} \quad (1)$$

Research hypothesis can be presented in statistical form as follows: H1 : $\gamma_1 > 0$. Expectation for each one control variable is as follows: $\gamma_2 > 0$; $\gamma_3 > 0$; $\gamma_4 < 0$; $\gamma_5 > 0$; $\gamma_6 > 0$; $\gamma_7 > 0$; $\gamma_8 \neq 0$; $\gamma_{9-17} \neq 0$.

The Model to test the effect of investor protection on degree convergence GAAP locals with IFRS as follows:

Model 2

$$IFRS_{i,t} = \delta_0 + \delta_1 IP_{i,t} + \delta_2 CEM_{i,t} + \delta_3 CMCAP_{i,t} + \delta_4 Log\ GDPCAP_{i,t} + \delta_5 DYEAR_{i,t} + \delta_{6-14} DCOUNTRY_{i,t} + \varepsilon_{i,t}. \quad (2)$$

Research hypothesis can be presented in statistical form as follows: H2 : $\delta_1 > 0$. Expectation for each one control variable is as follows: $\delta_2 \neq 0$; $\delta_3 > 0$; $\delta_4 > 0$; $\delta_5 \neq 0$; $\delta_{6-14} \neq 0$.

Operational Definition of Variables

Investor Protection

Investor protection is measured by legal tradition, corporate law and enforcement, and securities law (La Porta et al. 1998, 2006). Corporate law and enforcement consists of two components namely the anti-director rights index and rule of law. Value of index for the investor protection is the sum of the values for each of the four components of investor protection. Those components are assessed by giving the value 1 for countries that are classified as countries with better protection for investors (classified into "high"), and the value of 0 for countries that are classified as countries with poor investor protection (classified into "low"). Thus, the maximum value for a country is four and the minimum value is zero.

Legal origin of a country is measured by dummy variables with value 1 for common law countries and the value 0 for the civil law countries. Since the legal origin is not change trough time, this research uses classification of countries by legal origin based on La Porta et al. (1998). Common law country is considered as a country that provides good protection for investors ("high" = value 1), and a civil law country is considered as a country that provide poor protection for investors ("low"= value 0).

Corporate law and enforcement is measured by anti-director rights index, which consists of six items such as: the ability to vote by mail, the ability to gain control of shares during investors' meeting, the possibility of cumulative voting for directors, the ease of calling an extraordinary investors meeting, the availability of mechanism allowing minority investors to make legal claims against the directors, the presence of shareholders' pre-emptive rights that can be waived only by a shareholders' vote. Anti-director rights are usually regulated in the corporate act of the country. This regulation is also not change in time. Like the legal origin, this research also used classification of countries by anti-director right based on La Porta et al. (1998). A country is considered as a country that provides good protection for investors ("high" = value 1) if the country's anti-director rights index is above or equal to median value, and poor protection for investors ("low" = value 0) if the country's value of

Table 2
Samples Selection Procedures

The number of listed companies in 11 countries	10,498
Number of firms surveyed by CLSA in 2004 and 2006	582
Number of companies in China are included in the CLSA survey	(60)
Companies in Finance, Real Estate, and Property Industry	(110)
Company with incomplete data	(82)
Total sample firms	330
Total firms years observation before excluding outlier	660
Excluding observation for outlier	
Model 1	(48)
Model 2	(0)
Total firms years observation	
Model 1	612
Model 2	660

anti-director rights index is bellow than median value.

On the other hand, the law enforcement covers the four aspects (La Porta et al. 1998), namely: (1) *Efficiency of the judicial system*; (2) *Rule of law;* (3) *Corruption;* (4) *Risk of expropriation.* Since the law enforcement in a country tends to vary across time, this study uses value of those four aspects from International Country Risk (IRC) yearly report. Because the report usually capture the previous condition of the country, and to match with CG report this research use 2005 and 2007 report to capture the law enforcement in 2004 and 2006. A country is considered as a country that provides good investor protection ("high" = value 1) if it scores above or equal to median value, and 0 otherwise.

