CHAPTER II

THEORETICAL REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Theories

2.1.1. Agency Theory

Definition of Agency Theory based on William R. Scott (2015) is a branch of game theory that studies the design of contracts to motivate a rational agent to act on behalf of a principal when the agent's interests would otherwise conflict with those of the principal. Agency theory consists of two or more people. One side is called by the principal and the other side is called by the agent. The principal is the persons who invest their money into a company or it is called by the investor, while the agent is the persons who work in the management of the company.

Commonly, agent and principal have their own interest. The principal wants the agent to work hard or give some effort to provide what the principal wants. On the other side, the nature of the agent's effort is too complex for the principal to observe it directly (Scott, 2015). So, the principal probably doesn't exactly know whether the agent is already provide them sufficient and honest information or not. .This caused information asymmetry because agent has more information related to the company than the principal. The information asymmetry itself can give impact to the decision's taking by the investors, so it is hoped that the company will give or disclose more information to the principal. The agency problem here is to help the principal so that the agent can work best for providing the best information for principal.

The problems arose because of the different purpose between principal and agent. Those problems can caused the agency costs, which consists of monitoring costs, bonding costs, and residual losses. Monitoring cost is the cost arouse and beard by the principal to monitor or control the agent's behavior. Bonding cost is the cost beard by the agent to define and obey the mechanism to ensure that the agent acts in the interests of the principal. While the residual loss arouse from the fact that sometimes the agent's act is different from the principal expectation or different from the act to maximizing the principal's interest (Ranette, 2014).

The demand for information for decision-making purposes relates to the role of information in statistical decision theory. Information is valuable if it improves the allocation of resources and risks in the economy. It does this by reducing uncertainty.

2.1.2. Stewardship Theory

Stewardship theory's concept is based on trust and it assumes that in general, managers should be trusted as good stewards (Huse, 2007). The stewardship theory is different with agency theory because in agency theory the concept builds on the assumption of managerial opportunism, while stewardship theory disregards the basic assumption of a conflict of interest. In Stewardship theory, the managers should be regarded as people wanting to do a good job. Huse (2007) also stated that stewardship theory assume that managers are trustworthy and collectivistic people instead of individualistic, opportunistic and self-serving.

When managers are assume as stewards, it shows that their motives are aligned with the objectives of their principles and will not depart from the interests of their organization (Fernando, 2006). In example when there are some problems or some different view, argument, or need between managers and the principles, the managers as stewards will leave their need or argument and try to fulfill what principles want. So, in order to fulfill what the principle's wants, the steward will provide effort or anything to fulfill their want. It relates also with the concept of stewardship theory which assumes that managers are basically trustworthy and attach significant value to their own reputations. The market for managers with strong personal reputaitons serves as the primary mechanism to control behaviour, with more reputable managers being offered higher compensation packages (Fernando, 2006).

2.2. Disclosure

2.2.1. Definition of Disclosure

Godfrey, *et al* (2010) stated on their book that uncertainty in agency theory can be classified as ex ante or ex post. Ex ante (before the event) uncertainty exists at the time a decision is to be made, such as uncertainty about controllable events that will affect production or uncertainty about the skill of the manager. Ex post (after the event) uncertainty exists after the decision has been made and the results realized. This uncertainty is the same as ex ante uncertainty except that it can be reduced by the ex post reports on what actually happened. Agency theory focuses on the impact of alternative ex post reports that affect ex post uncertainty.

Definition of disclosure in a broader sense means the release of information. In more limited sense, which tends to use by the accountant, the disclosure means the delivery of company's financial information in the financial report, which is usually in annual report. Disclosure can also be interpreted as information which are not posted in the financial report itself, or the disclose of something like management discussion and analysis, footnotes, and supplementary report (Hendriksen and Breda, 1992).

2.2.2. Purpose of Disclosure

The purpose of disclosure in the financial statements by Chariri, Anis, and Ghozali (2007: 382) are :

1. Provide useful information to investors, creditors and other users in making rational decisions.
2. Provide information to help investors, creditors and other users assess the amount, recognition of net cash receipts.
3. Provide information about the economic resources of a company.
4. Provide information about business results (financial performance) of a company for 1 period.
5. Provide information which are useful for managers and directors in the interests of the owner.
6. To compare each company and each year to the others, which aims to provide information on incoming and outgoing cash inflows in the future.
7. To assist investors in determining return and investment.

2.2.3. Level of Disclosure

Hendriksen & Breda (1992) stated that how much information should be disclosed is dependent in part upon the expertness of the reader. The FASB, for instance has held that information being disclosed in financial reports should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

Hendriksen & Breda (1992) also identified three concepts of disclosure based on the standard deemed most desirable which are adequate, fair, and full disclosure. Adequate disclosure implies a minimum amount of disclosure congruous with the negative objective of making the statements not misleading. Fair disclosure implies an ethical objective of providing equal treatment for all potential readers. Full disclosure implies the presentation of all relevant information.

