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INTERNATIONAL FINANCIAL REPORTING STANDARD IMPLEMENTATION: DOES IMPROVE FINANCIAL REPORTING QUALITY?

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Abstract: *Previous studies have investigated the impact of international Financial Reporting Standard implementation (IFRS) on financial reporting quality, nevertheless those studies used the conceptual framework of the preparation of financial statements to measure of IFRS implementation by comparing the value relevance, timeliness, comparability and usefulness of financial reporting quality before and after the implementation of IFRS.*

This research aims to investigate the influence of corporate governance mechanism on implementation of international financial reporting standard (IFRS) and its impact to financial reporting quality by Indonesia stock exchange companies. The application of IFRS is measure with content of policy approach adopted from the theory of public policy implementation. Using survey method and data collected through questionnaires distribution show that, 1) 51, 52% of respondents would not implementing of IFRS if not required by the Regulation. 2) The process is costly. 3). Most of respondents perceive that the benefit of implementing IFRS to lower the cost of capital is rarely. Corporate governance mechanisms had significant effect on the IFRS implementation. Audit committee and internal audit as part of corporate governance are involved on IFRS implementation. The IFRS implementation had significant effect on financial reporting quality. Finally, IFRS implementation improved financial reporting quality

Keywords: *Corporate Governance, IFRS Implementation and Financial Reporting Quality*

1. INTRODUCTION

Some controversies have risen due to the implementation of International Financial Reporting Standard (IFRS) especially about recent years accounting information quality whether IFRS implementation could be compared to

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United Stated Generally Accepted Accounting Principle (US-GAAP). Based on the past research, many researcher has examine whether IFRS has increase timeliness, value relevance, and usefulness of financial statements (Beijerink, 2008 ; lantto et al, 2007 ; Callao et al, 2007)

IFRS implementation has enhanced the quality of accounting information, transparency and comparability of financial statements in European countries. (Iatridis, 2010; Paglietti, 2009 and Chen et al, 2009). IFRS has better value relevance and timeliness compared to US-GAAP (Beijerink,2008) and financial statements usefulness, (Callao, et al 2007).a Companies implementation International Accounting Standard (IAS) has higher accounting quality compared to companies implementing non-American domestic standard. (Barth et al, 2008).

IFRS implementation have improve financial statements transparency and make it comparable between European companies, (Jermaickowickz and Gornik-Tomaszewski, 2006), IFRS was implemented by European countries to increase protection towards investor, and also to increase comparativeness and comprehensiveness from financial information, (Hope et al 2005).IFRS implementation highly relates to good corporate governance mechanism (Verriest, et al 2011; Goodwin, et al 2009; Chen and Cheng 2007). A good and strong corporate governance mechanism is involved in the financial reporting when IFRS was implemented for the first time, companies with independent board and effective audit committee will reveal substantial information regarding IFRS effect on financial statements (Verriest, et al 2011).

Corporate governance mechanism makes IFRS easier to be implemented, and corporate governance as the recommended law is expected to decrease individual needs inside the company (Renders and Gaeremynck, 2007). Corporate governance also becomes an important mechanism to reinforce ineffective accounting standard, (Chen and Cheng 2007). Corporate governance mechanism requires the council to effectively monitor and direct corporation activities.(Anand 2008:77). Audit committee and internal audit take role as supervisor and also involved in IFRS implementation. (Al-shetwi et al 2011; KPMG 2007; The Institute of Internal Auditor Research Foundation 2009).

Even though many research has been conducted to test the impact of IFRS implementation on financial reporting quality, nevertheless those studies used the conceptual framework of the preparation of financial statements to measure of IFRS implementation by comparing the value relevance, timeliness, comparability and usefulness of financial reporting quality before and after the implementation of IFRS.

This research aims to investigate the influence of corporate governance mechanism on implementation of international financial reporting standard (IFRS) and its impact to financial reporting quality. IFRS Implementation Measurement is using contents of policy implementation approach adopted from the theory of public policy implementation. (Merilee S. Grindle 1980). To see the implementation quality of one policy, benefit would be the strong reason to implement the policy. IFRS implementation is also measured from skill staff and training, PSAK standard and guidance and IFRS implementation time. (Tan lay leng et al 2007; Jermaickowickz and Gornik-Tomaszewski, 2006). This research is done using survey method and its questionnaires were sent by post or directly to the respondent. The respondents of this research are non-finance companies listed in Indonesia Stock Exchange 2013.

