

Do the Institutional Factors Affect the Accounting information quality Post IFRS Adoption: Asian Countries Study

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Abstract. This study aims to investigate the effect of institutional factors (i.e., differences in national accounting standards with IFRS, enforcement of accounting and auditing standards, investor protection, and corporate governance) on the accounting information quality. We tested the hypotheses by multiple linear regression analysis, estimated on three measures of accounting information quality (i.e., accruals quality, value relevance, and earnings management). Statistically, the results show that H1 is supported on the dependent variable of earnings management but not for accrual quality and value relevance. H2 is not supported in all measures of accounting information quality (accrual quality, value relevance, and earnings management). The results show that statistically, H3 is supported for the dependent variable accruals quality and earnings management but not significant for the dependent variable value relevance. Finally, the results show that statistically, H4 is supported for the dependent variable of accrual quality but not for the other two dependent variables. The test results H1, H2, H3, and H4, are robust by controlling for country and company level variables (i.e., capital market developments, classification of developed/developing countries, legal system, company size, and sales growth).

Keywords: divergence, enforcement, investor protection, accrual quality, value relevance, earnings management

1 Introduction

Previous research confirms that higher quality financial reporting helps reduce suboptimal capital investment (e.g., [1]; [2]; [3]). Information asymmetry between companies and investors causes capital investment that is not optimal (e.g., [4]; [5]; [6]). Other studies have shown that higher reporting quality reduces adverse selection in securities markets (misalnya, [7]; [8]; [9]). Higher reporting quality also reduces the cost of capital (misalnya, [10], [11]) and improve the efficient information intermediary (misalnya, [9], [12]).

The IASB aims to promote uniformity of high-quality financial reporting worldwide by adopting International Financial Reporting Standards (IFRS). The adoption of IFRS aims to increase the transparency and comparability of financial reporting in order to reduce information asymmetry (e.g., [13]; [14]; [15]; [16]; [17]).

The introduction of IFRS is not without controversy [18]. [19] stated that several previous studies showed that the quality of information increased after the adoption of IFRS (e.g., [20]; [13]; [21]; [22]; [23]; [14]; [24]; [25]; [26]). Other studies have shown that after the adoption of IFRS, the quality of information decreases (e.g., [27]; [28]). Meanwhile, several studies have

shown that the quality of information remains the same after adopting IFRS (e.g., [29]; [30]; [31]).

The accounting information quality is not entirely uniform and comparable among IFRS adopting countries. Other forces shape accounting quality, in addition to accounting standards or rules [32]. [33] show that country-level regulation influences accounting practices. Several studies suggest the need to investigate the country's institutional factors that interact with the adoption of IFRS and the accounting information quality.

As a form of state institution, law enforcement affects the quality of financial reporting (e.g., [34]; [35]; [36]). Countries with strong law enforcement usually have higher accounting quality than countries with weak law enforcement (e.g., [37]; [11]; [38]). In the absence of strong law enforcement (specifically accounting and auditing enforcement), even high-quality standards will not make a difference to users of financial statements because the regulator will not enforce the standards [39].

Countries that adopted IFRS had varying degrees of divergence (national standard differences compared to IFRS) before adopting IFRS, so the level of variation from IFRS is an important issue to study (e.g., [40]; [41]). [42] examined the difference in the effect of IFRS on earnings management compared to national GAAP on earnings management before IFRS adoption. [42] proved that countries with higher divergence could benefit more from the adoption of IFRS.

The literature proves that the quality of financial reporting is determined by solid investor protection, strong law enforcement, and the common law legal system (e.g., [43]; [44]; [14]; [45]; [39]; [46]; [38]; [47]). The literature related to the adoption of IFRS indicates that high quality accounting standards and law enforcement are needed to reduce earnings management [42]. Corporate governance, both country and company level, will complement each other in countries with strong investor protection and high quality financial reporting [48]. Robust corporate governance mechanisms at the corporate level may be better able to reduce the negative impact of an ineffective legal system that causes weak investors and enforcement of financial reporting [49].

This study aims to investigate the effect of institutional factors (i.e., differences in national accounting standards with IFRS, enforcement of accounting and auditing standards, investor protection, and corporate governance) on the accounting information quality. Specifically, this study examines whether differences in national accounting standards with IFRS, accounting and auditing standards enforcement, investor protection, and corporate governance affect the accounting information quality.

2 Literature Review

IFRS Adoption and Accounting Standard Divergence

Those who support IFRS argue that IFRS produces high-quality standards, as evidenced by more timely loss recognition, reduced earnings management, and greater value relevance (e.g., [50]; [13]; [51]; [33]). IFRS encourages comparability and improves the quality of financial reporting, thereby theoretically lowering information risk and cost of equity capital (32). High quality financial reports also encourage cross-border capital flows and improve capital market efficiency (e.g., [52]; [14]).

Those who are opposed to IFRS adoption argue that adopting IFRS poses problems because it will create an operating burden on small companies that do not have significant international operations. Also, it would bear the costs associated with implementing IFRS that outweigh the benefits (33); lead to a loss of quality given GAAP (34); and resulting in improved earnings management due to the flexibility inherent in IFRS-based principles (e.g., [53]; [54]; [55]).

Accounting standard divergence is the degree of difference between local standards that apply in a country compared to applicable international standards (38). [40] and [41] explained that there were variations in national GAAP and IFRS divergences between countries before adopting IFRS.

The timing of IFRS adoption is done differently by many countries, affecting the quality of financial information. For example, as issued by the IASB, IFRS is still not permitted in some countries, such as India and Indonesia (Deloitte 2015). The leaders of the G20 countries encourage the implementation of IFRS as an applicable international standard. Based on the description above, we propose a hypothesis:

H1: The accounting standards divergence affects the accounting information quality.

Accounting standards enforcement

Enforcement is an activity to encourage compliance with laws or regulations. The literature states that enforcement is needed to improve compliance with accounting standards (i.e., IFRS) (e.g., [56]; [57]; [35]; [58]). So far, proxies for "law enforcement" are usually related to the country's legal system and institutions. For example, the "rule of law" proxy, provided by [46] and [59], was used widely because of its suitability in various countries, but the proxy was unable to capture the enforcement meaning associated with accounting standards and changes in accounting standard enforcement practices around the time of IFRS adoption.

[48] developed a previous study that examined the interaction between law enforcement and the quality of financial reporting after the adoption of IFRS, by focusing on accounting and auditing standards enforcement (e.g., [35]; [36]; [58]). Based on this argument, we propose a hypothesis:

H2: The accounting standards enforcement affects the accounting information quality.

Investor Protection;

The accounting information quality is determined by a country's overall accounting standards and institutional arrangements and corporate incentives for financial reporting (e.g., [43]; [60]). Country-level investor protection reduces earnings management, thereby improving the accounting information quality (e.g., [38]; [61]; [62]; [63]; [43]; [64]; [11]). Legal protection of investors from managerial takeovers is one of the legal aspects that has received significant attention [65]. Based on these arguments, we propose a hypothesis:

H3: Investor protection affects the accounting information quality.

Corporate Governance

[48] suspect that stated that in countries with strong investor protection and high-quality financial reporting, corporate governance at the corporate and country levels would complement each other. A strong corporate governance mechanism will be able to reduce the negative impact of an ineffective legal system [49]. The impact is different in countries with

weak investor protection and insufficient law enforcement. Research conducted by [19] aims to provide further evidence on the impact of IFRS adoption and corporate governance mechanisms on the accounting information quality, using data from Indonesia. Based on these arguments, we propose a hypothesis:

H4. Corporate governance affects the accounting information quality.

3. Methodology and Data Analysis

Sampel dan Data

The research sample uses Asian countries because of the diversity of institutional characteristics. There are developed countries (e.g., Japan, Singapore, and Hong Kong), developing countries (e.g., India, Philippines, Thailand, Malaysia, and Indonesia), and countries that have the potential to grow very large (e.g., Taiwan and Korea). Asian countries have diversity in terms of IFRS adoption and convergence. Until 2020, some countries prefer to converge instead of fully adopting IFRS (i.e., Japan, Indonesia, and Thailand). Another diversity that Asian countries have is in the level of accounting standard enforcement, investor protection, and corporate governance. The companies selected as samples are non-financial companies with complete data and financial data ending on December 31 from 2008-2020.

Testing the Hypotheses

This study tested the hypothesis using multiple linear regression analysis. Hypothesis testing using STATA 14 statistical tools. The model for estimating the hypothesis is as follows:

$$IQ = \alpha + \beta_1 X1Divergence + \beta_2 X2Enforcement + \beta_3 X3GCI + \beta_4 X4Gov + \sum Controls + \epsilon \quad (1)$$

where:

IQ: information quality (measured by market-based and accounting-based measures, namely value relevance, accrual quality, and earnings management)

Divergence: standard accounting divergence—the difference in a country's local standards compared to IFRS as measured by the divergence score by [42]

Enforcement: accounting standard enforcement—the degree of enforcement of accounting and auditing standards in a country as measured by accounting and auditing standards enforcement scores by [36].

GCI: investor protection—country-level investor protection as measured by the global competitiveness index (GCI) 2019 by the World Economic Forum

Gov: corporate governance scores developed by the Thomson Reuters database in 2019

€: error term

4. Research Result and Discussion

Table 1 describes the descriptive statistics. Based on Table 1, accrual quality (AQDD) has a mean value of 39135.9; value relevance (VR) has a mean value of 7.097767. ; earnings management (DA) has a mean value of .0888184; standard accounting divergence (DIVERGENCE) has a mean value of 6.841587; accounting and auditing standards enforcement (ENFORCEMENT) has a mean value of 9.002803; investor protection score (GCI) has a mean

value of 73.8718; capital market development (MARKET) has a mean value of 3.087018; the country classification (DEVELOP) had a mean value of .5621093; the legal system (LEGAL) has a mean value of .4415295; firm size (LNTA) has a mean value of 11.84111, and sales growth (GROWTH) has a mean value of .5541605.

Table 1. Descriptive Statistic.

Variable	Obs.	Mean	Std.Dev.	Min	Max
AQDD	13,341	39135.9	232506.2	0	1.21e+07
VR	13,226	7.097767	817.6036	-54.61753	94027.91
DA	13,636	.0888184	32.74301	-808.1208	3081.387
DIVERGENCE	13,913	6.841587	2.40789	0	9
ENFORCEMENT	13,913	9.002803	3.663801	6	22
GCI	13,919	73.8718	9.224717	9	84.8
GOV	1,079	46.00719	20.80674	3.416489	98.70056
MARKET	13,919	3.087018	6.419731	.2868648	20.37729
DEVELOP	13,919	.5621093	.4961453	0	1
LEGAL	13,913	.4415295	.4965873	0	1
LNTA	9,095	11.84111	2.920672	.7518255	84.8
GROWTH	8,215	.5541605	13.41187	-.3950583	989.8385

(source: data summarized from descriptive statistics)

Table 2 presents the results of hypothesis testing. The dependent variable is accrual quality, value relevance, and earnings management). H1 states that the accounting standards divergence affects the accounting information quality. Statistically, the results of the regression test prove that H1 is supported for the dependent variable of earnings management. On the other hand, the test results show that H1 is not supported for the dependent variables of accrual quality and value relevance.

Table 2. Result of Hypotheses Testing.

Variable	Accrual Quality Coef. (sig.)	Value Relevance Coef. (sig.)	Earnings Management Coef. (sig)
DIVERGENCE	9492.4038	.00026457	-.03605481**
ENFORCEMENT	23798.661	-.00861325	.00967109
GCI	-38222.786**	-.0217271	.07636305***
GOV	5063.9161***	-.00179512	.00129277
MARKET	-202661.92	.02928379	-.24650564
DEVELOP	4601692.4*	-.3849733	4.2796372
LEGAL	-3839681.6	.61481526	-4.8640196
LNTA	237083.51***	.01315921	-.0303122
GROWTH	12022.379	-0.00049251	.01129601
cons	-1188909.9	1.4746219	-4.8560009***

Significant at * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

H2 states that the enforcement of accounting and auditing standards affects the accounting information quality. The results show that statistically, H2 is not supported in all measures of accounting information quality (accrual quality, value relevance, and earnings management). Next, H3 states that country-level investor protection affects the accounting information quality. The results show that statistically, H3 is supported for the dependent variable accruals quality and earnings management but not significant for the dependent variable value relevance. Finally, H4 states that corporate governance affects the accounting information quality. The results show that statistically, H4 is supported for the dependent variable of accrual quality but not significant for the other two dependent variables. The test results H1, H2, H3, and H4, are robust by controlling for country and company level variables (i.e., capital market developments, classification of developed/developing countries, legal system, company size, and sales growth).

5. Implication and Suggestion for Future Research

The H1 test shows that the difference between accounting standards and IFRS affects earnings management. The results prove that the higher the difference in accounting standards, the lower the accounting information quality indicated by the value of discretionary accruals. The result has implications for efforts to reduce the magnitude of the difference between national accounting standards and international accounting standards (IFRS). The H2 test shows that the enforcement of accounting and auditing standards does not significantly increase the accruals quality, value relevance, or reduce earnings management. That is, other institutional factors must complement the accounting standards enforcement to improve the accounting information quality. The H3 test shows that statistically, country-level investor protection significantly affects the accruals quality and earnings management. Country-level investor protection does not significantly affect the value relevance of financial statements. The H4 test shows that statistically, corporate governance significantly affects the accruals quality but does not significantly affect the value relevance of financial statements and earnings management activities.

The test results imply that each institutional factor interacts with the other in improving the accounting information quality (i.e., increasing the accruals quality and value relevance of financial statements and reducing earnings management). Future research needs to explore other

variables that can institutionally improve the accounting information quality. Future research also needs to anticipate statistical analysis techniques that can overcome the threat of omitting variables and biases due to a large amount of missing data.

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