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Earnings quality: The Impact of implementation of IFRS-based financial accounting standard

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Abstract

The study aims to investigate the impact of the implementation of the International Financial Report Standard (IFRS) based financial accounting standards using the Stubben model. Findings reveal that the implementation of IFRS-based Financial Accounting Standard can suppress or reduce the earnings management done by the company in which the lower earnings management decreases, the better the earnings quality. In conclusion, the number of companies carried out from the earning management decreases from 2010 to 2011, even though the level of decrease is not significant.

Keywords: IFRS-based, Financial, Accounting, Earnings Quality.

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Calidad de los ingresos: el impacto de la implementación del estándar de contabilidad financiera basado en las NIIF

Resumen

El estudio tiene como objetivo investigar el impacto de la implementación de los estándares de contabilidad financiera basados en el Estándar Internacional de Informes Financieros (IFRS) utilizando el modelo Stubben. Los resultados revelan que la implementación de la Norma de Contabilidad Financiera basada en las NIIF puede suprimir o reducir la gestión de ganancias realizada por la compañía en la que disminuye la gestión de ganancias más baja, mejor es la calidad de las ganancias. En conclusión, el número de empresas realizadas a partir de la gestión de ingresos disminuye de 2010 a 2011, aunque el nivel de disminución no es significativo.

Palabras clave: Basada en IFRS, financiera, contable, calidad de ingresos

1. INTRODUCTION

Industrial globalization requires companies to adapt to current development. Thus causing their activities to become increasingly complex. The companies listed in Indonesia Stock Exchange are required to present the financial statement based on the applicable accounting standard to be useful for the users in making a decision.

In order to develop the simultaneous accounting system and financial report, it needs the globally-accepted financial accounting standard. After the launching in 2000 by IASC, The Accountant

Association of Indonesia as the highest power holder has assigned to adopt International Financial Reporting Standards (IFRS) fully. However, the process of the adoption has not been natural, they have delayed the schedule of its implementation from 2010 at first to 2012. The convergence of IFRS in Indonesia has entered the second stage; the first stage is during 2008 – 2012 and the second stage is during 2012 – 2015. To this day, the Financial Accounting Standard Board (FASB) has continuously been studying it in order to revise the IFRS-based Financial Accounting Standard Statement along with the international standard development.

GIVOLY, HAYN & KATZ (2010) Expressed the opinion of the Chair of the IFRS-IAI Implementation Team, BANGUN (2014), if Indonesia adopts IFRS, it will get seven benefits: (1) increasing the quality of Financial Accounting Standards (SAK), (2) reducing SAK costs, (3) increasing the credibility and usefulness of financial statements, (4) improve financial reporting comparability, (5) increase financial transparency, (6) reduce capital costs, and (7) improve the efficiency of preparing financial statements. If viewed from the statement above, of course, IFRS, if adopted by Indonesian companies, would be very profitable (USAK, KUBIATKO, SHABBIR, DUDNIK, JERMSITTIPARSERT, & RAJABION, 2019).

The adoption of IFRS causes the Financial Accounting Standard to likely use more fair value. The superiority of the accountancy that applies the fair value is that a measurement is conducted based on a current economic condition to be more relevant. However, the weakness is the difficulty in determining the fair value of assets or inactive traded liability. Therefore, the broadening use of fair value after IFRS adopted in Financial Accounting Standard Statement is presumed to cause more differences in earnings quality compared to before the IFRS is adopted (BANGUN, 2014; SHABBIR, ABBAS, AMAN, & ALI, 2019).).

Based on the background of this study, the main problem is: Is there any difference between earnings quality before and after the implementation of IFRS-based Financial Accounting Standard on Manufacturing Companies listed in the Indonesia Stock Exchange? The study aimed at investigating the difference between earnings quality before and after the implementation of IFRS-based Financial Accounting Standard on Manufacturing Companies listed in Indonesia Stock Exchange. The rest of this paper organized as follows: Section 2 for literature review and hypothesis development; Section 3 is to describe the methodology of research; Section 4 presents the results and discussion, and Section 5 concludes the paper.

