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Do IFRS Adoption and Corporate Governance Increase Accounting Information Quality in Indonesia?

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ABSTRACT

This study aims to determine the effect of IFRS (International Financial Reporting Standard) adoption and Corporate Governance on the accounting information quality in Indonesia. Corporate Governance in this study is represented by institutional ownership, independent commissioners and audit committees. This research is quantitative research with multiple linear regression models. The sample used in this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX). The type of data used in this study is secondary data in the form of financial statements and annual report from 2009 up to 2015. The sample selection using purposive sampling method with the number of samples amounted to 539 observation (firm-year).The regression method employs panel data with a period for six years (2009 - 2015). After conducting a model selection test, the chosen model is the fixed effect model. The results suggest that IFRS adoption, independent commissioners, and audit committees are not associated with the accounting information quality, while institutional ownership is positively associated with the accounting information quality.

INTRODUCTION

With the globalization of international financial markets, there needs to be harmonization of world accounting standards (Bryce et al., 2015). Potential investors and other market stakeholders require accurate and transparent information in making informed decisions. A widely accepted set of accounting standards could improve the ability to compare financial statements provided by accounting rules that various countries. Furthermore, it is expected that the same accounting rules in the world would remove barriers to International capital flows by reducing differences in financial reporting requirements and reducing financial reporting costs (Deegan, 2012; Nobes & Parker, 2012). Some attempts have been improved by the International Accounting Standard Board (IASB) to harmonize accounting standards throughout the world since its inception in 2001 (Bryce et al., 2015). The widespread adoption of IFRS objectives to improve transparency and quality of financial statements. Up to now, IFRS has been adopted in more than 120 countries (https://www2.deloitte.com).

However, some scholars did not agree with the statement that the quality of financial statements could be improved because of the inherent differences between the international financial reporting environment (Doupnik and Salter, 1995). It would be proven when we consider the different cultures in which accounting standards are developed. For example, Japan and Australia produced very different standards because of the history, culture, beliefs, and traditions held in both countries (Jones & Wolnizer, 2003). Therefore, the adoption of IFRS globally may be impractical or inappropriate. A different opinion on IFRS adoption is the fact that principle-based standards provide flexibility, in some cases that are excessive inflexibility, to companies that might be involved in earnings management, which results in a decrease in the quality of financial statements (Barth et al., 2008; Jeanjean & Stolowy, 2008).

Previous studies have attempted to evaluate IFRS Adoption provided different results. Hung & Subramanyam (2007), Barth et al. (2008), Chen et al., (2010), Chalmers et al. (2011), and Chua et al. (2012) concluded that IFRS adoption increases the accounting information quality. Conversely, Van Tendeloo & Vanstraelen (2005), Paananen & Lin (2008) found that accounting information quality declines after IFRS adoption. Furthermore, several studies indicated that IFRS adoption

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has little or no influence on the quality of financial statements (Jeanjean and Stolowy, 2008; Goodwin et al., 2008; Kabir et al., 2010, Bouchareb et al., 2014). In Indonesia, Claudya and Budiharta (2014), Himawan & Nugroho (2015), Rahmawati & Murtini (2015) found that the financial statements quality in Indonesia did not differ significantly both before and after the period of IFRS adoption. Meanwhile, Edvandini et al. (2014) found that the financial statement quality declines after IFRS adoption. Furthermore, Romadhoni & Purwanti (2017) found that financial statements quality increases after IFRS adoption. Based on previous studies, there are inconsistencies in the results of examining IFRS adoption on the accounting information quality in various countries including Indonesia. Therefore, it is essential to re-examine the effect of IFRS adoption on the accounting information quality by employing Indonesia company data as a developing country.