Securities Law includes three aspects of investor protection governed by the laws of capital markets (La Porta et al. 2006), namely: (i) the disclosure requirement; (ii) litigation standards, and (iii) the public enforcement. A country is considered as a country that provides good investor protection ("high" = value 1) if it scores above or equal to median efficiency of the disclosure requirement, litigation standard, and public enforcement, and 0 otherwise.

Corporate Governance

This variable measures the level of implementation of corporate governance at the company level. This study employs corporate governance score developed by the Asian Securities Credit Lyonnais (CLSA), as presented in the CLSA CG Watch 2005 and 2007 report. Since CLSA reports made periodically once every two years, this research uses two separates years of observation, 2004 and 2006. The report use in this research is 2005 and 2007 because it reports the survey result from the previous year. Corporate governance index value from CLSA CG Watch 2005 refers to condition of corporate governance in 2004 and corporate governance index value from CLSA CG Watch 2007 refers to condition of corporate governance in 2006. The score covers management discipline, transparency, independency, accountability, responsibility, fairness, and social awareness.

Degree of Convergence of Local GAAP with IFRS

The variable degree of convergence of local GAAP to IFRS measures the level of similarities of local accounting standards to the international accounting standards. Twenty international accounting standards are employed as a basis for measuring degree of convergence. In measuring degree of convergence, this study uses a scale of 1 to 4 with gradations: (i) there is no equivalent standard of local GAAP (1 point); (ii) there is an equivalent standard in the local GAAP but not the same as IFRS (2 points); (iii) there is an equivalent standard in local GAAP and same with IFRS with certain exceptions (3 points); (iv) and there is an equivalent standards in local GAAP and same with IFRS for all material aspects (4 points).

The degree of convergence is the average score or value of the 20 standards used as mentioned above. This measurement is based on the 2005 and 2007 reports of similarities and differences between of local GAAP to IFRS issued by Big 4 public accounting firms such as Ernst & Young, Pricewaterhouse Cooper, Deloitte, and KPMG (the 2005 report represents the condition in 2004 and the 2007 report represents 2006 condition). The countries used in this research have a variety of degree of convergence of Local GAAP to IFRS. The variety depends on the approach used to adopt IFRS. There are two major approaches to adopt IFRS, big bang approach and gradual adoption approach. For example, Indonesia and some other countries have started the

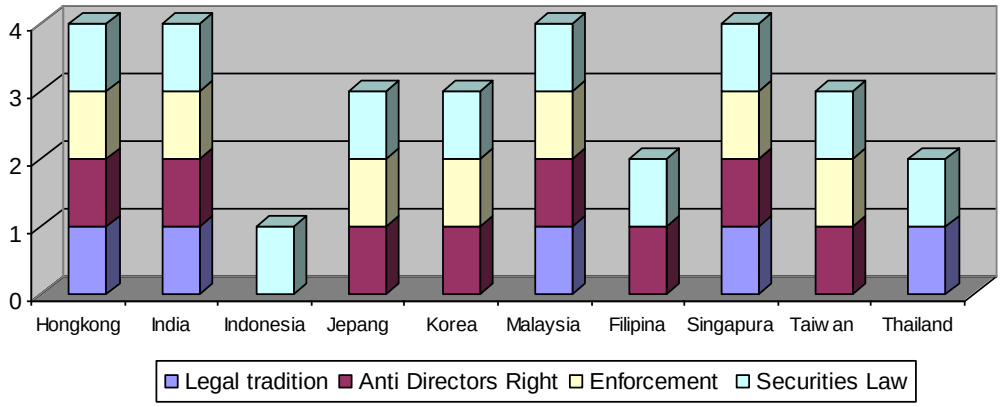


Figure 1
Investor Protection Score by Classification of "High" and "Low" among Ten Countries in Asia

Table 3
Statistic Descriptive of Corporate Governance Implementation among 10 Countries in Asia