2. MATERIALS AND METHODS

The users of the financial statement relate the earnings quality to the use of accounting information. It can differentiate between superior information (more beneficial) and inferior information (less useful). The conceptual framework of IFRS and FASS requires that financial information should have some qualities, namely: understandable, relevant, reliable, and comparable. The relevant information has predictive value, feedback value, and timeliness. Besides relevance, the accounting information should have reliability which can be verifiability, representational faithfulness, and neutrality.

All countries must follow IFRS as an international accounting standard, with the aim of producing good quality financial statements. BANGUN (2014) revealed in the results of his research that, requiring IFRS adoption can improve the quality of accounting, and could reduce managerial policies on accounting choices or inherently prohibit income smoothing or excessiveness.

BANGUN (2014) states that high-quality earnings should be more relevant. In other words, it should have a higher ability to explain the company’s market value. Several studies have found the quality of financial reports using relevance of earnings value to measure the earnings quality.

BANGUN (2014) states that earnings quality is a crucial feature in the financial report because the investors buy future earnings. Regardless of the importance of earnings for the stakeholders, the earnings quality is not clear and has different interpretations. Some writers correlate the earnings quality with the accurate representation of the transaction and economic events underlying it. Other interpretations focus on earning perseverance when the earnings with higher the ability can be sustained and survived in the future. The idea of perseverance suggests an interpretation that is more common by correlating the earnings quality with predictability, claiming that higher-quality earnings are good indicators for future earnings. Finally, some writers use the term in a conservative accounting concept (MAHMOOD, ARSHAD, AHMED, AKHTAR, & KHAN, 2018).

The substitution of an accounting standard is not able to guarantee an increase in profit reported by a company. Empirical findings show that requiring IFRS to the company does not have a significant impact on improving earnings quality or in this case accrual and real earnings management DOUKAKIS (2014). Based on this explanation, we built the hypotheses as follows:

H0: There is no difference between earnings quality before and after the implementation of IFRS-based Financial Accounting Standard on manufacturing companies listed in Indonesia Stock Exchange.

In general, it has been explained previously, that implementing IFRS can improve the quality of financial reports, as the results of research from GIVOLY, HAYN & KATZ (2010) that applying IFRS will improve the quality of good financial reports, followed by good earnings quality as well. Based on these findings, we stated hypotheses as follows:

H1: There is a difference between earnings quality before and after the implementation of IFRS-based Financial Accounting Standard on manufacturing companies listed in Indonesia Stock Exchange.

2.1 Samples and data

We conducted a study on manufacturing companies listed in Indonesia Stock Exchange for 292 companies. The research data consists of a financial statement of the companies in the form of the data before the implementation of IFRS-based Financial Accounting Standard in 2010 and the data after the implementation of IFRS-based Financial Accounting Standard in 2011. To analyze the data, the determination of samples and data criteria taken:

1. The companies observed must be in the list of the Indonesia Stock Exchange since 2010.
2. The complete financial statements are from 2010 to 2011.

2.2 Method of Data Analysis

In order to verify the hypothesis, it uses a paired sample t-test in which according to GARCÍA, ALEJANDRO, SÁENZ & SÁNCHEZ (2017), the test is aimed at to test the difference value between two tested populations through the paired sample.

The tested variable is the value of earnings quality projected by earnings management in which the earnings quality is measured by earning management in 2010 and 2011. The instrument is a Stubben model revealed by (BELLOVARY, GIACOMINO & AKERS, 2005). The formula of Stubben Model's Conditional Revenue Discretionary is:

Conditional Revenue Model

$$\Delta AR_{it} = \alpha + \beta 1\Delta R_{it} + \beta 2\Delta R_{it} \times SIZE_{it} + \beta 3\Delta R_{it} \times AGE_{it} + \beta 4\Delta R_{it} \times AGE\_SQ_{it} + \beta 5\Delta R_{it} \times GRM_{it} + \beta 6\Delta R_{it} \times GRM\_SQ_{it} + e_{it} \quad (3)$$