Harmonization of international accounting standards has become an impetus for good corporate governance. The failure of large companies such as Enron, WorldCom, and other large companies has caused a loss of shareholder confidence. It is concluded that one of the main causes of this business failure is companies that have poor corporate governance (Dhaliwal et al., 2006). Tang et al. (2013) found that the poor quality of corporate governance causes severe earnings management. Reflections on corporate governance that are diverse and often associated with characteristics and also for their impact on fulfilling contract clauses, firm value and transparency of financial reporting. With financial scandals, financial reporting quality has attracted many researchers. Although many reviews of research on the topic have been conducted, the debate remains theoretically and empirically. Research on the quality of financial statements is a subject that justifies the current events which are confirmed by some informative failures. The means of optimizing the quality of financial reporting is very dependent on the governance system as stated by Rezaee (2010).

Bouchareb et al., (2014) found that the size of the board of directors, institutional ownership, family ownership does not affect the financial statements quality. Meanwhile, independent directors, audit committees, ownership concentration, managerial ownership, public accounting firm Big 4 could improve the financial statements quality. Research on the components of good corporate governance still has different results. Iswara (2016) proved that independent commissioners have a positive effect on the financial statements quality, while managerial ownership and institutional ownership negatively affect the financial statements quality. Meanwhile, research conducted by Wulandari and Budiartha (2014) suggested that institutional ownership has a positive effect on the quality of financial statements as indicated by the integrity of financial statements, while managerial ownership, audit committees, and independent commissioners do not affect the quality of financial statements. Furthermore, Nadirsyah and Muharram (2015) concluded that audit committees, independent commissioners, managerial ownership and institutional ownership are positively associated with the quality of financial statements as indicated by the quality of earnings.

This study aims to examine the effect of IFRS adoption, corporate governance represented by audit committees, institutional ownership, independent commissioners on the financial statements quality using data from companies in Indonesia. The object of this study employs manufacturing companies because manufacturing companies are the most dominant sector in the Indonesia Stock Exchange. Also, manufacturing companies have similar characteristics, especially in the accounts presented in financial statements and have a complete business cycle. This research is expected to be able to provide benefits for shareholders or investors in decision making especially those related to the IFRS adoption.

Jensen and Meckling (1976) proposed agency theory which explains that the interests of managers (agents) and the interests of shareholders (principals) are often contradictory so that it may cause conflicts between the two of them. It could occur because managers tend to try to prioritize personal interests rather than the interests of shareholders. Conflict and attraction of interests between agents and principals may cause problems known as Asymmetric Information, which is unbalanced information because of the unequal distribution of information between principals and agents. The dependence of external parties on financial information makes the tendency of managers to seek their interests. This condition causes a manager's motivation to minimize information released to the principal with the aim of self-interest. The application of agency theory could be realized in a work contract that would regulate the proportion of the rights and obligations of each party while still taking into account the overall benefits. A work contract is a set of rules that govern the profit sharing mechanism, both in the form of profits, returns, and risks agreed upon by the principal and agent. The employment contract will be optimal if the contract has fairness quality. The essence of agency theory is the design of contracts that are appropriate for aligning principal and agent interests in the event of a conflict of interest (Scott, 2015).

In this study, the accounting information quality employs discretionary accruals as Bryce et al., (2015) where the financial statements quality increases when discretionary accruals are low. According to Sulistyanto (2008) earnings management is an attempt by company managers to intervene or influence information in financial statements with the aim of tricking stakeholders who want to know the performance and conditions of the company. The use of earnings management measurement and accrual quality as a proxy for the accounting information quality for the period before and after the period of IFRS adoption is relatively a new type of research in the field of accounting. This limited research examined the effect of IFRS adoption on accounting information quality. The findings from previous studies regarding the effect of IFRS adoption on the quality of financial statements have different results.

