The Effect of Convergence to International Financial Accounting Standards on Information Asymmetry–Evidence from Indonesian Companies Listed in the IDX from 2015–2019

Evilia Lesmanaputri, Yie Ke Feliana[(✉)], and Stefanus Budy Widjaja Subali

University of Surabaya, Surabaya, Indonesia
yiekefeliana@staff.ubaya.ac.id

Abstract. Since 1994, Indonesian financial accounting standards has referred to as International Accounting Standards/IAS (or International Financial Reporting Standards/IFRS started in 2001). Then, as a G20 member commitment, Indonesia took a more major step by developing standards that have been convergence to IFRS since 2009. A special breakthrough was done in 2015 as the gap between the IFRS, and Indonesian Financial Accounting Standards is only one year. Higher quality of accounting standards and financial reporting information is expected to decrease the information asymmetry in the capital market. This study aims to examine the effect of IFRS convergence on changes in information asymmetry. This study's sample consisted of 725 companies listed on the Indonesia Stock Exchange between 2015 and 2019 across industries. The cost of capital was used as a proxy for information asymmetry. This study shows that IFRS convergence has no significant effect on changes in information asymmetry. Macro control variables, i.e., inflation rate and market rate of return, also have no significant effect on changes in information asymmetry. However, the firm-specific control variables, i.e., firm size, leverage, and ROA, have a significant positive effect on information asymmetry, while beta has a significant negative effect. It argues that Indonesian investors could not make a difference in the quality of financial reporting.

Keywords: IFRS · information asymmetry · cost of capital · Indonesia Stock Exchange

1 Introduction

The IFRS convergence aims to improve the quality of financial statements, which can benefit investors [1]. Many previous studies have examined the association between IFRS adoption and information asymmetry [2–4]. The cost of capital and financial analyst forecast as information asymmetry proxies decreased after adopting IFRS in France [2, 3]. The spread of bid and ask prices decreased under IFRS adopters, although this effect was not significant to accounting information quality in China [4]. The benefit of

IFRS adoption on reduction of cost of capital was also shown in some previous studies [5–7]. In 34 countries from 1998to 2004, the cost of capital of IFRS full adopters was significantly lower than non-adopters [5]. The same evidence was found in Spanish [6] and 17 European countries [7].

Adopting IFRS is argued to provide a higher quality of financial information because it uses more fair value measurement, reflects current company performance, and is more objective [1]. In addition, IFRS mandated companies to provide enough disclosure to the public, making higher transparency [1, 8].

However, other research findings indicate that the information asymmetry of companies whose financial statements are prepared under IFRS is higher than under local GAAP [9]. They used three proxies for information asymmetry: analyst following, cost of equity capital, and uncertainty among analysts and investors (forecast dispersion and stock return volatility). They documented a positive effect of IFRS adoption on analyst following but failed to find evidence of a lower cost of capital for IFRS adopters. Contrary to expectations, uncertainty among analysts and investors appears to be higher for firms using IAS or US GAAP than for firms using local GAAP.

In the Indonesian context, we find two previous studies. The first study used data from 2001 to 2012 to compare information quality and information asymmetry before and after the convergence of IFRS in Indonesia [10]. They found there is no significant difference. However, this study was unclear why they compared the data period before and after 2007 and analyzed starting from 2001 data. This study was only based on 17 companies' agriculture and mining industry data. The second study used data from 2008 to 2016 to examine information asymmetry before and after IFRS adoption, with 2012 as the cut-off period [11]. They got evidence that the information asymmetry decreased after IFRS adoption only at a confidence level of 10%. The two studies used bid-ask spread as a measurement of information asymmetry.

In summary, previous studies provided indecisive conclusions about whether the adoption of IFRS reduced information asymmetry. The other drawback of previous studies is that before and after the study was not appropriate to examine the effect of IFRS on information quality in the Indonesian context because Indonesia's financial accounting standard board chose a gradual approach to adopting IFRS. Thus, this study re-examined it with some improvement. Specifically, this study examines whether information asymmetry is reduced during some period time of gradual IFRS convergence.

This study proves that gradual IFRS convergence in Indonesia does not reduce information asymmetry in the capital market. However, there has been a decreasing trend during the latest three years. This result is still reported, although Indonesia has taken an aggressive step to maintain only a one-year gap with IFRS at the international level. It contributes to Indonesia's standard setters and other countries that the adoption or convergence of IFRS is not the only solution to increase financial information quality in a short period.