2.2.4. Type of Disclosure

There are 2 kinds of disclosure viewing from the obligation to share the information term which is provided by disclosure which are mandatory disclosure and voluntary disclosure. Mandatory disclosure is disclosure which is minimum required by law. In Indonesia, the department who take care of this mandatory disclosure's regulation is BAPEPAM with Financial Institution with Indonesian Accounting Association. Companies with mandatory disclosure present basic information like balance sheet, profit and loss statement, cash flow statement, and brief notes to the accounts with low informational value. Voluntary disclosure is disclosure held by the company outside what is required by law and it could be informative or sensitive information relating to the economic environment, corporate governance, management judgment, and etc.

2.2.5. Method of Disclosure

There are several different method for company to disclose their information. Hendriksen & Breda (1992) stated that the selection of the best method of disclosure in each case depends on the nature of the information and its relative importance. The methods of disclosure which are usually used can be classified as follows:

1. Form and arrangement of formal statements.
2. Terminology and detailed presentations.
3. Parenthetical information.
4. Footnotes.
5. Supplementary statements and schedules.
6. Comments in the auditors' report.
7. The letter of the president or chairman of the board.

2.3. Voluntary Disclosure

The benefits of enhanced disclosure may include lower transaction costs in the trading of the firm's securities, greater interest in the company by financial analysts and investors, increased share liquidity, and lower cost of capital". There was also a recent report which shows that by enhancing companies' voluntary disclosure, the companies can achieve capital markets benefits. The report includes guidance on how companies can describe and explain their investment potential to investors (Choi and Meek, 2005).

Financial reporting can be an imperfect mechanism for communicating with outside investors when managers' incentives are not perfectly aligned with the interests of all shareholders. Managers' communication with outside investors is imperfect when (1) managers have superior information about their firm, (2) managers' incentives are not perfectly aligned with the interests of all the shareholders, and (3) accounting rules and auditing are imperfect. Evidence strongly indicates that corporate managers often have strong incentives to delay the disclosure of bad news, "manage" their financial reports to convey a more positive image of the firm, and overstate their firm's financial performance and prospects.

Managers have better information than external parties about their firm's current and future performance. Several studies show that managers have incentives to disclose such information voluntarily. In voluntary disclosure the company is free to disclose any kind of information related to the financial condition, outside what is required by the regulation. Managers may provide voluntary accounting disclosures in order to illustrate and communicate in further detail their financial policies, their decisions and actions and other explanatory information. Information which is provide by the company in voluntary disclosure are notes to the accounts and sensitive information relating to the economic environment, critical information about the business, corporate governance, internal control systems, debt covenants, risk profile, details on changes in accounting policies and impact on accounting figures, segmental information, use of financial instruments and derivatives, management remuneration, employee inventive schemes, recognition and measurement issues, management judgment, market-related information, etc.

The disclosure of voluntary information would seek to reduce uncertainty information asymmetry and skepticism, and would tend to reinforce investor's confidence on the company's management (Dye, 1998).

The provision of voluntary disclosures would lead to the reduction of information asymmetry, which would in turn be hailed by financial analysts and investors (Gigler and Hemmer, 2001). Voluntary disclosures would give financial analysts a better picture of firms' financial performance and position, and would enable them to issue more reliable forecasts (Lang and Lundholm, 2009).

2.4. IFRS (International Financial Reporting Standards)

2.4.1. Definition of IFRS

IFRS is a set of standard created by a London based international standard-making organization which is called by IASB (International Accounting Standard Board) or formerly called by IASC (International Accounting Standard Committee). IASC is an independent organization to set an accounting standard which is called by IAS (International Accounting Standard). The aim of this organization is to develop and encourage the used of high quality global accounting standard, yet understandable and comparable (Choi et al, 2005). IFRS's characteristic is principle based (broad principles with limited detailed rules), while U.S. GAAP which is the national standard for accounting in America, is rule based.

Doupnik & Perera (2007) stated that there are some differences between IFRS and U.S. GAAP. IFRS is more flexible than U.S. GAAP in many cases and also IFRS have less bright-line guidance than U.S. GAAP, so that the company which applied IFRS as its standard need more judgment.

Characteristic of the principle based are:

1. More emphasize on interpretation and application of standard so that should be focused on the spirit of application of the principle.
2. The standard requires an assessment of the substance of the transaction and evaluates whether the accounting presentation reflects the economic reality.
3. Requires professional judgment on the application of accounting standard.

