The Difference of Earnings Management before and after IFRS Adoption in Indonesia

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Abstract: This study aims to examine the difference in earnings management before and after IFRS adoption. Since 2012 Indonesia has adopted IFRS, which is a high-quality financial reporting standard that can be accepted internationally. One feature of the quality of financial statements is the low level of earnings management. The population was manufacturing firms listed on the IDX, with samples of 115 firm-year observations before IFRS adoption and 115 firm-year observations after IFRS adoption. The result shows that there is no difference in earnings management practices before compared to after IFRS adoption.

1 INTRODUCTION

The term International Financial Reporting Standards (IFRS) is known as a single set of accounting standards published by the International Accounting Standards Board (IASB). Providing investors and other users of financial statements with the ability to compare financial performance. At present, IFRS (International Financial Reporting Standard), together with US GAAP (the United States Generally Accepted Accounting Principles), is one of two globally recognized financial reporting standards. Before the accounting scandal that occurred in the United States, specific accounting standards that led to US GAAP were seen as the most effective form (Eaton, 2005). The declining popularity of US GAAP has caused many countries to turn to IFRS.

With economic globalization, many countries are trying to harmonize their accounting standards, and even adopt the same set of new reporting standards. The actual benefit of implementing compulsory new standards in various countries is a topic of debate among academics and practitioners. Several arguments led to the adoption of IFRS there was a significant increase in the quality of financial reporting, but there are also conflicting arguments

The argument supporting the adoption of mandatory IFRS reporting brings significant benefits in European with the assumption that IFRS increases transparency and increases the comparability of financial reporting (Daske et al., 2008)(Daske et al., 2008). The improvement in accounting quality is indicated by the decreasing level of earnings management and the increasing relevance of the value of earnings and the book value of equity (Barth, 2008; Liu et al., 2011)

Another argument state that accounting standards have a limited role in the quality of financial reporting due to incentives in financial reporting. There is an obligation in recording transactions regarding the reappraisal of accuracy based on the present value of assets, liability, and equity because IFRS adheres to a fair value-based system. Standards with principle-based that do not emphasize the rules and use much judgment cause accounting judgments based on subjective views so that it allows different earnings management opportunities. (Leuz, Nanda and Wysocki, 2003). Lang, Smith, and Wilson (2006) found that despite the use of the same accounting standards, the financial statements of cross-listed (European/ other) and US companies cannot be compared, and earnings management is more widespread in non-US companies than in US-based companies.

The convergence of IFRS by the European Union and Australia in 2005 started a domino effect that caused IFRS to be used by more than 120 countries in the world at that time (Larson and Street, 2011). Likewise, Indonesia began the IFRS convergence

program in 2009. Before the IFRS convergence program in Indonesia, the International Accounting Standards and the United States Generally Accounting Principles were the basis for the preparation of Indonesia's financial accounting standards.

On December 23, 2008, the Indonesian Institute of Accountants (IAI) declared Indonesia's plan for convergence of IFRS in setting financial accounting standards. IAI revealed that compliance with IFRS increased the comparability and transparency of financial statements. Besides, relevance and reliability are the essential qualities of financial information within the conceptual framework of IFRS. So it needs to be questioned whether the IFRS convergence process, which is not cheap, results in an increase in the quality of accounting in Indonesia. Accounting quality is measured by earnings management and value relevance, such as the study conducted by (Barth, Landsman, and Lang, 2008)(Barth, 2008). Liu et al. (2011), which shows an increase in accounting quality is shown by decreasing the level of earnings management and increasing the relevance of the value of earnings and book value of equity. To find out whether IFRS affects accounting quality in Indonesia, this study attempts to examine differences in the level of earnings management in Indonesia before and after IFRS adoption.

According to Scott (2015), earnings management is earnings management actions to choose accounting policies from a certain standard to maximize welfare or company market value/. Earnings by managers in a company due to agency problems, namely conflicts of interest between principals/shareholders and management. Management has more information about the company so that it allows management to practice accounting with a profit-oriented orientation to achieve a certain performance.

This research is useful to increase knowledge about the presence or absence of earnings management changes due to the effect of IFRS. Besides, this research is useful as a material consideration for regulators in assessing the benefits of IFRS adoption related to earnings management. Earnings management due to agency problems, namely conflicts of interest between owners/shareholders and managers/management. Management has more information about the company so that it allows management to practice accounting with a profit-oriented orientation to achieve a specific performance.

Doukakis (2014) have found that there was no impact of IFRS adoption to both changes real and accrual-based earnings management in Europe as measured by jones models and looking at the abnormal level of production costs, cash flow from operations and discretionary costs. (Callao and Jarne, 2010) found that there was an improvement in earnings management in the period after IFRS adoption. (Murtini and Lusiana (2016) found no significant differences between earnings management before and after IFRS adoption. The adoption of IFRS in China has been proven to improve accounting quality, which is characterized by an increase in the relevance of earnings value and a decrease in earnings management (Barth, Landsman and Lang, 2008); Chen et al. (2010); Liu et al. (2011). Other studies provide different results. Jeanjean and Stolowy (2011) found that the pervasiveness of earnings management did not decrease after the introduction of IFRS, and even in fact, increased in France. So as the study by (Ames. 2013) has shown that the earnings quality is not significantly improved after IFRS adoption.