Information asymmetry occurs when there is a disparity in information between two or more parties. Information asymmetry exists because of an agency problem between

principal and agent [12, 13]. It is possible to reduce information asymmetry by increasing transparency and publishing financial reports, which reduces the presence of confidential information [14]. Transparency reduces information asymmetry by providing investors with more information about the company's state. The investor's or owner's risk decreases as the investor understands more.

The adoption of IFRS can improve financial statement transparency [8] and reduce information asymmetry [2–4]. When financial statement transparency and comparability enhance, the cost of capital decreases [5–7]. The cost of capital reflects the level of risk that investors are willing to accept. Thus, it makes the cost of capital an appropriate measure of information asymmetry [2, 3, 9]. If information asymmetry is low, investors will be able to monitor the company's performance, lowering the risk borne by investors and the rate of return demanded by investors [8]. Thus, information asymmetry will affect the company's cost of capital [14]. This study's hypothesis is as follows.

H: Gradual adoption of IFRS will reduce information asymmetry during some periods.

2 Research Methods

The population in this study was Indonesian companies listed in the IDX from 2015 to 2019. Table 1 exhibits the description of the final sample. The data were collected starting from 2015 because, since that year, Indonesia's financial accounting standards have only a one-year gap to IFRS at the international level. The Institute of Indonesia Chartered Accountants stated this as the second convergence step [15]. The 2019 data was the latest data available when this study was conducted.

These collected data were then analyzed using a multiple linear regression model.

$$\text{COC}_{i,t} = \beta_0 + \beta_1 \text{SZ}_{i,t} + \beta_2 \text{LEV}_{i,t} + \beta_3 \text{ROA}_{i,t} + \beta_4 \text{Beta}_{i,t} + \beta_5 \text{IR}_t + \beta_6 \text{RM}_t + \beta_7 \text{IFRS}_t + \epsilon_{i,t}$$
(1)

$\text{COC}_{i,t}$: cost of equity capital firm i year t, i.e., weighted average cost of capital.
$\text{SZ}_{i,t}$: size of the firm i year t, i.e., log of total assets.
$\text{LEV}_{i,t}$: leverage of firm i year t, i.e., total long-term liabilities divided by sum of total long-term liabilities and equities.
$\text{ROA}_{i,t}$: return on assets firm i year t, i.e., net income divided by total assets.
$\text{Beta}_{i,t}$: beta stock firm i year t, i.e., average of weekly raw beta.
IR_t: Indonesia's inflation rate year t.
RM_t: market return year t, i.e., the difference value between composite stock market price year t and composite stock market prices year t−1.
IFRS_t: dummy variable for time period of IFRS convergence, i.e., 1, 2, 3, 4, 5 for 2015, 2016, 2017, 2018 and 2019, respectively.

$$\text{WACC} = (\text{Wd} \times \text{Kd}) + (\text{We} \times \text{Ke})$$
(2)

Wd: weight of debt, i.e. total liabilities divided by sum of total liabilities and equity.
We: weight of equity, i.e. total equity divided by sum of total liabilities and equity.

Table 1. Sample Description

Description				Firm Years	
Population (690 listed firms in 2019)				3,220	
Report Net Loss				863	
Beta data is not available				1,139	
Not listed in the full year 2015–2019				334	
Data outlier				80	
Final Sample				725	
Yearly Distribution	2015	2016	2017	2018	2019
	142	142	143	149	149

Ke: net income divided by total equity.
Kd: (interest expense/total liabilities) * (1−tax).
The hypothesis is accepted if β7 in Eq. (1) less than zero.

Linear regression is suitable if the data fit under classic assumptions. In this study, the data pass normality, autocorrelation, and multicollinearity but have heteroscedasticity problems for firm-specific control variables, i.e., SZ, LEV, ROA, and Beta.

3   Results and Discussion

Table 2 exhibits statistics descriptive of variables in which all variables are under normal conditions.

Table 3 exhibits regression results. Firm-specific control variables, i.e., SZ, LEV, ROA, and Beta, have a significant effect on COC. Variables SZ, LEV, and ROA have a positive influence, but the Beta variable has a negative effect on COC. Meanwhile, variables IR, RM, and IFRS do not have a significant effect on COC.