The differences in the results of previous studies related to accounting information quality before and after the application of IFRS which provided different conclusions could occur due to dividing IFRS adoption as mandatory and voluntary. Companies that voluntarily adopt IFRS are more likely to experience an increase in the quality of financial reports since companies adopted IFRS to reduce the rules of IFRSs in countries that were previously inadequate (Cai et al., 2014; Nina et al., 2009). On the contrary, companies adopting IFRS should probably change their standards because of factors that could not be controlled (political pressure, stock market rules, etc.). In this case, IFRS may have sufficient financial reporting quality, and IFRS adoption could not change or may even result in lower quality of financial statements.

Even though IFRS is principle-based and broadly similar to previous PSAK, there are still some striking differences. It is useful to explore the effect of IFRS adoption that has been held on the accounting information quality, because new principles may contribute to or hinder the financial statements quality. Asymmetric information leads managers in the company having more information than the company owner. The most obvious example is the manipulation of financial statement data for manager interests. With the presence of IFRS, the choices of accounting methods used by managers are increasingly limited. Thus it could improve the financial reporting quality. Therefore, the hypothesis in this study are:

H1: IFRS adoption is positively associated with the accounting information quality

In dealing with agency problems that have an impact on information asymmetry between agents and principals, it takes control of the audit committee as part of the implementation of corporate governance. The audit committee is expected to have a monitoring function of the behavior of managers in running the company. Several studies have examined the audit committee relationship or some of its characteristics (size, independence, competence, the frequency of meetings) on earnings management. Peasnell et al., (2005) proved no to the influence of the existence of an audit committee in the sample the majority of their company on the quality of financial reporting. Piot and Janis (2007) found that the existence of an audit committee reduced the effect of discretionary accruals. They added that the independence and competence of audit committee members had no impact on the different components of accounting profits. Bouchareb et al. (2014) concluded that audit committees could improve the quality of financial statements. Agency problems that cause managers to choose more information than the owner of the company results in need for a monitoring function of the performance of managers in the company. The audit committee is one of the elements in the composition of corporate governance so that with the existence of an audit committee, managers would further discipline their behavior to improve the quality of financial statements. Thus, the hypothesis in this study are:

H2: Audit committee is positively associated with accounting information quality.

Asymmetric information affects the behavior of managers based on their interests and can harm the owner of the company. The presence of institutional investors with significant interests in capital may also have the effect of reducing fraud committed by the managers. Jiambalvo et al. (2002) suggested that institutional investors are more interested in long-term profitability, so managers tend to act on earnings manipulation. Shang (2003) suggested that companies with small discretionary accruals are companies with high institutional ownership. Furthermore, Shang found that institutional investors sell their shares when there is profit manipulation. In line with Chung et al., (2005) suggested that institutional ownership decreases upward earnings management and downward earnings management through discretionary accrual manipulation.

Meanwhile, Cornett el al. (2006) found that institutional ownership limits earnings management which are motivated by complications in the form of stock options. Bouchareb et al. (2014) concluded that institutional ownership did not affect the quality of financial statements. The role of institutional ownership is very large because it could monitor the opportunistic behavior of managers in financial reporting. Institutional ownership could minimize agency problems that occur between managers and company owners. Thus, the hypothesis in this study are:

H3: Institutional ownership is positively associated with accounting information quality.

The existence of asymmetry information between agents and principals results in a control function for manager behavior in the company that needs to be conducted. Corporate governance implementation is expected to be able to reduce opportunity actions conducted by managers. An element that is not less important as a corporate governance component in a company other than an audit committee and institutional ownership is an independent commissioner. Nadirsyah and Muharram (2015) proved that the presence of independent commissioners could improve the quality of financial statements. The presence of independent commissioners could have a monitoring function that is not bound by the company to the performance and behavior of managers. With the presence of independent commissioners, it is expected that the quality of financial statements would increase, thereby minimizing information asymmetry between managers and company owners. Control functions carried out by independent commissioners by professional relations and not tied to any party so that the existence of opportunistic actions taken by managers for their interests could be minimized by the presence of independent commissioners. Thus, the hypothesis in this study are as follows:

H4: Independent commissioners are positively associated with accounting information quality.

