

**THE ADOPTION OF IFRS AND EARNINGS QUALITY OF INDONESIA  
REAL ESTATE, PROPERTY AND BUILDING CONSTRUCTION  
COMPANIES**

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**Abstract**

This study aims to prove empirically whether there are significant differences of earnings quality from the adoption of IFRS, especially for real estate, property, and building construction companies listed in IDX. There are two time periods examined in this research; two years before mandatory adoption (2010-2011), and two years after IFRS mandatory adoption (2012-2013). The proxy for earnings quality in this research is discretionary accrual. This research uses the Kolmogorov Smirnov Test to test data distribution normality and The Wilcoxon Signed Rank Test to test the hypothesis.

From the data analysis, it is concluded that  $H_a$  is accepted, meaning that there is significant difference in discretionary accrual before and after the adoption of IFRS.

**Keywords:** International Financial Reporting Standards (IFRS), discretionary accruals, earnings quality

## **I. INTRODUCTION**

Financial report is the final result of the accounting process. Financial report describes the financial conditions in a certain period. The general purpose of financial report is as 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).

In 2009, the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia) demanded all publicly traded firms to apply International Financial Accounting Standard-based accounting standard (IFRS-based PSAK) in preparing their financial statements. The implementation of IFRS is one of the efforts to meet the needs of global accounting and has been fully adopted since 1 January 2012.

The adoption of IFRS causes some changes including more principles-based standards, more use of fair value, and more practice of professional judgment (Sinaga, 2012). Before the convergence of IFRS, PSAK 30 (1994) about leasing is more rules-based standard. Rules-based standard is able to improve the consistency and comparison between companies throughout time. However, rules-based standards become less relevant because of the inability of the standards to reflect the real economic event between different entities. One common argument against rules-based standard is that they provide executives with the opportunity to engage in transaction structuring and thus induce bias in financial reporting information (Nelson et al, 2002). These conditions will make difference in earning quality.

Different from rules-based standards, principles-based standards make a number of estimations that should be justifiable and require more professional judgment (Schipper, 2003). The example is IAS 17 adopted in PSAK 30 (2011) about leasing. Principles-based standards reflect more real transactions or economic

event. The principles-based nature of IFRS encourages firms to report accounting information that is better to reflect the economic substance over form and therefore promote greater transparency (Maines et al. 2003 in Chua et al. 2012). Thus, it is logical to argue that differences exist in the financial report quality resulted by IFRS-based accounting standards and by the previous accounting standards. A more subjective standard with principles-based nature causes inconsistent judgment. As a result, larger opportunities for practicing earning management are possible when inconsistent judgment is carried out (Schipper and Nelson, 2003).

Convergence of PSAK to IFRS introduces more use of fair value. Fair value accounting refers to the practice in which companies increase or decrease the value of their assets or liabilities in the financial statements in order to reflect the changes in the market prices of these assets (IASB 2003). The ability to reflect recent economic situation is the benefit of fair value (relevance). On the other hand, fair value also has shortcomings. One of them is the difficulty in determining the fair value of assets or liability which has no active market value. As the consequence, the appraisal tends to be subjective because there is no standard for assessment. Therefore, more fair value in the adoption of IFRS into PSAK could cause differences of earning quality compared to before the adoption of IFRS.

The implementation of IFRS in Indonesia is expected to give differences in the quality of financial reports and earning quality of companies in Indonesia. However, several researches that have been done in Indonesia are not yet able to explain whether IFRS-based accounting standards could cause differences in earning quality. For instance, the research conducted by Santy, et. al. (2012) suggests that adopting IFRS would not affect earnings management action of banking companies in Indonesia. Another study done by Handayani (2014), it was also found that the adoption of IFRS would not affect accruals and real activity earnings management of manufacturing companies in Indonesia. Nevertheless, the research conducted by Narendra (2013) showed that the adoption of IFRS had some positive effects for earnings management although the decreasing level of earnings management is not too significant. Wan Abidah et al (2013) found that IFRS

adoption is associated with higher quality of reported earnings. It is found that earnings reported during the period after the adoption of IFRS is associated with lower earnings management and higher value relevance.

The changes of the regulation motivate researcher to examine the difference of earnings quality before and after the adoption of IFRS. To determine the effect of IFRS adoption on earnings quality, the researcher examine whether the level of earnings management is significantly different after the adoption of IFRS. The researcher uses Real Estate, Property and Building Construction Companies that are listed on Indonesia Stock Exchange as the object of this study because the value of property is always increasing every year. Also, better judgment to appraise the value of property is more desired. The study covers two periods, two years before the adoption (2010-2011) and two years after the adoption (2012-2013).

