CHAPTER I

INTRODUCTION

1.1. Research Background

In 2009, the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia) as the standard setting body in Indonesia made a resolution that requires all publicly traded firms to apply International Financial Accounting Standard-based accounting standard (IFRS-based PSAK) for preparing their financial statements beginning on January 1, 2012. IFRS is issued by the International Accounting Standard Board (IASB) which takes over the responsibilities of the International Accounting Standard Committee (IASC) since 2001. The mandatory adoption of IFRS is set as a result of Indonesian membership on G20 Forum. On a meeting of G20 Forum member held on November 15, 2008 it was agreed that the global IFRS adoption is aimed to strengthen transparency and accountability of the financial statements. Prihadi (2011) argue that by implementing IFRS, it will lead to least probability of doing unfair practices, because the methods allowed to be used is limited.

As it is written on the Statement of Financial Accounting Concepts (SFAC) No.8 chapter 1 about the Objective of General Purpose Financial Reporting that: "*The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve* *buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit*." (SFAC No.8 chapter 1: OB2), it is reasonable to look at the quality of financial information of Indonesian publicly traded firms at the post-IFRS adoption period.

A high quality financial statement will be able to provide both existing and potential investors information that mostly represents the actual condition of the firm. Thus, investors have a trustable reason to rely on the financial statements issued. Researches done in other countries have their measurements for a better reporting quality. Research done by Sun et al. (2011) uses the earnings quality for the measurement of foreign firms in United States. The research focused to the mandatory adoption of IFRS, resulted that small positive earnings decreased and earnings persistence increased. The same measurement used by Kabir et al. (2010) to examine the effect of IFRS adoption towards earnings quality of New Zealand firms, resulted a higher absolute discretionary accruals on the post-IFRS period, suggesting that IFRS increase earnings management. Landsman (2012) examined the effect of mandatory IFRS adoption towards information content of earnings announcement of 16 countries, measured through abnormal return volatility and abnormal trading volume. This research came up with result that abnormal return around earnings announcement increases after IFRS adoption.

Previous researches examined the effects of adoption in countries outside Indonesia. Iatridis (2010) examined the presentation of financial statements in United Kingdom, Cormier et al. (2009) examined the effect of

IFRS towards accounting practices in French, Morais & Curto (2008) in Portugal; Jeanjean & Stolowy (2008) in Australia, France, and United Kingdom; Ball et al. (2003) in Hong Kong, Malaysia, Singapore, and Thailand examined the effect of IFRS towards properties of accounting numbers, Lantto & Sahlstrom (2009) examined the effect of IFRS to financial ratios in Finland, Daske & Gebhardt (2006) in Austria, Germany, and Switzerland; Amstrong et al. (2010) in Europe examined the effect of IFRS to market reaction, find that IFRS cause significant changes in accounting amounts, their properties and correlation coefficients with market price. However, the degree of IFRS effect will be vary on each country depends on several things such as the strength of law enforcements and also the difference between the previous local accounting standard used before IFRS and the IFRS itself.

Scott (2000) in Hoesada (2008) states that in order to achieve a globally comparable financial report used between issuer and investor, and to avoid asymmetric information as well as to prevent moral hazard, a high quality accounting standard is needed. The adoption of IFRS caused Indonesian Accounting Standard that used to be *Ruled-based* change, and becoming *Principle-based.* The *Principle-based* nature of IFRS encourages firms to report accounting information that better reflects the economic substance over form and therefore promotes greater transparency (Maines et al. 2003 in Chua et al. 2012). Thus, it is logical to argue that there will be differences exist in the financial reporting quality resulted by IFRS-based Accounting Standard and by the previous accounting standard used. In this research, the difference is concerned to the financial reporting quality which in specific is the effect of mandatory IFRS adoption towards market reaction.