2.4.2. IFRS Convergence

Convergence is a kind of process of harmonizing or improving the conformity of the accounting practice with setting certain standards to reduce the diversity of existing practice. In Indonesia, the IFRS convergence is the process of adjusting the

Financial Accounting Standard (SAK) which is local accounting standard in Indonesia with IFRS.

The purposes of convergence are:

1. Improve the quality of financial statement information to be more easily understood by investors and other users.
2. Generate accounting standards which are more easily used as a reference for authors and auditors.
3. Improve the comparability of inter-state financial statements.

In IFRS converging process, there are 2 convergence approach. The first approach is Big Bang Approach. It is an adoption process which is done by adopting the overall IFRS standard at once without going through certain stages. This approach is usually used by a number of developed countries. The second approach is Gradual approach, which is a gradual adoption of IFRS. This strategy is used by a number of developing countries include Indonesia.

There are 5 level of convergence, they are:

1. Full adoption. This adoption is similar with Big Bang approach where a country adopts all the IFRS standard and translates the overall of IFRS standard without changing its contents.

2. Adopted. This condition is when the IFRS is already adopted by a country but there are some adjustments made under the conditions of the country.
3. Piecemeal. This condition is when a country only adopts most items of IFRS like certain standard number and certain paragraph only.
4. Referenced or Convergence. This condition is where the constituents of accounting standard in a country are making their own accounting standard using IFRS as the reference. This applied in Indonesian PSAK.
5. Not adopted. This condition is where a country does not adopts the IFRS at all or not using IFRS as the reference to make the standard. It might be happened when the local regulations of the country and IFRS has so many differences.

The IFRS convergence in Indonesia begun from 2008. In 2008, the IFRS was firstly introduced in Indonesia. In 2009-2010, Indonesia had prepared for that accounting standard convergence, and in 2011 is the last preparation for the company in Indonesia started to apply the PSAK with IFRS. Last session, start from January 1, 2012 the government of Indonesia had been announced that since from that date all of the company in Indonesia should started to apply the PSAK with IFRS fully, until now.

2.4.3. PSAK based on IFRS

PSAK (Pernyataan Standar Akuntansi Keuangan) is a standard of accounting that applied in Indonesia. They give rule for all accountant to make the financial report. Commonly, the differences between PSAK after IFRS convergence (revision year 2009) and PSAK before IFRS convergence (revision year 1998) are:

Table 2.1

PSAK Characteristics based on IFRS

No.	PSAK Characteristics based on IFRS	Notes
1.	Principle Base	Should focus on the spirit of the application of the principles. The standard requires an assessment of the substance of the transaction and evaluation whether the accounting presentation reflects the real economic situation or in other word the application of the standard refers to the economic substance and refers on the legal form.
2.	Professional Judgment	Professional judgment in accounting standard implementation is needed.

3.	Fair Value	Using fair value in the assessment, if there is no active market value, so the own assessment (necessary competence) should be conduct or use the services of the appraisers.
4.	Disclosure	Require more disclosure for both quantitative and qualitative.

Source:https://www.scribd.com/presentation/116050114/Perkembangan-PSAK-Singkat

2.5. Previous research

Research about whether there is an increase in the extent of voluntary disclosure after IFRS was adopted or converted into the local accounting standard has been conducted by some researchers. One of the prior research was did by Silvia Consoni and Romualdo Douglas Colauto (2016), by using 66 Brazilians companies which are listed as active companies in BM&Fbovespa during 2005 until 2012 as the sample. From this research, they found that the convergence process to IFRS is presented as an exogenous factor that affected positively and significantly voluntary disclosure in the analyzed period. It leads to the complementary rationale between mandatory disclosure and the voluntary disclosure.

George Emmanuel Iatridis (2012) had already conducted a research about voluntary IFRS disclosure with the evidence from the transition from UK GAAP to IFRSs. Using Gray's (1980) comparability index, the study has found that voluntary IFRS disclosures have generally experienced a positive change while moving to IFRSs. Firms that disclosed IFRS-related information in the pre-official IFRS adoption period tended to exhibit stronger financing needs. The study also shows that voluntary IFRS disclosers are larger and visible in the market and display a significant growth potential.

The study explains managerial behavior with respect to the managerial choice to disclose voluntary accounting information. It implies that firms would tend to provide voluntary (IFRS) disclosures when it is managerially beneficial. The need to obtain financing on better terms would motivate managers to provide voluntary (IFRS) disclosures to show that they are familiar with the upcoming regulatory change and ready to implement it when it becomes effective. This would imply that voluntarily providing unfavorable and financially adverse disclosures would improve firms' financial credibility. Voluntary disclosures would also motivate managers to focus on problematic areas and improve their financial position. This would tend to be more intensive in countries with strong investor protection mechanisms where the demand for public disclosure is stronger.