## **II. Research Question:**

The key question of the relation between the adoption of IFRS and earnings quality can be summarized as follow.

- Is the earnings quality significantly different before and after IFRS adoption for listed real estate, property and building construction companies on IDX?

## **III. Hypothesis Development**

In 2008, Indonesia started to adopt IFRS into PSAK. The convergence of IFRS into PSAK causes difference like the change from rules-based into principles-based standards. Rules-based is consistent because there is clear standard and quantitative standard. In other side, Principle-based standards provide manager to choose the accounting method that can reflect substantially more real transactions or economic event. This argument suggests that using principles-based standards will improve the relevance and usefulness of financial reporting information (Herz, 2003). Because of that, it will indicate that earnings quality of the company will increase. Principles-based standards require more professional judgment, it makes

the standard become flexible and subjective in assessing assets or liabilities. However, earnings management occurs when managers intentionally conduct bad judgment.

The adoption of IFRS requires PSAK to use more fair value. The advantage of using fair value is that fair value accounting reports assets and liabilities on the basis of their actual or estimated fair market prices. In other words fair value reflects true economic situation. The examples of fair value are PSAK 16(2011) and PSAK 13(2011). According to PSAK 16(2011) and PSAK 13(2012), increases or decreases in earning that arise from the revaluation of assets (PSAK 16) and the revaluation from investment property (PSAK 13). Thus, the fair value recognition gives impact to earnings. On the other hand, fair value also has weaknesses. One of the weaknesses is the difficulty for determining the fair value of assets or liability which has no active market value. As a consequence, the appraisal tends to be subjective because there is no standard for assessment. PSAK 13 revised 2011 for the regulation of investment properties in the process of construction and development forces the company to use reliable fair value. If the fair value is not reliable, companies should directly use acquisition price. If the manager still uses fair value that is not reliable, it will give opportunity to the manager to manipulate earnings through changes in fair value. Consequently, the use of fair value in the adoption of IFRS into PSAK could cause differences in earnings quality between before and after the adoption of IFRS.

Based on the previous explanation about the changes in PSAK after IFRS adoption, it can be seen that the adoption of IFRS can increase or decrease earnings quality. Similar previous research was conducted by Ismail and Kamarudin (2013) that examined earnings quality and the adoption of IFRS-based accounting standards in Malaysia. The results show that IFRS adoption is associated with higher quality of reported earnings. It is found that earnings reported during the period after the adoption of IFRS is associated with lower earnings management and higher value relevance. However, research done by Handayani (2014) found that the adoption of IFRS would not affect accruals and real activity earnings

management of manufacturing companies in Indonesia. The increase or decrease of earnings management causes the difference in earnings quality of companies. Based on these ideas and previous research, the following hypothesis can be formulated:

Ha : There is significant difference in earnings quality between before and after IFRS adoption

#### IV. Empirical Model

To measure the level <sup>1</sup>of earnings management, researcher calculated the value of discretionary accruals using the Jones (1991) model, as modified by Dechow et al. (1995), by running the following regression:

a. Calculated total accrual using cash flow approach:

$$TACC_{it} = NI_{it} - CFO_{it}$$

Where:

TACC<sub>it</sub>= Total accrual of company i in year t

NI<sub>it</sub> = Net Income of company i in year t

CFO<sub>it</sub>= Cash Flow Operation of company i in year t

b. Determining coefficient from accrual regression.

Discretionary accrual is the difference between total accrual (TACC) and nondiscretionary accrual (NDACC). Determining nondiscretionary accrual by doing this regression:

$$\frac{TACC_{i,t}}{TA_{i,t-1}} = \beta_1 \left( \frac{1}{TA_{i,t-1}} \right) + \beta_2 \left( \frac{\Delta Rev_{i,t}}{TA_{i,t-1}} \right) + \beta_3 \left( \frac{PPE_{i,t}}{TA_{i,t-1}} \right) + \varepsilon_{i,t}$$

Where:

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<sup>1</sup> Husni measures earning quality in real estate, property and building construction companies by using the Jones (1991) model, as modified by Dechow et al. (1995).