Country	Mean		Median		Min		Max		StDev	
	2004	2006	2004	2006	2004	2006	2004	2006	2004	2006
Hongkong	60	60	50	65	24	25	96	92	24	17
India	55	60	49	63	25	30	92	93	18	16
Indonesia	47	47	48	49	16	14	80	72	16	18
Japan	69	72	72	77	40	37	92	94	13	14
Korea	41	46	35	43	22	27	62	65	13	11
Malaysia	58	58	63	62	23	27	76	80	14	14
Philippines	45	48	43	47	20	22	66	69	15	14
Singapore	73	74	76	77	50	50	90	90	11	10
Taiwan	61	63	60	64	31	32	79	80	10	10
Thailand	59	59	60	58	31	30	79	80	13	13

convergence process in 2002. The approach used to adopt IFRS is gradual adoption. Thus, even though Indonesia claimed to adopt IFRS in 2012, the process of adoption actually started from 2002. Some countries like Singapore and Hong Kong used big bang approach to adopt IFRS.

4. DATA ANALYSIS AND DISCUSSION

Sample

Sample selection procedure can be seen in Table 2. It consists of 330 companies. Observation is considered an outlier and is deleted if it is outside the range of the average ± three times the standard deviation for each variable in each research model.

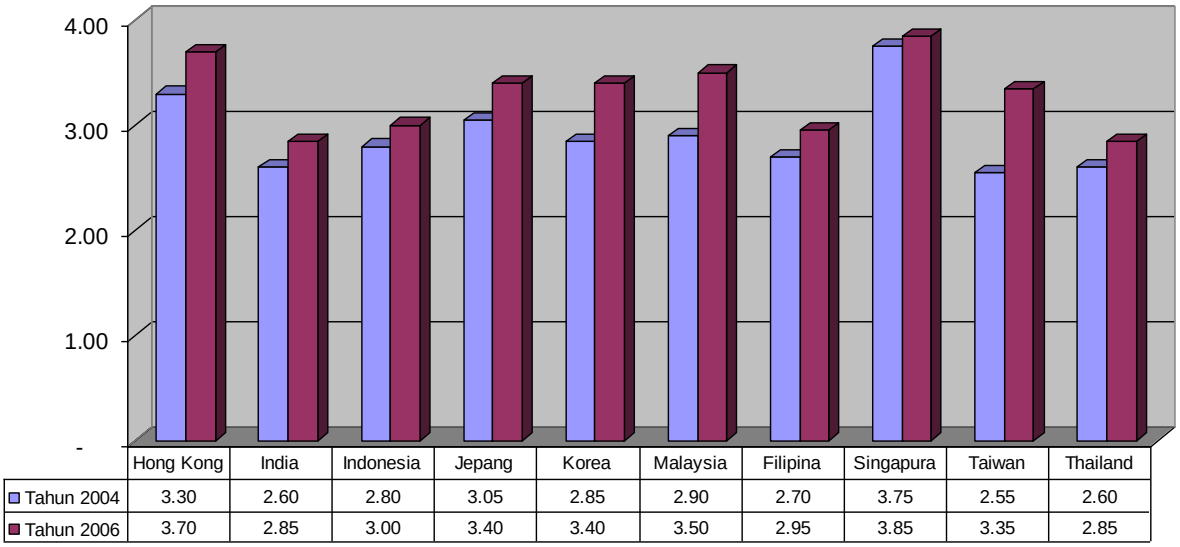
This study got 612 firms in the year of observations for Model 1 and 660 firms in the year of observations for Model 2. The number of sample firms is relatively small compared to the number of listed companies in ten countries covered in this study. However, since the sample firms represent high proportion of total market capitalization, this study concluded that the sample companies fairly represent the stock markets of the countries in this study.

Descriptive Statistic of Investor Protection, Implementation of Corporate Governance, and Degree of Convergence of Local GAAP to IFRS across Countries

In Figure 1, it shows countries with high score of investor protection are Hong Kong, India, Malaysia, and Singapore. These countries are common law countries that have above median score of *anti directors' right*, *law enforcement* and *securities law.* Japan, Korea, and Taiwan that are a civil law country that has above median score of *anti directors' right*, *law enforcement* and *securities law.*

Countries that give poor protection to investor among the 10 countries are Indonesia, Philippine, and Thailand. For Philippines, the score shows that the weakness of investor protection is on the law enforcement and for Thailand the weakness of investor protection is on the regulation about anti directors' right and the law enforcement. Indonesia is the country with the poorest investor protection among ten countries in Asia. The above median score for Indonesia is only in securities law.