Notes:

AR = Account Receivable

R1_3 = income in the first three quarters

R4 = income in the fourth quarter

SIZE = natural log of total assets at the end of the year

AGE = company's age (year)

GRM = gross margin

_SQ = square of the variable

e = error

Stages of measurement:

1. Tabulating components data on the measurement of accrual earnings management by using the model of revenue discretionary (DANG, HE & SUN, 2017).
2. After tabulating all the data needed, it is then determining the change of income using the formula on each model.
3. Determining the company's size obtained from the natural log of total assets
4. Determining the company's age used in this study obtained from the financial statement
5. Determining the amount of gross margin with the formula of:

$$\frac{\text{Gross earnings}}{\text{Sales}}$$

6. Calculating the quadrat of the company's age and gross margin
7. After all the investigated components of data, calculate the amount of residual. The total residual shows the amount of accrual earnings management

Classifying the value of accrual earnings management with a limited range of not indicated -0,075 to 0,075 by accrual earnings management. The limitation adjusted to a study conducted by EDEIGBA & AMENKHIENAN (2017) because it is considered approaching the number of 0 and there is similarity of measurement concept of earnings management value with the study conducted by (CHUA, CHEONG & GOULD, 2012).

3. RESULTS

The total samples obtained in this study are 190 manufacturing companies listed in the Indonesia Stock Exchange consisting of 78 companies listed in 2010 and 78 companies listed in 2011. We can observe the summarized procedures of sampling in the following table 1.

Table 1: The procedures for sampling

Note	Amount
The manufacturing company listed in Indonesia Stock Exchange from 2010 to 2011	252
The manufacturing companies that have reported their financial statement from 2010 to 2011	(2)
Companies that conduct IPOs towards the end of 2010 and 2011	(4)
The manufacturing companies that conduct merger, acquisition, and divestitures from 2010 to 2011	(4)
The manufacturing companies that have reported their financial statement in USD from 2010 to 2011	(52)
The outliers data of companies	(34)
The companies that become the research samples	156

Source: the processed secondary data, 2018

Before we conducted the paired test, the analysis of earnings quality observed from earnings management was primarily conducted using the Stubben model. From this model, we obtained the residual value or error score. After that, we did the classification and measurement to find out which company conducts the earning management and the ones do not.

Table 2: Classification of Companies Which Indicated Doing Earnings Management

Classification	Category	The Year of 2010		The Year of 2011		Amount
		Frequency	%	Frequency	%	Frequency
< -0,075	Doing Earnings Management	15	19,23	18	23,08	33
-0,075 s/d 0,075	Not Doing Earnings Management	31	39,74	34	43,59	65
> 0,075	Doing Earnings Management	32	41,03	26	33,33	58
Total		78	100	78	100	156

Source: tabulation result in 2018

From table 2, it can to explain that based on the residual value of Stubben model, the indicated companies which have done earnings management practice are 47 by having the percentage for 60,25% in 2010 and 44 companies with the percentage for 56,41% in 2011. Then, the category of companies for not doing earnings management is 31 or 39,74% in 2010 and 34 or 43,59% in 2011. There are a decreasing number of companies on the earnings management in 2011 and the improvement of companies that do not conduct the earnings management practice due to the implementation of IFRS-based Financial Accounting Standard. Although the number decreases, the total improvement is not high enough.

The normality test is carried out before the paired t-sample test. It is to investigate whether the data normally distributed or not. The instrument is used to verify the Kolmogorov-Smirnov test. The results presented in the following table 3.

Table 3: Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
EM2010	,076	78	,200*	,972	78	,087
EM2011	,081	78	,200*	,947	78	,003
	*. This is a lower bound of the true significance.					
	a. Lilliefors Significance Correction					

From table 3, the normality test result shows that the statistical value of earnings management (EM) in 2010 is positive 0.076 and the significance value is 0.20. Then, the statistical value of earnings management (EM) in 2011 is positive at 0.081 and significance value is 0.20 which is higher than 0.05. Thus, that H_0 is accepted. It indicates that the residual data is normally distributed, and appropriated to use in this study.