RESEARCH METHODS

The method in this study was conducted using panel data regression. The dependent variable in this study is the accounting information quality (AIQ) using a discretionary accrual (AD) proxy. The higher the AD, the worse the quality of accounting information, and vice versa. AD in this study uses the proxy used by Kothari et al. (2005), as follows:

$$accuals = a\left(\frac{1}{TAt-1}\right) + b\frac{\Delta salest}{TAt-1} + c\frac{PPEt}{TAt-1} + dROAt + \epsilon t$$

Accruals are calculated from income before extraordinary minus the cash flows from operations less extraordinary items in year t divided by Total Asset of year t-1. The above equation is estimated cross-sectionally every year to produce expected (non-discretionary) accruals and the difference between the observed value and fitted value (residual t) which is the Discretionary Accruals Predicted (DAP).

Furthermore, the independent variables in this study are IFRS, audit committees, institutional ownership, independent commissioners. The IFRS proxy follows Bryce et al. (2015); Bouchareb et al. (2014); and Himawan and Nugroho (2015), namely 1 if the current year is the period after the application of IFRS and 0 if otherwise. The audit committee (ComAud) is the number of audit committees in the company following the proxy used by Bouchareb et al., (2014) and Nadirsyah and Muharram (2015). Institutional ownership (InsOwn) is the percentage of share ownership by financial institutions divided by total company shares, the proxy used follows Bouchareb et al., (2014), Nadirsyah and Muharram (2015). Independent Commissioner (IndCom) is the number of independent commissioners divided by the total board of commissioners, following the proxy used by Iswara (2016), Nadirsyah and Muharram (2015).

This study also employes control variables namely firm size, Return On Assets (ROA), Leverage, and DA Lag. The size of the company follows the proxy used by Bryce et al., (2015) natural logarithms of total company assets. ROA follows the proxy used by Bryce et al. (2015), namely net income divided by total assets. Leverage (LEV) follows the proxy used by Bryce et al. (2015), namely the total liabilities divided by total assets). Meanwhile, DA lag is used in research with the aim of providing a stable effect of the research model.

The object of research is a company listed on the Indonesia Stock Exchange (IDX). The data used is obtained from financial report data and issuer's annual reports listed on the Indonesia Stock Exchange and by the research criteria for the period 2009 to 2015. This study employs secondary data from www.idx.co.id and finance.yahoo.com.

The population used in the research is manufacturing companies listed on the Indonesia Stock Exchange. The technique for selecting samples used is using a non-random sampling technique. There are several criteria used to produce the final sample in this study. First, the companies used in the sample are manufacturing companies that have registered their shares on the Indonesia Stock Exchange from January 1, 2009, up to December 31, 2015. Second, the Company has complete financial reports and other information needed in this study starting from January 1, 2009, up to December 31, 2015.

The data used in this study are all financial data of manufacturing companies listed on the IDX, with sample selection criteria as follows:

Table 1. Research Sample Selection Criteria

Criteria	Number of Companies
All manufacturing companies listed on the IDX as of November 1, 2017	145
The companies began operations and listed its shares after January 1, 2009	(29)
Manufacturing companies that began operations and listed their shares before January 1, 2009	116
Manufacturing companies whose financial statement data is incomplete used in research and incomplete between 2009-2015	(39)
Selected manufacturing companies	77
Total research samples for 7 (seven) periods (2009 until 2015)	539

The models in this study are as follows:

$$AIQ_{it} = \beta 0 + \beta 1IFRS_{it} + \beta 2ComAud_{it} + \beta 3InsOwn_{it} + \beta 4IndCom_{it} + + \beta 5BSIZE_{it} + \beta 6ROA_{it} + \beta 7LEV_{it} + \beta 8lagDA + \varepsilon_{it};$$

RESULTS AND DISCUSSION

In this study, descriptive analysis is used to provide a general description of the data under study where data are described using mean values, maximum values, minimum values, and standard deviations (Std. Dev.). Table 2 shows the results of descriptive statistics, which describe information on variable characteristics in this study.