Descriptive statistic of corporate governance



	Hong Kong	India	Indonesia	Jepang	Korea	Malaysia	Filipina	Singapura	Taiwan	Thailand
Tahun 2004	3.30	2.60	2.80	3.05	2.85	2.90	2.70	3.75	2.55	2.60
Tahun 2006	3.70	2.85	3.00	3.40	3.40	3.50	2.95	3.85	3.35	2.85

Figure 2
Average of Degree of Convergence of Local GAAP to IFRS among 10 Countries in Asia

Table 3
Statistic Descriptive of Model 1: The Effect of Investor Protection to Corporate Governance Implementation

Variables	Mean	Minimum	Maximum	Std. Deviation	Skewness
LOGGOV	4.045	2.660	4.570	0.319	-1.137
LOGIP	1.077	0.000	1.390	0.370	-1.698
GROWTH	0.259	-0.723	2.046	0.292	2.072
LTA	13.83	8.001	21.06	2.278	0.366
PPESALES	0.672	0.008	4.126	0.681	2.058
STDRET	0.100	0.014	0.337	0.051	1.410
PRIORROE	20.45	-82.93	102.7	17.16	0.705
DREG	Proportion of regulated industry = 32.4%			Proportion of unregulated industry = 67.6%	
Valid N (list wise)					612

Table Information: This table represents a descriptive statistic of each variable used in Model 1. This table aims to give description about central tendency, variance, and data distribution for data used in estimate Model 1. Dependent variable in this model is LOGGOV, which is natural logarithm of corporate governance index. Independent variable in this model is LOGIP which is natural logarithm of score of investor protection. Control Variable in this model is LTA (Natural Logarithm of Total Assets); GROWTH (percentage of sales growth from previous year); PPESALES (Ratio of total property, plan, & equipment, divided by total net sales); STDRET (Standard Deviation of monthly return in one year); PRIORROE (income before extraordinary items and discontinued operation divided by total equity in the year of t-1; DREG (Industry Dummy with value of 1 if company is included in regulated industry and 0 if other, regulated industry is consist of the industry oil and gas, telecommunication, and utilities which the industry classification is based on two digit of SEC Code.

implementation can be shown in Table 3. It shows that companies in Singapore and Japan have the highest average of corporate governance index for period of 2004 and 2006. Country that has the lowest index of corporate governance is Korea for year of 2004 and 2006. Indonesia has the third lowest quality of corporate governance implementation after Korea and Philippine for year of 2004 and 2006. This score has also indicates that Indonesia's firm do not experience of improvement from 2004 through 2006.

Figure 2 shows a descriptive statistic of the average of degree of convergence of local GAAP to IFRS for 2004 and 2006. From Figure 2, it can be found that local GAAP of the sample countries relatively already convergence to IFRS. This reflects from value of average degree of convergence that approach score of three. This means that in average the country has already an equivalent standard in their local GAAP and similar to IFRS, with certain exception such as there are differences in disclosure requirement, measurement alternative, and little different about standard coverage. This figure also shows that Singapore and Hong Kong are countries with highest convergence to IFRS and Taiwan is country with the lowest convergence in 2004 and India is country with the lowest convergence in 2006.