2. LITERATURE REVIEW

2.1 Corporate Governance and IFRS Implementation

IFRS implementation requires high quality from all stakeholders and includes good support of corporate governance mechanism. Audit committee and internal audit committee also play crucial role in corporate governance implementation and are responsible for to create accountability and high quality financial reporting (Rezaee and Riley, 2010:124).

The financial statements arrangement standard change from Indonesia GAAP to IFRS requires audit committee and internal audit committee inside IFRS implementation process (KPMG 2007; *The Institute of Internal Auditor Research Foundation* 2009). Committee has to prepare their management transition plan by identifying required human resources and its educational background, how to maintain supervision and integrity of financial statements during IFRS implementation transition. Audit committee and internal audit committee have to be one of the key played inside IFRS implementation due to its wide impact to internal control of the company. *(*KPMG 2007 ;*The Institute of Internal Auditor Research Foundation 2009).*

Previous research reveal that, good corporate governance mechanism has relation to IFRS implementation, (Verriest, et al 2011; Goodwin, et al 2009; Chen and Cheng 2007). A good corporate governance mechanism involves highly inside financial reporting during the first implementation of

IFRS. Companies consisting good independent board and effective audit committee will reveal substantial information about IFRS effect on financial statements (Verriest, et al 2011). Corporate governance existence cause IFRS more likely to be applicated due to its effective law power in IFRS implementation and weak law reinforcement (Renders and Gaeremynck, 2007). Based on above statements, the proposed hypothesis is :

1st Hypothesis. Audit committee affects IFRS implementation

2nd Hypothesis. Audit internal affects IFRS implementation

2.2 Financial Reporting Quality

After IASB Introduced International Financial Reporting Standards (IFRS) to all listed European firms in 2005. IFRS and United Stated-Generally Accepted Accounting Principle (US-GAAP) were seen as the two world financial reporting standards. Before the introduction of IFRS, US-GAAP was accepted widely as the international set of standards to ensure high quality financial statements. IFRS implementation has risen many controversies toward financial reporting qualities in this recent years. (Beijerink, 2008)

Accounting standard difference could cause difference inside accounting quality, (Chen et al 2010). IFRS and US-GAAP has different rules about recognition or reporting thus affecting information content from accounting number information, (Beijerink, 2008). IFRS implementation could increase accounting quality, IFRS reduces obscurity and inconsistency inside local standard as it is easier to be intrepeted and implemented. This continuously decrease the chance for managers to take profit from obscurity or the ambiguity of local standard by create earning management, (Chen et al 2010; Barth et al, 2008).

Previous research shows that IFRS implementation has produced increased accounting quality in mainland European countries (Barth et al, 2008) and this quality increase is related to IFRS adaptation, (Chen et al 2010). IFRS implementation increases transparency, comparability, and accounting quality of European company financial statements (Jermaickowickz and Gornik-Tomaszewski, 2006; Iatridis, 2010; Paglietti, 2009) and financial information comprehensiveness *(*Hope et al, 2005). IFRS has higher value relevance and timeliness compared to US-GAAP, (Beijerink, 2008). After that, Callao et. al. (2007) states that financial statements value relevance has experienced betterment after IFRS implementation and financial statements usefulness could be reach. Based on above statements, the proposed hypothesis is as follow:

3rd Hypothesis. IFRS implementation could increase financial statements quality

3. DATA AND RESEARCH DESIGN

The population of this research is all listed companies inside Indonesian Stock Exchange 2013. (www.idx,com). Data collecting was done using survey method and the questionnaire were sent by airmail or delivered directly to the respondents.

3.1 Measurement of Variable

We used two corporate governance mechanisms to measure corporate governance quality which are audit committee and audit internal (Rezaee and Riley, 2010:124; Rezaee2008; IIA 2011; Decree of Chairman of Capital Market and Finance Institutions Supervisory Agency Indonesian (BAPEPAM) Number: Kep-643/BL/2012; Decree Chairman of Capital Market and Financial Institutions Supervisory Agency Indonesian (BAPEPAM) No. Kep-496/BL/2008. The financial reporting quality was measured using qualitative characteristics of financial statement (HKICPA 2008: 8; Kieso et al 2011: 7; Indonesian Institute of Accountants; 2012). IFRS implementation was measured using contents of policy implementation approach adapted from public policies theory, (Merilee S. Grindle 1980). This theory states that to see the quality of one policy implementation, benefit is one of the key measurement reason for the implementation of that policy. IFRS implementation is also measured by staff skill and training, PSAK guidance standard, and IFRS implementation time (Tan lay leng et al 2007; Jermaickowickz and Gornik-Tomaszewski, 2006).

4. EMPIRICAL RESULT

In Indonesian Stock Exchange listed companies IFRS implementation as financial statements arrangement standard was quite good. 51,52% respondent agreed that a full IFRS implementation was not voluntary but as an obligation from regulator. The respondents felt that IFRS implementation wasn't beneficial yet for the companies. They were also uncertain that IFRS implementation could reduce financial statements arranging cost and capital cost, and also open access to capital market and help facilitate foreign funding.

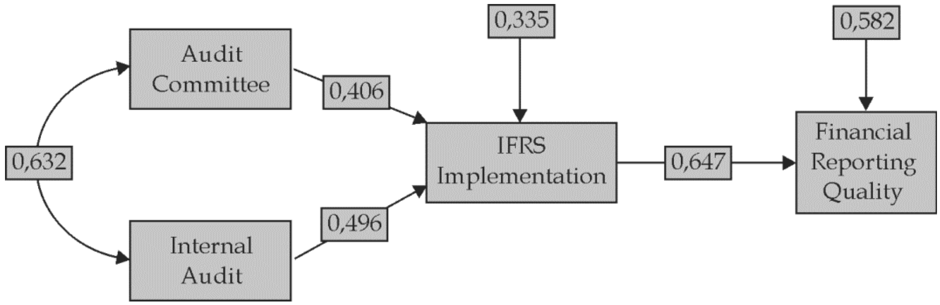
In the beginning of IFRS implementation, companies has spent cost to strengthen the system, technology, and human resources, thus making them feel IFRS implementation cannot make financial statements arranging more effective. According to the finding of Jermaickowickz and Gornik-Tomaszewski in 2006 IFRS adaptation needs huge cost, and it is also a complex and exhausting process for European companies. 40% until 60% of accounting staff has adequate knowledge about IFRS by following professional training twice a year. In their IFRS first implementation, companies usually use professional consulting service. IFRS descriptive statistic is explained in the table 1 below:

Table 1
Respondent Commentary towards IFRS Implementation

No	Questions	Respondent Response (%)	Mode
1.	Reason of IFRS implementation		
	100% IFRS implementation caused fully by regulatory obligation	51,52%	4
	IFRS implementation decrease cost	39,39%	3
	IFRS implementation open access to foreign funding	45,45%, 21%	3, 1
	PSAK difficulty compared to IFRS	72,73%	3
2.	Staff skills and Training		
	Possessing IFRS training program	39,39%	4
	Preparing quantity skill of staffs	42%, 39%	3,4
	Possessing IFRS ability	42%, 36%	3,4
	Accountancy Staff Ability of IFRS	18%	4
	Using consultancy service to arrange the financial statements (IFRS)	45%	3,4
3.	PSAK standard and Guidance		
	Accounting Policy of company	48%	4
	PSAK draft exposure and implementation time	36%	4,3

4.1 The Influence of Audit Committee on IFRS Implementation

Data analysis used to test they hypothesis was path analysis using the assistance of Lisrel 8.70 Software. The research result is formulate inside these pathway diagram below:



Based on the diagram above, statistically audit committee has significant effect towards IFRS implementation while audit committee has higher involvement during IFRS implementation. Audit committee supervises and ensure IFRS implementation process and supervising IFRS implementation during financial statements arrangement. Audit committee has 16,5% effect towards IFRS, while its indirect effect through audit and internal audit committee relation is 12,7%, with total effect of 29,2%. This data showed that the more quality audit committee possess the more effective IFRS implementation will be.