The hypothesis in this study is rejected because the convergence IFRS (IFRS) has no significant effect on information asymmetry as measured by the cost of capital. Although the coefficient is negative, the significance is more than 5%. Thus, there is no significant difference in information asymmetry during the convergency period of IFRS.

Figure 1 depicts the trend in the cost of capital from 2015 to 2019. In an earlier year, COC increased, then stable at around 0.090. However, the COC decreased sharply after 2017. The COC in 2019 as the latest data is less than the earliest data, 2015, despite insignificance for the total period. We should take longer to see whether the decreasing trend is consistent after 2019. The delayed effect of reduction of information asymmetry to some extent was found in France [2].

There are two possible reasons for these results: the investor and financial information sides. First, investors in the Indonesian capital market are still unable to differentiate between information with economic and non-economic value. Short-term-oriented investor dominates Indonesian investors, so the financial information is not thoroughly understood. They only imitate other investors [16]. Second, a gradual approach made

Table 2. Statistics Descriptive of Variables

Var.	Min.	Max.	Mean	SD
COC	0.00043	0.53417	0.08489	0.06978
SZ	7.80288	14.54649	12.12962	1.51642
LEV	0.00000	0.84492	0.24941	0.17945
ROA	0.00008	0.52670	0.07465	0.07168
Beta	0.00258	3.49308	0.93568	0.66969
IR	0.02720	0.03610	0.03162	0.00302
RM	−0.12128	0.19992	0.04396	0.11679

Table 3. Regression Results

Variable	β	t	Sig.
Constant	0.00003	0.008	0.994
SZ	0.00057	3.416	0.001*
LEV	0.03012	20.503	0.000*
ROA	0.98542	270.268	0.000*
Beta	−0.00095	−2.490	0.013*
IR	−0.07072	−0.676	0.499
RM	0.00040	0.175	0.861
IFRS	−0.00001	−0.052	0.959
Adjusted R2	0.9908		
F (sig.)	11,124.711 (0.000*)		

* = significant at 5%

no significant difference in the quality of financial information during the period. Since 1994, Indonesia's financial accounting standards have been developed, referring to IFRS. Then, in 2012, Indonesia's financial accounting standards converged to IFRS with a three-year gap. Lastly, since 2015 Indonesia's financial accounting standards are only a one-year gap with IFRS applied at the international level [15].

The firm-specific control variables are significant. The size of the company has a significant and positive effect on COC, implying that the larger the company, the higher the cost of capital borne by the company. This is consistent with previous research [17]. In Indonesia, larger companies have higher information asymmetry due to the difficulty of investors understanding the financial performance of large company businesses. In addition, large company business is usually also diversified. LEV has a significant positive effect on information asymmetry. The higher the leverage, the greater the risk, and thus the rate of return demanded by investors. This high rate of return is intended to compensate for information gaps. In other words, a high level of leverage indicates a high level
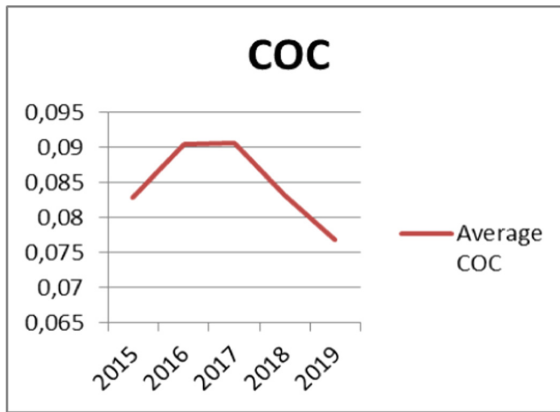
Fig. 1. Cost of Capital during 2015–2019

of information asymmetry. ROA has a significant and positive impact on information asymmetry. ROA describes the company's performance in utilizing its assets to generate a profit, so an increase in ROA will be one of the factors considered by investors when making investments. [18]. When the company's performance is satisfactory, investors will demand a high rate of return, raising the cost of capital [19]. This high rate of return indicates that the risk borne by investors is getting higher. In other words, this high risk indicates that the information asymmetry that exists is increasing. Beta has a negative effect on information asymmetry. Higher beta means a higher correlation between firm stock price and market or higher systematics risk. In the Indonesian capital market, lower unsystematic risk leads to lower information asymmetry [17].