Table 4
Regression Result for Model 1: The Effect of Investor Protection to Corporate Governance Implementation

Model 1
Log GOVi,t = γ0 + γ1Log IPi,t+ γ2LTAi,t+ γ3GROWTHi,t+ γ4PPESALESi,t + γ5STDRETi,t + γ6PRIORROEi,t + γ7DREGi,t + γ8DYEARi,t + γ9-17DCOUNTRYi,t + εi,t
Dependent Variable: Log GOV

Independent Variables	Sign Expectation	Coefficient	Significance	VIF
C	?	***3.0752	0.000	
LOG(IP)	+	***0.1399	0.003	1.96
LTA	+	***0.0654	0.000	1.72
GROWTH	+	***-0.1119	0.004	1.15
PPESALES	-	**-0.0419	0.015	1.42
STDRET	+	***-0.7645	0.001	1.37
PRIORROE	+	**0.0012	0.032	1.19
DREG	+	0.0159	0.463	1.16
DYEAR	+/-	0.0094	0.621	1.07
DCOUNTRY	+/-	DCOUNTRY Variables are included in the model. Dummy countries that has significant coefficient are Korea, Singapore, and Taiwan.		
F test Sign			0.0000	
Adj R Square			0.4857	
N			612	

***Significant at level of 1%
** Significant at level of 5%
* Significant at level of 10%

Table Information: This table represents regression result to estimate Model 1. This table aims to give result of estimation test using data panel analysis using common intercept. Dependent variable in this model is LOGGOV, which is natural logarithm of corporate governance index. The independent variable is LOGIP which is natural logarithm of score of investor protection which consist of legal origin, corporate law & enforcement, and securities law.

The control Variable is LTA (Natural Logarithm of Total Assets); GROWTH (percentage of sales growth from previous year); PPESALES (Ratio of total property, plan, & equipment, divided by total net sales); STDRET (Standard Deviation of monthly return in one year); PRIORROE (income before extraordinary items and discontinued operation divided by total equity in the year of t-1; DREG (Industry Dummy with value of 1 if company is included in regulated industry and 0 if other; DYEAR (Dummy variable which stands 1 for observation of year 2006 and 0 for other); and DOCOUNTRY (Dummy variable which stands 1 for country related to the observation and 0 for other, Indonesia as reference).

The Effect of Investor Protection to Corporate Governance Implementation

Descriptive Statistics

Table 3 and Table 4 point out the data utilized to estimate Model 1. Since the model is found with heteroscedasticity problem, the model is transformed into a log function whereas the dependent variable and main independent variable are transformed in to natural logarithm. Descriptive statistics on Table 1 shows that from scale 1 until 100, average value GOV (anti logarithm of 4.045 = 57.11) showed that in average sample firm has low quality of implementation of corporate governance. Meanwhile, from score of Investor Protection, from scale 0 until 4, average value IP (anti logarithm of 1.077 = 2.93) indicate that on an average ten countries in this study has given quite good investor protection.

Regression Result

Model 1 is regressed to test hypothesis 1. The result can be seen on Table 4. Based on t test on each variable, hypothesis 2 showed that investor protection has a positive effect to index corporate governance. The relationship was accepted on 1% level of significance. This proves the argument that better law environment at a state will enforce the companies to apply principles corporate governance in higher quality. This result is consistent with Klapper and Love (2004) that find positive relationship among judicial efficiency and anti directors' right index as component in investor protection, with ranking corporate governance.

The Effect of Investor Protection on Degree Convergence GAAP Local with IFRS

Descriptive Statistic

Table 5 shows a descriptive statistics for the effect of investor protection on degree of the convergence for GAAP locals with IFRS. Descriptive statistic on Table 5 shows that from measurement scale 1-4, average value of IFRS (anti logarithm of 1.118 = 3.058) indicates that on an average 10 states that at observation in this research has relative accounting standard that is already convergent to IFRS.

Table 5
Statistic Descriptive of Model 1: The Effect of Investor Protection to Degree of Convergence of Local GAAP to IFRS

Variable Names	Mean	Minimum	Maximum	Std. Deviation	Skewness
LOGIFRS	1.118	0.940	1.350	0.127	0.168
LOGIP	1.069	0.000	1.390	0.398	-1.298
CEM	0.009	0.000	0.026	0.008	0.871
LOGGDPCAP	8.716	6.420	10.50	1.412	-0.179
CMCAP	0.365	0.059	1.819	0.340	2.398
Valid N (listwise)					660

Table Information: This table represents the descriptive statistics of each variable used in Model 1. The purpose of this tab le is to give an idea about the condition of central tendency, spread, and distribution of the data used in estimating Model 1. The dependent variable in this model is LOG IFRS. The independent variable in this model is LOGIP. Yet, other independent variabl es used as control variables are the CEM, GDP, CMCAP, and Log GDPCAP.

The operational definition of each variable is as follows: (i) LOGIFRS: Natural Logarithm of score of degree of convergence of local GAAP with IFRS; (ii) LOGIP: natural logarithm of score of investor protection which consist of legal origin, corporate law & enforcement, and securities law, (iii) CEM: The average value of all corporate earnings management in a country, (iv) CMCAP: Total value of market capitalization on the stock of a country divided by the value of GDP, (v) Log GDPCAP: Natural Logarithm of level of GDP per capita in one country.

Regression Result

To test hypothesis 1, this study uses regression of Model 1. The result can be seen on Table 6. Based on t test on each variable, hypothesis 2 is accepted, showing that investor protection has a positive effect on the index of degree of convergence GAAP local with IFRS at one particular state at 1% level of significance. It is means that a state with good law environment gives high protection for its investor will encourage standards setter to establish the better standard, which is via convergence with IFRS. This result is consistent with Hope et al. (2006) that state with good protection for its investor will tend to adopt accounting standard that ensure financial reporting transparency.

Discussion and Analysis

This research provides empirical evidence on the positive effect of investor protection on the quality of corporate governance. It is consistent with Klapper and Love (2004), because it also proves that the legal environment related the protection of investors in one country across Asia also affect the application of corporate governance at the company level. If the legal system offers a weak protection for investors, it is expensive for companies to adopt different provisions of the law because it means that the company must make a non-standard contract (which is not regulated in the law of the country). Therefore, the company in a country that generally has a weak legal environment will have limited ability to increase protection for the investor, and therefore will have a lower value of corporate governance. Klapper and Love (2004) showed that companies that are in a country that has a weak legal system, on average, have lower ranking governance.

These results also support the theoretical arguments proposed by Shleifer and Wolfensohn (2002), in Klapper and Love (2004), which states that the company will not be able to creating a legal environment for their own good, but they must rely on the efficiency of the judicial system in which they are located. Then, Klapper and Love (2004) also states that if the environment weak corporate law, the company will not be able to "overwrite" against the legal system in the country and the company's flexibility in efforts to improve corporate governance to be limited. Therefore the quality of implementation of corporate governance in a company will strongly influenced by the quality of the legal system in the country.

This research also provides empirical evidence about the positive effect of investor protection on the degree on convergence of local GAAP with IFRS. Countries which have a legal system of protection for investors better tend to make a standard that supports the rights of shareholders of the companies in the country. The improvements are in the protection for investors in a country because the requirement discloses more transparent information is higher. IFRS is an international accounting standards which are considered to be more superior compared with other accounting standards (Ashbaugh and Pincus 2001; Gassen and Sellhorn 2006; Barth et al. 2007; Meulen, Gaeremynck, and Willekens 2007). Beatty et al. (1996) stated that the use of IFRS will increase the transparency of financial reporting, so that investors will react positively to it. While Hope et al. (2006) found that countries that have a high commitment in the protection for investors will tend to adopt IFRS.

Protection for investors influences the formation of accounting standards in a country. A coun-

Table 6
Regression Result of Model 2: The Effect of Investor Protection to Degree of Convergence of Local GAAP to IFRS

Model
Log IFRSi,t = δ0 + δ1Log IPi,t + δ2CEMi,t+ δ3CMCAPi,t + δ4Log GDPCAPi,t +δ5DYEARi,t + δ6-14DCOUNTRYi,t + εi,t
Dependent Variable: Log GOV

Independent Variable	Sign Expectation	Coefficient	Significance	VIF
C	?	***0.5449	0.000	
LOG(IP)	+	***0.1264	0.000	1.21
CEM	+/-	***0.8948	0.000	1.09
CMCAP	+	***0.0310	0.000	1.23
LOG(GDPCAP)	+	***0.0654	0.000	1.39
DYEAR	+/-	***0.0745	0.000	1.08
DCOUNTRY	+/-	DCOUNTRY Variables are included in the model. All Dummy countries variables are significant.		
F test Sign			0.0000	
Adj R Square			0.9868	
N			660	