That mixed result contradicts the need for research to determine the effect of IFRS adoption on earnings management in Indonesia. That mixed result makes it necessary to research to determine the effect of IFRS adoption on earnings management in Indonesia. This research is useful to increase knowledge about the changes in earnings management due to the adoption of IFRS. Besides, this research is useful as a material consideration for regulators in assessing the benefits of IFRS adoption related to earnings management.

2 LITERATURE REVIEW

2.1 Earnings Management

Earnings management can be defined as intentional interference by management in the external financial reporting process to obtain personal benefits (Schipper, 1989). Earnings management occurs when managers use considerations in financial reporting and structuring transactions to change financial statements to mislead some stakeholders about the company's economic performance or to influence contractual results that depend on accounting numbers (Healy and Wahlen, 1999). Management behavior that benefits oneself through earnings management can be explained by agency theory. The owner of the company is the principal who delegates tasks to the agent, namely, management. The agent will act to satisfy his interests and always have more information than the principal has (Jensen and Meckling, 1976).

2.2 IFRS Adoption in Indonesia

Accounting standards in force in Indonesia have experienced continued development to date. In 1974, the Indonesian Institute of Accountants had compiled accounting standards under the name Indonesian Accounting Principles (PAI) with US GAAP as the primary reference. However, ten years later, Indonesian financial accounting standards shifted to using the International Accounting Standards Committee (IASC) standard as the primary reference. Then in 1994, IAI decided to harmonize with the accounting standards published by the IASC called the International Accounting Standard (IAS). Although since 1994 IAI has been harmonizing with the International Accounting Standards, the IAI has only taken a serious step towards the end of 2008. On December 23, 2008, IAI inaugurated the IFRS 2012 convergence program. IFRS convergence program aims to achieve the full adoption of the 2009 version of IFRS in 2012. So that the financial statements in 2011 have applied standard adopted from IFRS.

The difference between US GAAP and IFRS that is the rule-based approach that underlies US GAAP and the principle-based approach that underlies IFRS (Gill and Rosen, 2007). Principle-based accounting standards are usually characterized by explicit statements of purpose but do not have detailed implementation instructions, so accountants are required to use professional judgment in their application (Collins, Pasewark and Riley, 2012).

There are two arguments related to the effect of IFRS on the quality of financial reporting, including. (Schipper, 2003) Argues that with a principle-based approach, managers get more flexibility in choosing accounting methods that reflect better economic activity that can improve the informativeness/relevance of accounting numbers, which ultimately improves the quality of financial reporting. In contrast, contradictory opinions is stating that greater reliance on the judgment can reduce not only the consistency and comparability of financial information but also create manager opportunities to manipulate accounting numbers (Barth et al. , 2008).

The application of IFRS, which is a more stringent standard than GAAP, is expected to reduce the level of opportunistic earnings management so that it can improve accounting quality (Barth et al. , 2008). Research on the effect of IFRS adoption on earnings management in various countries has been carried out and found different results between countries. Research conducted in 15 European Union member states shows a decrease in the level of earnings management, which is seen in a decrease in earnings management to targets, a decrease in the absolute value of discretionary accruals and an increase in the quality of accruals after the adoption of IFRS (Chen et al., 2010). Similarly, research on the adoption of IFRS in Australia showed a decrease in the level of earnings management after the adoption of IFRS (Elias, 2012). However, this is not in line with IFRS adoption in Germany, which shows no differences in earnings management between firms that apply IFRS and GAAP (Tendeloo and Vanstraelen, 2005) while a study in China shows a different conclusion towards the adoption of IFRS. (Zhou, Xiong, and Ganguli, 2009)Shows that IFRS adopting companies have smaller earnings management when compared to companies that use GAAP. However, Li and Park (2012) found that there was an improvement in earnings management by Chinese companies after the adoption of IFRS. Research in India shows that IFRS adopting companies are more likely to engage income smoothing compared to non-adoption IFRS companies (Rudra and Bhattacharjee, 2012).

Given the conflicting arguments and research results regarding the relationship between IFRS adoption and the quality of financial reporting, which includes earnings management, the following hypotheses are proposed:

H1: Earnings Management in Indonesia after IFRS adoption is different compared to the period before IFRS adoption.