TACC<sub>it</sub> = Total accrual of company i in year t

TA<sub>it-1</sub> = Total asset of company i in end year t-1

ΔREV<sub>it</sub> = Change of revenue from sales company i in year t -1

PPE<sub>it</sub> = Property, plant, equipment of company i in year t

ΔREC<sub>it</sub> = Change of net receivable company i in year t -1

e = Error

c. Determining nondiscretionary accrual.

Regression in equation (2) resulted coefficient β<sub>1</sub>, β<sub>2</sub>, dan β<sub>3</sub>. Those coefficient are used to predict nondiscretionary accrual through equation:

$$NDACC_{it} = \beta_1 \left( \frac{1}{TA_{it-1}} \right) + \beta_2 \left( \frac{\Delta Rev_{it} - \Delta Rec_{it}}{TA_{it-1}} \right) + \beta_3 \left( \frac{PPE_{it}}{TA_{it-1}} \right) + \varepsilon_{it}$$

d. Determining discretionary accrual.

Discretionary accrual is calculated by total accrual (result from equation (a)) minus nondiscretionary accrual (result from equation (c)).

$$DACC_{it} = \left( \frac{TACC_{it}}{TA_{it-1}} \right) - NDACC_{it}$$

Where: DACC: Discretionary accrual company I in year t and converted into absolute value. Converted into absolute value because not all discretionary accrual always in positive value. When summing the positive

value and the negative value, it is possible the value of discretionary accrual become 0. Zero means there is no earnings management through discretionary accrual, but has already been known that the company always do earnings management through discretionary accrual with positive or negative value. Thus, the negative value must be converted into positive.

## **Method of Analysis**

### **1. Descriptive Statistic**

Descriptive statistics is the process of research data in the form of tabulations so it is easily understood and interpreted. Descriptive statistic shows the summary of the data in total sample, minimum value, maximum value, mean, and standard deviation.

### **2. Data Normality Testing**

Normality test is carried out to find out whether the data used in this research is normally distributed or not. Normality test becomes important because it is prerequisite for parametric test. Since there are more than 50 data, then One-Sample Kolmogorov-Smirnov is used in this research. Data is considered normally distributed if significant value of Kolmogorov-Smirnov (Sig.)  $> 0,05$ , while data is not considered normally distributed if significant value of Kolmogorov-Smirnov (Sig.)  $< 0,05$  (Sarjono, 2011:64).

### **3. Hypothesis Testing**

The steps done in this research are:

If the variable has a normal data distribution, the steps are as follows.



1. The Paired Sample T-test will be used with Hypothesis as follows.

$H_0 : \mu_1 = \mu_2$ , meaning that there is no significant difference of earning quality before and after IFRS adoption.

$H_a : \mu_1 \neq \mu_2$ , meaning that there is significant difference of earning quality before and after IFRS adoption.

The criteria is stated as follows

In this test P-value will be used with  $\alpha = 5\%$ .

If P-value is  $< \alpha$ ,  $H_a$  is accepted,

If P-value is  $> \alpha$ ,  $H_a$  is rejected.

2. If the variable does not have normal data distribution, step to be done:

a) Wilcoxon Rank Test will be used with criteria:

In this test P-value will be used with  $\alpha = 5\%$ .

If P-value is  $< \alpha$ ,  $H_a$  is accepted,

If P-value is  $> \alpha$ ,  $H_a$  is rejected.

## V. SAMPLING

### Sample Selection

The research sample selection is listed below.

#### Sampling Process

| No | Criteria  | Companies |
|----|---|-----------|
| 1. | Real Estate, property and building construction companies from 2010 – 2013 that listed on IDX | 55        |
| 2. | The company's yearly financial statement is not available on IDX                              | (13)      |

|    |   |     |
|----|---|-----|
| 3. | Real Estate, property and building construction companies which doesn't use Indonesian Rupiah currency. | (0) |
|    | Total Companies   | 42  |
|    | Total Observation 42 x 4  | 168 |

## VI. Descriptive Statistic, Normally Test and Hypothesis Test

### 1. Descriptive Statistics

The descriptive statistics describes about the mean (the central tendency of data), standard deviation, and the number of data. The outcome of descriptive statistics is listed below

**Table 4.2**

#### Descriptive Statistic

|                    | N  | Minimum     | Maximum      | Mean          | Std. Deviation |
|--------------------|----|-------------|--------------|---------------|----------------|
| DACCBefore         | 42 | .0066922390 | .2592134660  | .068099457524 | .0595072151936 |
| DACCAfter          | 42 | .0196742260 | 1.6538717790 | .170787288357 | .2583044018992 |
| Valid N (listwise) | 42 |             |              |               |                |

Based on the results of the descriptive statistics tests for discretionary accruals, can be seen mean value of discretionary accrual before IFRS adoption are 0.068099457524 and after IFRS adoption are 0.170787288357. Before adoption of IFRS, the minimum value of earnings quality is 0.0066922390 and the maximum value is 0.2592134660. Meanwhile, after adoption of IFRS, the minimum value of earnings quality is 0.0196742260 and the maximum value is 1.6538717790.