4.2 The Influence of Internal Audit on IFRS Implementation

Besides playing part crucial part inside corporate governance, internal audit also has important role in IFRS implementation. Audit internal is involved in IFRS implementation and internal audit quality has positive effect towards IFRS implementation. Internal audit effect towards IFRS is 24,6% while its indirect effect through internal audit and audit committee relation is 12,7%, making its total effect to be 37,3%. Internal audit reviews implementation process and identifies affected area by IFRS implementation. It can be concluded that the supervising and pressure function of internal audit can increase the quality of IFRS implementation.

The hypothesis test showed that both audit committee and internal audit affects IFRS implementation. Audit committee and internal audit is a part of corporate governance integral and also involves inside the process to ensure the progress of a good IFRS implementation. From this finding, we can interpret that the pressure and role of corporate governance mechanism could support IFRS implementation as a new standard to do effective financial statements arrangement.

This research supports Verriest, et al 2011 research in a way that good corporate governance mechanism could support financial reporting in the first time IFRS is implemented. Companies possessing an effective audit committee will reveals substantial information about IFRS affect towards financial statements. Corporate governance is recommended as an effective law in IFRS adaptation during weak law reinforcement, (Renders and Gaeremynck, 2007). Corporate governance is an important mechanism to reinforce ineffective accountancy standard (Chen and Cheng, 2007)

4.3 The Influence of IFRS Implementation on Financial Reporting Quality

Statistically, IFRS implementation has significant effect toward financial reporting. The result has given empirical evidence that IFRS could increase financial reporting quality. The accuracy of financial statements reporting has increased after the companies had implemented IFRS inside their financial statements arrangement. Based on majority of the sample, most companies who managed to collect their financial statements on time gave it to the regulator.

This research is in line with Beijerink, 2008 finding that states IFRS has higher value revelance and timeliness compared to US-GAAP. Barth et al (2008) reported American Companies implementing US-GAAP generally have higher accountancy unit with higher value relevance compared to those non-American companies adopting IAS from 1995 to 2006. IFRS and US-GAAP have different rules for reporting and measurement thus affecting the information of accountancy unit (Beijerink, 2008).

IFRS implementation has contribution or effect of only 41,81% towards financial reporting quality, this indicates other factor contributing to reporting quality. Some research states the other factor contributing on reporting quality are management risk during financial report arrangement, incentive from report arrangement, regulations, regulations reinforcement, and institutional characteristic.

5. CONCLUSION

Corporate governance mechanism and controlling are needed in IFRS implementation. The involvement and pressure from corporate governance mechanism could support IFRS implementation as an effective new standard in financial statements arrangement. As corporate governance mechanism, audit committee and internal audit is involved in IFRS implementation by doing supervising and ensuring a good IFRS implementation.

A strong corporate governance mechanism involved higher in the first time IFRS is implemented. Meanwhile companies with effective audit committee will reveal substantial information about IFRS effect towards financial statements, (Verriest, et al 2011). Corporate governance mechanism is recommended as an effective law to reinforce ineffective accountancy standard (Renders and Gaeremynck, 2007; Chen and Cheng, 2007).

IFRS implementation increase the quality of financial reporting and also its accuracy. Althouth 41,42% of the respondents stated at their IFRS implementation reason was fully due to obligation from regulatory board. IFRS implementation hasn't given many benefits to the companies, due to some uncertainty that IFRS can reduce cost of financial statements arrangement and capital cost. IFRS is also not believed to open access to foreign funding in the capital market.

6. RESEARCH IMPLICATION

The limitations of this research are as follow: (1) Limited sample size (33 companies) due to low respond rate, (2) Corporate governance mechanism used in this research is only audit committee and internal audit while there are 4 others management mechanism that can affect financial reporting: board of commissioner, external audit, team management and governing bodies (Rezaee and Riley 2010; hopwood et al 20012). (3) IFRS implementation is always match with benefits gained by the companies

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