3 METHODS

3.1 Population and Sample

The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange. The analysis period is classified into 2 parts (2007-2011 and 2012-2016) to reflect the situation before and after the adoption of IFRS. The sample selection used by stratified random sampling with consideration of the population is homogeneous. Manufacturing companies were chosen because they have the same accrual characteristics. The data used in this study from the company's financial statements that were downloaded through the official website of the Indonesia Stock Exchange, www.idx.co.id, as well as a summary of share prices in the Indonesian Capital Market Directory (ICMD). To measure

3.2 Operational Definition and Measurement of Earnings Management

Earnings management is intentional interference by management in the external financial reporting process, intending to obtain personal benefits Earnings management is measured by proxy value discretionary accruals. Healy (1985) distinguishes between accruals mandated by the standard drafting bodies and accruals arising from managerial policies. Accruals arising from the manager's policies are called discretionary accruals or abnormal accruals. To date, several models have been found in estimating the number of discretionary accruals (Jones 1991, Dechow et al., 1995; Lacker and Richardson, 2004; Kothari et al., 2005). This study uses the modified Jones model by Kothari et al. (2005), with current-year ROA as the control variable in measuring the number of discretionary accruals. The following equation estimates discretionary accruals:

Accruals it = a + b (1/Assets t-1) + c ΔSales t + d PPE t + e ROA t + μ t (1)

In Regression (1), total accruals (Accruals), changes in sales (ΔSales), and gross property, plant, and equipment (PPE) are each deflated by total assets at the beginning of the year. (Asset). ACCRit = total accruals for the company, i in year t, which is defined as earnings before extraordinary items minus cash, flows from operating activities; TAit - 1 = total assets for the company i in year t - 1 observation. By applying parameter estimates to the actual value for each company-year, it produces estimates of total accruals. The difference between total actual accruals and estimates is a proxy for discretionary accruals.

4 RESULTS AND DISCUSSION

4.1 Descriptive Statistical Analysis

The following table shows the descriptive statistics of earnings management variables

Table 1. Earning Management Before IFRS Adoption

	Minimum	Maximum	Mean	Standard Deviation
Manajemen Laba akrual	-1.08128	4.14929	-.0000001	.46210595
ACCRUALS /TA	-.59433	5.24268	.0487523	.51909762
1/ ASSET	.0000000652	.0000229421	.000003713197	.0000043219098
DSALES/ TA	-1.57050	1.11572	.1796539	.31719582
PPE/ TA	.00389	1.07039	.3448308	.25399922
ROA	-.22366	.53168	.0981337	.09306407

Table 2. Earnings Management After IFRS Adoption

	Minimum	Maksimum	Rata-rata	Deviasi Standar
Manajemen Laba akrual	-.47478	.55262	-.0000001	.13012004
ACCRUALS /TA	-.76251	.78903	-.0083264	.18125376
1/ ASSET	.0000000346	.0000109259	.000002289215	.0000027330836
DSALES/ TA	-.66702	.64620	.0518780	.20428540
PPE/ TA	.02819	1.08592	.3493316	.23957582
ROA	-.24683	.78810	.0857639	.13276915

The number of samples obtained was 230 companies a year, consisting of 115 samples before IFRS adoption and 115 samples after IFRS adoption. Tables 1 and 2 provide an overview of the accrual earnings management sample data and the components that make it up, namely accruals, 1 / total assets, increased sales, property, plant, and equipment, and the last, ROA as the control variable. The period before (5 years) and after the adoption of

IFRS (5 years). The means of earnings management shows negative numbers both before and after the adoption of IFRS, meaning that accrual earnings management is done through income decreasing, with the same magnitude of -10^{-7}.

4.2 Data Normality Test

Before the model is tested, a data normality test is performed. Kolmogorov-Smirnov test to test residual normality. Data are normally distributed if the significance level is> 0.05. Based on the normality test that has been done obtained (p-value 0,000). Thus it can be concluded that the data are not normally distributed because the probability value is smaller than 0.05. Because the results indicate that the data are not perfectly rational, then this data cannot be transformed. Furthermore, the different tests will be performed using a different test, which includes a non-parametric test, namely the Wilcoxon test.

4.3 Hypothesis Testing

To test the hypothesis used an independent sample t-test with the Mann Whitney test with the basis of decision making as follows:
H0 is accepted if probability> 0.05
H1 is rejected if probability <0.05
From the data processing, the results are obtained as shown in table 3 below

Table 3. Hypothesis Testing Result

Wilcoxon W	Asymp. Sig	Conclusion
12417	0.414	There is no means difference

Based on the table above, the probability value of 0.414 is well above 0.05, so it can be concluded that there are no average means. Thus it can be interpreted that there is no difference in accrual earnings management before and after the adoption of IFRS. These results indicate that the newly adopted IFRS standard has not been able to suppress the level of accrual earnings management, which is likely due to the principle-based approach of IFRS that makes managers can still use judgment according to their interests, including in conducting earnings management.

5 CONCLUSION

Compliance with IFRS is expected to increase the comparability and transparency of financial reports so that it will improve the quality of financial statements. One of the high-quality financial statements is seen from the low management of opportunistic earnings. With tighter IFRS standards than domestic standards, it is expected that changes will occur at the level of earnings management in Indonesia. This study aims to examine whether there are differences in earnings management before and after the adoption of IFRS. The results show that there was no change in average accrual earnings management before and after IFRS adoption. It can be concluded that earnings management is not changed after IFRS adoption compared to before IFRS adoption. These results are expected to be a consideration for standard-setting in Indonesia to improve standards to reduce the level of earnings management.

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