### 2. Normally Test

**Table 4.3**

**Table 4.3**

#### One-Sample Kolmogorov-Smirnov Test

|                                  |                | DACCPre           | DACCPost          |
|----------------------------------|----------------|-------------------|-------------------|
| N                                |                | 42                | 42                |
| Normal Parameters <sup>a,b</sup> | Mean           | .068099457524     | .170787288357     |
|                                  | Std. Deviation | .0595072151936    | .2583044018992    |
| Most Extreme Differences         | Absolute       | .254              | .279              |
|                                  | Positive       | .254              | .252              |
|                                  | Negative       | -.151             | -.279             |
| Test Statistic                   |                | .254              | .279              |
| Asymp. Sig. (2-tailed)           |                | .000 <sup>c</sup> | .000 <sup>c</sup> |

a. Test distribution is Normal.

b. Calculated from data.

c. Lilliefors Significance Correction.

Based on the results of the normality tests, it can be seen that each paired data population is not normally distributed for the reason that the value of Asymp. Sig. is  $< \alpha$  or 0.05 in each case. The pre-IFRS convergence and post-IFRS convergence data populations for the measure of discretionary accruals have an Asymp. Sig. value of .000 and .000 respectively. Therefore, hypothesis testing in this research will utilize the Wilcoxon Signed Ranks Test as the difference test for the paired data populations of means.

### 3. Hypothesis Test

**Table 4.4**

#### **Wilcoxon Signed Ranks Test for Discretionary Accruals**

**Test Statistics<sup>a</sup>**

|                        | DACCPost -<br>DACCPre |
|------------------------|-----------------------|
| Z                      | -3.070 <sup>b</sup>   |
| Asymp. Sig. (2-tailed) | .002                  |

a. Wilcoxon Signed Ranks Test

b. Based on negative ranks.

Based on the result of the Wilcoxon Signed Ranks Test, the value of Asymp. Sig (2-tailed) is 0.02. This value is less than the value of  $\alpha$  or 0.05. The evidence indicates that there is significant difference in the measure of discretionary accruals between before and after the full implementation of IFRS convergence. Thus, the first research hypothesis (Ha1) is accepted.

## **VII. Discussion**

From the results of testing hypotheses measured through discretionary accruals, it can be concluded that there was significant difference in the earnings quality on the practice of the manipulation through accruals between before and after the adoption of IFRS into PSAK. The full implementation of IFRS convergence started on 1 January 2012 have significant impact on earnings quality among listed real estate, property and building construction firms on IDX.

The adoption of IFRS into PSAK gives impact in increasing and decreasing on earnings quality. It is because the adoption of IFRS causes some changes such as more principles-based nature, use of fair value and more professional judgment (Sinaga, 2012). Principles-based standards make a number of estimations that should be justifiable and require more professional judgment (Schipper, 2003). As of principles-based standards require more professional judgment, it makes the standard become flexible and subjective in assessing assets or liabilities. As a result, larger opportunities for practicing earnings management are possible when inconsistent judgment is carried out (Schipper and Nelson, 2003).

The use of more fair value causes the difference on earnings quality. Fair value accounting refers to the practice in which companies increase or decrease the

value of their assets or liabilities in the financial statements in order to reflect the changes in the market prices of these assets (IASB 2003). The ability to reflect recent economic situation is the benefit of fair value (relevance). On the other hand, fair value also has weaknesses. One of the weaknesses is the difficulty for determining the fair value of assets or liability which has no active market value. As a consequence, the appraisal tends to be subjective because there is no standard for assessment.

### **VIII. Conclusion**

Results from the hypothesis testing shows that there is significant difference in the level of earnings quality after the full implementation of IFRS convergence in listed real estate, property and building construction companies that effective in 2012. It means that hypothesis is accepted. The full adoption of IFRS that started in 2012 can give significant difference in earnings quality.