We can observe the earnings quality in this study x from the measured earnings management (EM) using the Stubben model. The result is in the following table.

Table 4: Descriptive Statistic

			Statistic	Std. Error
EM2010	Mean		,0337	,01817
	95% Confidence Interval for Mean	Lower Bound	-,0025	
		Upper Bound	,0699	
	5% Trimmed Mean		,0362	
	Median		,0396	
	Variance		,026	
	Std. Deviation		,16050	
EM2011	Mean		,0291	,01746
	95% Confidence Interval for Mean	Lower Bound	-,0057	
		Upper Bound	,0638	
	5% Trimmed Mean		,0357	
	Median		,0493	

	Variance	,024	
	Std. Deviation	,15420	

Source: Data tabulation using SPSS 2018

Table 4 shows that the average score of earnings quality which is from earning management before the implementation of IFRS-based Financial Accounting Standard in 2010 is 0.03 with deviation standard for 0.16. Then, the average score of earnings quality that is from earning management after the implementation of IFRS-based Financial Accounting Standard in 2011 is 0.029 with deviation standard for 0.15.

We use the test to find out the correlation between earnings quality obtained from earning management before the implementation of IFRS-based Financial Accounting Standard in 2010 and after the implementation of IFRS-based Financial Accounting Standard in 2011. The result is in the table below.

Table 5: Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	EM2010 & EM2011	78	,002	,988

Source: Data tabulation using SPSS, 2018

Based on table 5, the correlation value between earnings quality from earning management before the implementation of IFRS-based Financial Accounting Standard in 2010 and after the implementation of IFRS-based Financial Accounting Standard in 2011 is 0.002 with significance value for 0.988. It explains that the significance is higher than 0.05, which means there is no correlation between earnings quality from earning management before the implementation of IFRS-based Financial Accounting Standard in 2010 and after the implementation of IFRS-based Financial Accounting Standard in 2011

We apply the test to investigate if there is any difference between earnings quality measured by earnings management before and after implementation of IFRS-based Financial Accounting Standard on manufacturing companies listed in Indonesia Stock Exchange.

Table 6: Result of Paired Samples Test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	EM2010 - EM2011	,00462	,22238	,02518	-,04552	,05476	,183	77	,855

Source: Data tabulation using SPSS 2018

The result shows that the average value of earnings quality measured by earnings management before and after the implementation of IFRS-based Financial Accounting Standard on manufacturing companies is 0.004 with deviation standard for 0.222 and average error standard for 0.025. Besides, the significance value (2-tailed) is 0.855. It indicates that there is no difference between earnings quality measured by earnings management before and after the implementation of IFRS-based Financial Accounting Standard on manufacturing companies listed in the Indonesia Stock Exchange because significance value for 0.855 is higher than 0.05.

4. CONCLUSION

The findings of the study reveal that there is no significant difference between earnings quality before the implementation of IFRS-based Financial Accounting Standard in 2010 and after the implementation in 2011. It is proved by the paired t-test result that obtains the significance value for 0.855 higher than alpha at 0.05. Although there is no significant difference between earnings quality before and after the implementation of IFRS-based Financial Accounting Standard using paired t-test, the earnings management using Stubben model shows that the number of companies carried out from the earning management decreases from 2010 to 2011, even though the level of decrease is not significant.

The limitation of the study is observation time that is only one year before and one year after the implementation of IFRS in Financial Accounting Standard. Therefore, it is considered to seem not enough to prove comprehensively about the earnings quality produced by the manufacturing companies.

In order for this research to be able to provide a more comprehensive study, the suggestions for further research are to expand the year of observation data; then the accounting standard variables can be measured from other indicators: recognition, measurement, presentation, disclosure, and also a comparison of models in quality measurement. Profit, in this case, is earnings management.

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