4   Conclusion

This study aims to examine whether there is a reduction in information asymmetry during the second phase of the IFRS convergent period in Indonesia. If there is information asymmetry, investors will demand a high rate of return as compensation for the risk they bear; thus, in this study cost of capital is the proxy of information asymmetry. According to the findings of this study, the adoption of IFRS has not reduced the information asymmetry despite the decreasing trend reported during the last three years.

This may be due to the short-term focus of Indonesian investors. They frequently invest without considering the information contained in financial statements. The other possible reason is changing quality of financial information over the years was smooth due to the gradual approach of the IFRS convergence policy in Indonesia.

These results contribute to Indonesia's accounting standard setters and other countries that also choose a gradual approach; the IFRS is not a simple solution to increase financial reporting quality in a country in a short period.

References

1. Ball, R. (2006). International Financial Reporting Standards (IFRS): Pros and cons for investors. *Accounting Business Research, 36*(sup1), 5–27. https://doi.org/10.1080/00014788.2006.9730040
2. Turki, H., Wali, S., & Boujelbene, Y. (2017). IFRS mandatory adoption effect on the information asymmetry: Immediate or delayed? *Australasian Accounting, Business, and Finance Journal, 11*(1), 55–77. https://doi.org/10.14453/aabfj.v11i1.5
3. Turki, H., Wali, S., & Boujelbene, Y. (2016). The effect of IFRS mandatory adoption on the information asymmetry. *Cogent Business & Management, 3*(1), 1209100. https://doi.org/10.1080/23311975.2016.1209100
4. Kao, H. S., & Wei, T. H. (2014). The effect of IFRS, information asymmetry and corporate governance on the quality of accounting information. *Asian Economic and Financial Review, 4*(2), 226–256. https://archive.aessweb.com/index.php/5002/article/view/1156
5. Kim, J.-B., Shi, H., & Zhou, J. (2013). International Financial Reporting Standards, institutional infrastructures, and implied cost of equity capital around the world. *Review of Quantitative Finance and Accounting, 42*(3), 469–507. https://doi.org/10.1007/s11156-013-0350-3
6. Castillo-Merino, D., Menéndez-Plans, C., & Orgaz-Guerrero, N. (2014). Mandatory IFRS adoption and the cost of equity capital: Evidence from Spanish firms. *Intangible Capital, 10*(3), 562–583. https://doi.org/10.3926/ic.491
7. Lee, E., Walker, M., Christensen, H. B., & Zhao, R. (2008). *Mandating IFRS: Its impact on the cost of equity capital in Europe.* ACCA Research Report no. 105.
8. Daske, H., & Gebhardt, G. (2006). International financial reporting standards and experts' perceptions of disclosure quality. *Abacus, 42*(3–4). https://doi.org/10.1111/j.1467-6281.2006.00211.x
9. Cuijpers, R., & Buijink, W. (2005). Voluntary adoption of non-local GAAP in the European Union: A study of determinants and consequences. *European Accounting Review, 14*(3), 487–524. https://doi.org/10.1080/0963818042000337132
10. Rahayu, R., & Cahyati, A. D. (2015). Komparasi Asimetri Informasi Sebelum dan Sesudah Konvergensi IFRS (Studi Kasus pada Perusahaan Agriculture Dan Mining Yang Terdaftar di BEI). *Widya Warta*, 01 tahun XXXIX (pp. 25–40). https://adoc.pub/komparasi-asimetri-informasi-sebelum-dan-sesudah-konvergensi.html
11. Suhartono, S., & Triyani, Y. (2018). Komparasi Kualitas Informasi dan Asimetri Informasi Sebelum dan Sesudah Adopsi IFRS di Indonesia. *Jurnal Akuntansi, 7*(2), 130–148. https://doi.org/10.46806/ja.v7i2.461
12. Panda, B., & Leepsa, N. M. (2017). Agency theory: Review of theory and evidence on problems and perspectives, *10*(1), 74–95. https://doi.org/10.1177/0974686217701467
13. Scoot, W. R., & O'Brien, P.C. (2020). *Financial accounting theory* (8th ed.). