

The effect of IFRS implementation on earnings quality and corporate value (an empirical study on go public manufacturing companies)

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ABSTRACT

IFRS Implementation on Earnings Quality and Corporate Value needs to be paid attention. This is due to the fact that in the era of globalization, the companies require an international accounting system that can be applied internationally in every country, or a necessary harmonization of international accounting standard in order to produce comparable financial information, ease in conducting competitive analysis and good relationship with customers, suppliers, investors, and creditors. The purpose of this research is to obtain empirical evidence on the effect of IFRS implementation on earnings quality and corporate value. The samples used are manufacturing companies listed on the Indonesia Stock Exchange, during the period of one year before the implementation of IFRS and one year after the implementation of IFRS. The results of this study indicate that there are differences in earnings quality and corporate value, either after or before the implementation of IFRS. IFRS can provide quality reporting and better business environment.

ABSTRAK

Implementasi IFRS pada Laba Kualitas dan Nilai Perusahaan perlu diperhatikan. Hal ini disebabkan oleh fakta bahwa di era globalisasi, perusahaan memerlukan sistem akuntansi internasional yang dapat diterapkan secara internasional di setiap negara, atau diperlukan harmonisasi standar akuntansi internasional untuk menghasilkan informasi keuangan yang sebanding, kemudahan dalam melakukan analisis kompetitif dan hubungan baik dengan pelanggan, pemasok, investor, dan kreditur. Tujuan penelitian ini adalah untuk mendapatkan bukti empiris tentang pengaruh implementasi IFRS pada kualitas laba dan nilai perusahaan. Sampel yang digunakan adalah perusahaan yang terdaftar di Bursa Efek Indonesia manufaktur, selama periode satu tahun sebelum pelaksanaan IFRS dan satu tahun setelah pelaksanaan IFRS. Hasil penelitian ini menunjukkan bahwa ada perbedaan kualitas laba dan nilai perusahaan, baik setelah atau sebelum pelaksanaan IFRS. IFRS dapat memberikan pelaporan kualitas dan lingkungan bisnis yang lebih baik.

1. INTRODUCTION

All countries apply different standards in financial reporting. This occurs due to the applicable standards set by the profession association existing in any country. The current era of globalization calls for an international accounting system, that can be applied internationally, or requires a harmonization of international accounting standard, with the aim to produce comparable financial information, to facilitate in performing competitive analysis and to keep good relationship with customers, suppli-

ers, investors, and creditors. Many countries are considering adopting International Financial Reporting Standard (IFRS) as a standard that is currently used in developed countries. Therefore, countries, with the differences in institution, economy, politic, and environment, seek to understand IFRS and its effects.

Globalization in business can be seen through interstate commerce activities resulting in the emergence of multinational corporations. This has resulted in the need for an accounting standard that

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is widely applicable across the world. Indonesia, a country that will implement the adoption of IFRS fully in 2012, not only requires preparation and socialization, but also anticipates the possible rise of various constraints and obstacles. The formulation of the problem is whether the implementation of the IFRS affects the earnings quality and corporate values of companies in Indonesia? This research is expected to be able to determine the effect of IFRS implementation on earnings quality and corporate value of companies in Indonesia during the period of 2009-2011.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS

Previous Studies

Daske et al. (2008), this study aimed to determine the economic consequences of international accounting standards, namely IFRS, by using variables of economic consequences, liquidity, cost of capital, and Tobin's Q. The result of this study claims that after adopting IFRS, there is an increase in liquidity, a decrease in firm's cost capital, and an increase in Tobin's q.

Callao, S, Jarne JJ (2010), this study aimed to determine the decrease or the increase in *earnings management* that occurs before and after the adoption of IFRS. The result of this study shows that earnings management has been intensified since the adoption of IFRS in Europe, because the discretionary accruals have increased in the period after the implementation.

Liu, Chunhui et al. (2011), this study aimed to examine the effect of IFRS on accounting quality in China, where the variables are IFRS, *earnings management*, *value relevance*. The result of this study shows that the reported earnings value relevance increases while the revenue of earnings management decreases after the adoption of IFRS.

International Financial Reporting Standards (IFRS)

IFRS is an international accounting standard issued by the International Accounting Standards Board (IASB) and used as a standard arrangement of financial statements that is applied in the developed countries. In general, there are four main points set out in the accounting standards.

The first is related to the elements of financial statements (assets, liabilities, capital, income and expenses) or other related information. The second is the measurement and the assessment to determine the value of an element of financial statements either at the time of the financial transaction

or during the presentation of financial statements (balance sheet date). The third is the recognition, that is the criteria to recognize the elements of financial statements so that the elements can be presented in the financial statements. The fourth is the presentation (Balance Sheet, Profit / Loss) and the disclosure of financial statements as a note that accompanies the financial statements. This standard will apply to a company which applies IFRS when it states first use by an explicit statement of unconditional compliance with IFRS.

According to Immanuel Diamond (2009), the purpose of IFRS is to ensure that the company's internal financial statements, for the periods referred to in the annual financial statements, contain high quality information, such as (1) transparent to users and comparable throughout the periods presented, (2) provide adequate starting point for accounting based on IFRS, (3) able to be produced at a cost that does not exceed the benefits to the users.

Earning Quality

Earnings information is an important role for the company in making various decisions. Earnings that do not show the presence of actual information on management performance can mislead the users of the report.

Research conducted by Sunarto (2009) stated that the measurement of earnings persistence can be based on the concept of core operating income (COI) or the income statement, especially for the profit or loss items of the company's normal activity [SFAS No. 1 paragraph 56 (f)]. In other words, earnings persistence is measured by net income before extraordinary items (NIBE).

This uses variable of earnings management which is proxied by absolute abnormal accruals (discretionary accrual) as a proxy for the accounting earnings quality. The estimation of discretionary accrual can be measured directly to determine the earnings quality. The smaller the discretionary accrual the higher the earnings quality and vice versa. The reason for using accruals as a proxy for earnings quality is because, according to Richardson (2003), the amount of the accrual measurement is a good indicator to determine the level of earnings quality.

Corporate Value

A company is founded and run to achieve the goal, i.e the owner's welfare, which is indicated by the stock price. The higher the stock prices, the higher the corporate value. The high corporate value is the expectation of the owner of the company, because

the high value indicates the high prosperity of the stockholders. To achieve the corporate value, investors generally submit their management to the professionals. The professionals are positioned as managers or commissioner. When the management handover occurs, the conflicts of interest begin to happen. (Euis Soliha and Taswan 2002).

The calculation of the firm market value, in this study, uses Tobin's Q as it is considered to be able to provide the most excellent information. This ratio was developed by James Tobins (1969) from Yale University, the Nobel laureate in economics, who hypothesized that the combination of the market value of all firms in the capital market should be equal to replacement costs. Tobin's q is an indicator to measure the company's performance, particularly on the corporate value, which shows the performance of management in managing the assets of the company. Stock market (market value of all outstanding stock) and the market value of all debt are compared with the value of the entire capital placed in the assets of production (the replacement value of all production capacity), the Tobin's q can be used to measure the performance of companies, in terms of the potential market value of a company (Bambang and Ellen 2010).

3. RESEARCH METHOD

It analyzes the effect of IFRS implementation on earnings quality and firm value by analyzing before and after the implementation of IFRS. This study uses a quantitative approach in testing hypotheses, and there will be made to the observation of the financial statements and the calculation of the financial ratios. Data analysis techniques are performed using SPSS statistical software 16.

The population in this study is go public manufacturing companies listed on the Indonesia Stock Exchange (IDX) 2009-2011. Sampling method is the judgment sampling method, that is one of purposive sampling forms by taking a pre-determined sample based on the intent and purpose of the study with the following criteria:

1. Manufacturing companies dealing with Automotive & Components, Textile & Garment, Tobacco Manufacturers listen on the Indonesia Stock Exchange period 2009-2011.
2. The companies issues financial statements and annual reports 2009-2011 completely.
3. The companies presented audited financial statements.
4. The company's shares were actively traded during 2009-2011.
5. The companies have applied IFRS adoption

since 2009.

The data analysis technique, in this study, is conducted through several stages, such as: Conducting samples selection using purposive sampling method.

1. Calculating earnings quality by measuring *discretionary accruals* which shows the level of earnings management carried out by the companies, and Tobin's q to measure the corporate value from the financial statements each year.
2. Determining descriptive statistical analysis to explain the proportion of the data. The description of the data that will be used is the minimum value, maximum value, and standard deviation.
3. Processing data with SPSS 16 to perform the normality test with a significance level of 5%. The test is performed using the Kolmogorov-Smirnov test.
4. Conducting t-test at a significance level of 5% ($p = 0.05$), by using SPSS 16 to test two hypotheses: 1) the difference in earnings quality of companies in Indonesia after using IFRS convergence and 2) the difference in the corporate value of companies in Indonesia after using IFRS convergence.

4. DATA ANALYSIS AND DISCUSSION

Based on the result of the test on the 47 samples of manufacturing companies, it can be concluded that there are differences in earnings quality and corporate value between before and after the implementation of IFRS. It can be seen in the result of the t test which shows that H_0 is rejected with a significance value of 0.000 for discretionary accruals to measure earnings quality, and H_0 is rejected with a significance value of 0.014 for Tobins'q to measure the corporate value. The explanations of each variable are as follows:

1. Earnings Quality

Earnings quality is affected by the presence of earnings management, where earnings as part of the financial statements. Earnings information is an important role for the company in making various decisions. The adoption of IFRS has a very big effect on the company, especially in company's financial reporting.

Based on the hypothesis testing, it is obtained empirical evidence that the implementation of IFRS has a significant effect on earnings quality of companies that already use IFRS convergence. In a sense that there is a difference before and after the implementation of IFRS. This is supported by the results of the descriptive statistical tests showing

that the mean value of discretionary accruals increases compared to before the implementation of IFRS, i.e -0.1328 before the implementation of IFRS, and -0.0025 after the implementation of IFRS. This indicates that with the presence of the implementation of IFRS, fewer companies perform earnings manipulation.

Judging from the value of discretionary accruals before the implementation of IFRS, there are many companies that perform earnings management with income decreasing pattern. This result is consistent with the research conducted by Liu et al. (2011), Chua et al. (2012) which stated that after the adoption of IFRS there is a decline in earnings management. Therefore, with the implementation of IFRS as a high-quality accounting standards, it can press the management to present the actual and reasonable circumstances, then the action of earnings management can be minimized. The implementation of IFRS can make a better quality reporting so as to provide financial information which is more relevant, accurate, timely, and comprehensive.

2. Corporate Value

Corporate value is commonly indicated by the price to book value. The high price to book value will make the market trust the future prospects of the company (Fendi and Rovila 2011). High firm value is the expectation of the owner of the company, because the high value indicates high prosperity of the shareholders (Soliha and Taswan 2002). This is supported by the result of descriptive statistical test, which shows a difference, although not too high, that can be seen from the mean value of Tobins'q that there is a decrease after the implementation of IFRS i.e 0.5123 before the implementation of IFRS and 0.4923 after the implementation of IFRS. This occurs because there are many companies with the number of shares outstanding before the implementation of IFRS is equal to the number of shares outstanding after the implementation of IFRS. This result is consistent with the research by Daske et al. (2008) which states that there is a difference in the corporate value before and after the adoption of IFRS.

Stock market price is a reflection of the corporate value because the company's stock market price reflects the investors' overall assessment of any equity held. The implementation of IFRS can help investors compare companies with good or poor quality, and can reduce asymmetric information. The implementation of IFRS can improve the quality of reporting and affect the central assess-

ment of all market participants. The stock market price is the company's management performance indicators in which the result shows an increase in the corporate value.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

In general, it can be drawn some conclusions as the following.

1. The implementation of IFRS significantly affects the earnings quality, in which after the implementation of this IFRS, the pattern of the earnings management is done with *income increasing*.
2. The implementation of IFRS significantly affects the corporate value, in which there is a difference in the corporate value between before and after the implementation of IFRS.

This study is expected to provide an input and consideration for the company managers and investors. It has some suggestions as follows:

1. For further researches, it is important to add other types of companies, not only manufacturing companies.
2. For those who wish to conduct the same field of research, the researcher should increase the period of the study for the improvement of the research.
3. For further researches, it is imperative to use determinant methods other than *discretionary accrual*, so that it can be seen the existence of earnings management from the different viewpoints.
4. It is also necessary to use IFRS as a variable in future research.

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APPENDICES

List of Samples

No.	Names of Companies	Code
1	AKR Corporindo Tbk	AKRA
2	Apac Citra Centertex Tbk	MYTX
3	Asia Pacific Fibers Tbk	POLY
4	Astra Graphia Tbk	ASGR
5	Astra International Tbk	ASII
6	Astra Otoparts Tbk	AUTO
7	Bentoel Internasional Investama Tbk	RMBA
8	Betonjaya Manunggal Tbk	BTON
9	Duta Pertiwi Nusantara Tbk	DPNS
10	Ekadharma International Tbk	EKAD
11	Fajar Surya Wisesa Tbk	FASW
12	Gajah Tunggal Tbk	GJTL
13	Gudang Garam Tbk	GGRM
14	Hanjaya Mandala Sampoerna Tbk	HMSP
15	Holcim Indonesia Tbk	SMCB
16	Indal Aluminium Industry Tbk	INAI
17	Indo Kordsa Tbk	BRAM
18	Indocement Tunggal Prakarsa Tbk	INTP
19	Indofood CBP Sukses Makmur Tbk	ICBP
20	Indofood Sukses Makmur Tbk	INDF
21	Jakarta Kyoei Steel Works Tbk	JKSW
22	Kabelindo Murni Tbk	KBLM
23	Kalbe Farma Tbk	KLBF
24	Kedawung Indah Can Tbk	KICI
25	Kedawung Setia Industrial Tbk	KDSI
26	Langgeng Makmur Industrial Tbk	LMPI
27	Lautan Luas Tbk	LTLS
28	Modern Internasional Tbk	MDRN
29	Multi Bintang Indonesia Tbk	MLBI
30	Multistrada Arah Sarana Tbk	MASA
31	Pan Brothers Tbk	PBRX
32	Perdana Bangun Pusaka Tbk	KONI
33	Polychem Indonesia Tbk	ADMG
34	Prasidha Aneka Niaga Tbk	PSDN
35	Prima Alloy Steel Universal Tbk	PRAS
36	Pyridam Farma Tbk	PYFA
37	Roda Vivatex Tbk	RDTX
38	Sekar Laut Tbk	SKLT
39	Selamat Sampurna Tbk	SMSM
40	Sinar Mas Agro Resources and Technology Tbk	SMAR
41	Sumi Indo Kabel Tbk	IKBI
42	Surya Toto Indonesia Tbk	TOTO
43	Tempo Scan Pacific Tbk	TSPC
44	Tiga Pilar Sejahtera Food Tbk	AISA
45	Ultrajaya Milk Industry and Trading Company Tbk	ULTJ
46	Unilever Indonesia Tbk	UNVR
47	Unitex Tbk	UNTX

Source: ICMD 2011.