***Significant at level of 1%
** Significant at level of 5%
* Significant at level of 10%
Table Information: This table represent regression result to estimate Model 2. This table aims to give result of estimation test using data panel analysis using common intercept. The dependent variable in this model is LOG IFRS. The independent variable in this model is LOGIP. While other independent variables used as control variables are the CEM, GDP, CMCAP, Log GDPCAP, DYEAR, and DCOUNTRY.
The operational definition of each variable is as follows: (i) LOGIFRS: Natural Logarithm of score of degree of convergence of local GAAP with IFRS; (ii) LOGIP: natural logarithm of score of investor protection which consist of legal origin, corporate law & enforcement, and securities law, (iii) CEM: The average value of all corporate earnings management in a country, (iv) CMCAP: Total value of market capitalization on the stock of a country divided by the value of GDP, (v) Log GDPCAP: Natural Logarithm of level of GDP per capita in one country; (vi) DYEAR: Dummy variable which stands 1 for observation of year 2006 and 0 for other; and (vii) DOCOUNTRY: Dummy variable which stands 1 for country related to the observation and 0 for other, Indonesia as reference.

try that has a good legal system and institutionally provides a strong protection for investors tends to make a better standard accounting. Previous studies, such as Ashbaugh and Pincus (2001), Gassen and Sellhorn (2006), Barth et al. (2007), Meulen, Gaeremynck, and Willekens (2007) generally showed that IFRS is more superior as compared to US GAAP or local GAAP of a country. Therefore, with improvements in the protection for investors in a country, there is a tendency to adopt to better accounting standards. Results of this study prove that the stronger protection for investors, the higher the degree of convergence of local GAAP with IFRS. These results are consistent with Hope et al. (2006) stating that countries that provide good protection for investors will tend to adopt accounting standards that guarantee the transparency financial reporting.

The implication of these results is that the Indonesian government should conduct the improvement of legal system and enforcement, both in terms of the firm law as well as capital market law. The improvement must have a purpose to provide better protection for investors, especially minority investors.

The improvements must be in the quality of the legal system in a country, the standard accounting adopted in the country, corporate governance implemented at the corporate level will be more effective.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

Several conclusions can be derived from this research. First, a better investor protection can lead to the better implementation quality corporate governance. This finding is consistent with Klapper and Love (2004) who also find positive relationship among judicial efficiency and anti directors' right as component in investor protection with level corporate governance. This result is also consistent with argument by Shleifer and Wolfenson (2002) in Klapper and Love (2004), that the firm can establish law environment well for their own, but the quality of corporate investor protection via implementation of corporate governance mechanisms will depend on efficiency of judicial system of the country where the firm operates.

Besides, it is recommended that the company should have a better investor protection so that they can encourage the higher convergence of the accounting standard to IFRS. This is in line with the

argument by Hope et al. (2006) who also found that to give good protection for its investor a country will tend to adopt higher quality of accounting standard to ensure financial reporting transparency. It indicates that a country should reform the law system related to investor protection in order to increase demand for better accounting standards.

Several limitations of this research that should be noted for future research as the following: (i) subjective judgment in developed a measure of the level of convergence of local GAAP to IFRS with comparisons between the local GAAP to IFRS for 20 accounting standard. For future research, subjectivity could be decreased by conducting Focus Group Discussion to assess the degree of convergence; (ii) this study uses data investor protection taken from La Porta et al. (1997, 1998, and 2006).

The disadvantage is that data were not up to date. Even though the data were still relevance to measure investor protection, further research could use other up dated data to measure investor protection; (iii) the sample of companies in this study is the companies included in the CLSA survey. Companies selected as the respondents on that survey are in large-scaled companies. Therefore, these results may not be generalized for small-scale firms; and (iv) this study uses only two-year study period, which is 2004 and 2006. Further research should expand the research period.

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