1.2. Problem Statement

The reason why some people think that adopting IFRS will increase quality of financial statements is because IFRS requires fair value and more disclosure. If the degree of fair value and disclosure required in the financial statements is higher than the previous standard, it is expected that more investors will use financial statements as their information in making investment decisions. Therefore, value relevance becomes stronger. When information has a greater value relevance, market is expected to be reacted. Relevancy and faithful presentation are the basic qualitative characteristics of financial statements. "*Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making difference in a decision even if some users choose not to take advantage of it or already aware it from other resources.*" (Conceptual Framework, 2010: A33). Barth, Beaver, and Landsman (2001) defines value relevance as an empirical operationalization of the criteria of relevance and reliability of accounting numbers as reflected in the equity value. Researches done by Khanagha (2011) and Trikawala (2010) come up with result that value relevance of accounting information has decreased over the last decades. Another research done by Kargin (2013) come up with result that value relevant of accounting information of Turkish firms has improved in the post-IFRS period.

The use of fair value by IFRS is significant. The guidance for fair value is written in IFRS 13 about Fair Value Measurement which mandatory effective since January 1 2013. The reason of applying fair value theory is based on the idea that in some cases, the historical prices are no longer relevant to represent price of an asset in the market because of some reason such as distressed sales, announcement made after transactions, and environmental changes. Christensen and Nikolaev (2012) researched the choice of fair value or historical cost accounting for non-financial assets in Germany and UK around IFRS adoption and find that fair value is unlikely to become primary valuation method for illiquid non-financial assets on a voluntary basis. However, research done by Kazmouz (2010) who was researching the effect of fair value application towards companies in United Kingdom argue that the fair value of financial statements can reflect the firm's economic reality which enhances not only efficiency of the invested capital, but also management efficiency, financial statements harmonization and the justness of income distribution.

The decision to apply IFRS also brings the consequence of preparing disclosure of financial statements. By providing disclosure, financial report transparency is possible to be increased. Improving transparency helps to ensure that the distribution of income is done according to the law. Thus, any investment decision made by investors will have a rational basis. Referring to these changes of the degree of value relevance, fair value, and disclosure used, and researches done unto it, this research tries to examine whether changes in accounting standard will give impact to the usefulness of publicly available information which in specific is the market reaction changes before and after IFRS adoption. Thus, the research question is:

- Is the market reaction to the earnings announcement significantly different before and after IFRS adoption?

1.3. Research Scope

Variables used in this study are International Financial Accounting Standard (IFRS) and market reaction. The IFRS period will be divided into two groups as follows.

1. The year before IFRS adoption.

   The year of 2010 and 2011 is chosen because the two years are the nearest years before IFRS is mandatory adopted in January 1 2012.

2. The year after IFRS adoption.

   The year after IFRS adoption is 2012 and 2013.

1.4. Research Objective

The objective of this research is to answer the question presented in problem statement. The answer will include information about mandatory International Financial Reporting Standard (IFRS) adoption that affect market reaction of listed companies in Indonesia from 2010-2013.

1.5. Contribution of Research

This research titled "Market Reaction to the Adoption of IFRS in Indonesia" is expected to give contributions for each of the following parties.

(a) For the writer

It is hoped that by the process of writing this research, the writer gain a sophisticated understanding related to the current issue in financial accounting, in specific is the mandatory adoption of IFRS in the relation with market reaction. It is expected that the writer is acknowledged and ready to be experienced in real work.

(b) For the university

It is hoped that this research has the quality and capability to serve as one of the references in the library and serves as a literature for next researches with similar variable.

(c) For practitioners

This research is hoped to be useful for accounting practitioners such as accountants, investors, and business entity to help reaching their goal in the relation to the investing climate.

1.6. Thesis Structure

This thesis titled “Market Reaction to the Adoption of IFRS in Indonesia” is divided into five chapters as follows.

CHAPTER 1 INTRODUCTION

This chapter consist background of the research, problem statement, research objective, and contribution of the research.

CHAPTER 2 THEORETICAL BACKGROUND AND HYPOTHESIS DEVLOPMENT

This chapter explains further about theories that support the variables, previous researches done in different region, and hypothesis development.

CHAPTER 3 RESEARCH METHOD

This chapter consist sample, data resources, and method of data analysis which are used in this research.

CHAPTER 4 DATA ANALYSIS

This chapter explains the data operationalization and analysis of the data to reach conclusions.

CHAPTER 5 CONCLUSIONS

This chapter consist conclusion of the research, research limitations, and suggestion for further research with similar variables.