Another study about the IFRS adoption and voluntary disclosure was searched by Jose Elias Feres de Almeida and Herbert Simoes Rodrigues (2015). Their research used the Brazilian Public Companies which are listed on the Sao Paulo Stock Exchange (Bovespa) as the sample with totaling 674 observations between 2006 and 2013. The result shows that all disclosure indexes increased during the IFRS adoption periods. One of the evidence of the research are there is positive association between the interaction of post-

IFRS and higher analysts' coverage and full voluntary disclosure index and disclosure of social and environmental information.

The conclusion of this research is that post-IFRS period affects negatively voluntary disclosure, however post-IFRS affects positively voluntary disclosure in the firms with higher covered by analysts and American Depositary Receipts listing.

2.6. Hypothesis Development

There was a transition in Indonesian Accounting Standard form prefer to U.S. GAAP into prefer to IFRS. It was happened because Indonesia is one of G-20 members where it a must for the members to provide financial report with refer to IFRS to make it more comparable not only in local area but also comparable in the broader or international area. U.S. GAAP based and IFRS based accounting standard is different. The character of U.S. GAAP is rules based which means it involves high level of standardization or contains of specific rules (Iatridis and Alexakis, 2012). On the contrary, the character of IFRS is principle-based. Principle-based doesn't have bright-line or specific rules. The principle based characteristic also make the absence of highly prescriptive financial reporting guidance, so the decision making should emphasizing on professional judgment. Professional judgment can be made correctly if the information disclose by the company are provided and can be accessed easily. It means that the more company disclose information, the better professional judgment can be made.

IFRS standards are commonly deemed to be more principle based than local GAAP in many adopting countries (Ball, 2006). Disclosure increase transparency while market transparency is observed as a fundamental mechanism in order to decrease the information asymmetry among the market's participants (Bleck et al., 2007). Companies might be motivated to provide voluntary disclosures, in order to obtain easier access to domestic and international capital markets or to facilitate their growth process (Iatridis and Alexakis, 2012).

So, the change in Indonesian PSAK from the US GAAP reference to the IFRS reference will give some changes to the financial and non-financial information disclosed, especially to the positive changes. The PSAK revision 2012 is assumed as the standard which makes company become more transparent rather than in PSAK revision 2009. One of the example showing the difference between before and after IFRS convergence is PSAK 22 about business combination. There was a difference between the business combination based on PSAK 22 revision 2012, which already applied the IFRS, and business combination on PSAK revision 2009 or then called by business merger.

In the mandatory disclosure, PSAK 22 revision 2012 has additional pages which consist of several appendices and one of the appendices is about application guidance including information to be disclosed. It is different with PSAK 22 revision 2009 which had no appendix at all and only stated the items which should be disclosed on the disclosure part. The total items of what should be disclosed are also different. PSAK 22 revision 2009 contains

9 items to be disclosed, while PSAK 22 revision 2012 has 4 rules about disclosing information relates with business combination through it's appendices which are B64-B66 and B67. B64-B66 consist of disclosure about the possible information for the investors or users to evaluate the characteristic and financial impact from the business combination while B67 consist of disclosure about exchange rate arising during the reporting period. B64 itself has 17 items need to be disclosed with some specific information on each item, B65 stated about the way how to disclose the business combination which is individually immaterial, B66 stated about the disclosed of business combination after the reporting period. Both B65 and B66 don't have specific additional item, while B67 consists of 5 items and some items have their specific information of what to be disclosed.

In the voluntary disclosure, PSAK 22 revision 2009 stated only about all regulation what should be disclosed while PSAK 22 revision 2012 stated about the possibility of the company to disclose more information. It is proved by a paragraph that can be found in PSAK 22 revision 2012, especially paragraph 63 on disclosure part. It is stated that if the specific disclosure which is required by this statement and other SAK didn't achieve the specified goal in paragraph 59 and 61, so the acquisition party discloses all additional information needed to achieve that. Paragraph 59 itself stated about the disclosure of information which make the user of financial report can evaluate the characteristics and financial impact on that business combination, while paragraph 61 stated about the disclosure of information that make the user of financial report can evaluate the financial impact from the adjustment which admittedly on the reproting period related with business combination. This might be implied that the “new” PSAK 22 allows company to voluntarily disclose information relates on business combination on their reporting to fulfilled the specific goal in paragraph 59 and 61.

The previous study in Brazil, conducted by Consoni & Colauto (2016) also claim that the IFRS convergence process is presented as an exogenous factor that affected positively and significantly voluntary disclosure in the analyzed period.

Thus, from the explanation above the formulation of the hypothesis is:

Ha: There is a significant increase on the extent of voluntary disclosure after IFRS convergence in Indonesia