Furthermore, based on the results of testing the

Tabel 2. Descriptive Statistics

	DA	IFRS	AUDCOM	INST	INDCOM	DAR	ROA	SIZE
Mean	-0.06681	0.57142	2.35621	0.69994	0.38471	0.51558	0.08048	27.9580
Med.	-0.01503	1.00000	3.00000	0.74080	0.33333	0.47430	0.05920	27.7249
Max.	0.77548	1.00000	7.00000	1.00000	1.00000	3.21000	0.74840	33.1340
Min.	-1.60832	0.00000	0.00000	0.00000	0.00000	0.03723	-0.61970	24.9686
Std. Dev.	0.35648	0.49533	1.40736	0.19713	0.15792	0.41502	0.11523	1.63414

regression model selection (chow test, Lagrange multiplier test, Hausman test) suggests that the most appropriate panel data regression model to be used in this study is the fixed effect model. The results of data examining are shown in Table 3.

Table 3. Panel Data Regression Test Results

Variable	Coefficient	t-Statistic	Prob.	
IFRS	-0.007515	-0.498865	0.3091	
AUDCOMM	0.000182	0.027455	0.48905	
INST	-0.257320	-2.466587	0.00705	***
INDCOM	-0.029933	-0.490749	0.31195	
ROA	0.482935	4.231663	0	***
DAR	0.191036	3.059076	0.0012	***
SIZE	-0.008557	-0.277695	0.3907	
LagDA	-0.067647	-1.225547	0.11055	
R-squared		0.774091		
Adjusted R-squared		0.723755		
F-statistic		15.37870		
Prob(F-statistic)		0.000000		

The association between IFRS adoption and accounting information quality

From the result of hypothesis examining, it suggests that IFRS adoption is not associated with the accounting information quality. This result is relevant to Jeanjean and Stolowy (2008), Goodwin et al. (2008), Kabir et al. (2010), Bouchareb et al. (2014). In Indonesia, Claudya and Budiharta (2014), Himawan & Nugroho (2015), Rahmawati & Murtini (2015). However, the result is different from research conducted by Van Tendeloo and Vanstraelen (2005), Barth et al. (2008), Hung & Subramanyam (2007), Chen et al. (2010).

Financial Accounting Standards that employ IFRS are expected to improve the financial statements quality in a country. Although IFRS employs principle-based, those rules provide fewer choices for financial report compilers, in this case, managers in the company. Financial Accounting Standards that adopted IFRS starting in 2012 which were started by Indonesia companies did not provide evidence that could improve the financial statements quality. The difference is assumed that managers in Indonesia still take advantage of IFRS loopholes in the preparation of financial statements as before IFRS-based were applied. However, earnings management activities are still conducted by managers. IFRS adoption implementation does not guarantee the manager in a company to improve accounting information quality. Those lead accounting information quality has not improved yet. Thus, there is no difference in the accounting information quality before and after the application of IFRS-based standards.

The association between the audit committee and accounting information quality

From the result of hypothesis examining, it suggests that the audit committee is not associated with accounting information quality. This study is in line with Wulandari and Budiartha (2014) who stated that the audit committee still did not maximize the accounting function in the company. Also, this study is relevant with Peasnell et al. (2015) who fiund there is no association between the existence of an audit committee and the the quality of financial reporting. The audit committee does not prove to have a monitoring function for managers in preparing financial statements. IFRS-based regulations are only the responsibility of managers in the company, while the corporate governance component, including the audit committee, is not too concerned with IFRS regulations.

Based on this research finding, from 2009 up to 2015, the audit committee did not have a role function in improving financial statements in Indonesia. Also, the responsibilities of the audit committee are allegedly still not recognize accounting policies carried out by the board of directors of companies in Indonesia. Fulfillment of the number of audit committees in the company that must be carried out because of fulfilling the requirements. However, the quality and competency of the audit committee in the context of monitoring the performance and behavior of managers in the company is still lacking in Indonesia.

The association between institutional ownership and accounting information quality

From the result of hypothesis examining, it suggests that institutional ownership is positively associated with accounting information quality. This research is in line with the research conducted by Nadirsyah and Muharram (2015) which stated that institutional investors attach great importance to long-term corporate performance, so that share ownership by institutions could suppress opportunistic behavior of managers because institutional investors carry out optimal supervision in the company. Furthermore, this study is relevant with Chung et al., (2005) and Cornett el al. (2006). Large share ownership in Indonesia owned by financial institutions proves that those have a function of monitoring the behavior of managers in Indonesia. The monitoring function carried out by institutional shareholders continued during the period 2009 to the period of 2015.

According to Vo (2016), the role of institutional investors is more in-depth in emerging markets. Institutional investors are active investors and have a large role in the stock market. Also, the role of institutional investors in developing countries including in Indonesia is similar to foreign investors who could increase the level of corporate governance. Institutional investors could increase the level of corporate governance and are usually effective in influencing management and the company's board of directors to achieve the maximum goals of shareholder value. Therefore, the role of institutional ownership in companies is very important in limiting opportunistic actions taken by managers. The presence of institutional owners could force managers to be able to improve the quality of accounting information that is useful for investors in decision making.

The association between independent commissioners and accounting information quality

From the result of hypothesis examining, it suggests that independent commissioners do not affect the quality of financial reporting. The independent commissioner does not prove that he could have a monitoring function on the behavior of managers in Indonesia in the preparation of financial statements. This research is in line with Wulandari and Budiartha (2014) who stated that the presence of independent commissioners in the company may be carried out as a fulfillment of government regulations and regulations, but could not function to enforce good governance.

Independent commissioners in Indonesia generally are lack competency in the field of financial accounting standards or independent commissioners are less focused on the preparation of financial reports carried out by managers within the company. The role of independent commissioners in monitoring the company's opportunistic behavior is not optimal because independent commissioners could not limit the opportunistic behavior of managers in Indonesia. Although the company has been met with a minimum number of independent commissioners, managers still have discretion in accounting policy choices that could benefit the manager interests itself instead of the interests of the owner of the company.

CONCLUSIONS

This study concluded that there is no increase in the accounting information quality after the adoption of IFRS in Indonesia. There are still gaps in IFRS carried out by managers in conducting earnings management practices in Indonesia. The result of this study indicates that IFRS adoption is still only to meet the application of the provisions of convergence of accounting rules throughout the world but still does not have the implications of improving financial statements in Indonesia. Similarly, the functions of corporate governance in companies in Indonesia are still not optimal in monitoring the performance of managers in the preparation of financial statements. The presence of audit committees and independent commissioners do not lead to improving accounting information quality. Meanwhile, those who still have a role in improving the quality of financial statements are institutional investors in the company.

This research is only conducted by using a limited period of research sample, which only uses 7 (seven) years (2009-2015) using a manufacturing company. Therefore, the results of this study still do not reflect the condition of all companies in Indonesia. The results of this study could be used as a reference in future studies that would examine accounting information quality. Future research could use companies with broader sectors and longer periods to reexamine the results of this study. Also, future studies could include corporate governance with different measures or could use corporate governance as a moderating variable.

Related to the results of this study, IFRS adoption is not only used as a rule in PSAK, but there needs to be a real implementation in improving the quality of financial statements. Therefore, it is expected that the Indonesia Accounting Standard Board and the Indonesia Financial Services Authority could play a role in improving the quality of financial reports, especially for companies listed on IDX. Furthermore, independent commissioners and audit committees in companies should have an adequate understanding of accounting by IFRS-based financial accounting standards to enhance their role in monitoring manager behavior in selecting accounting policies that have an impact on the financial statements quality.

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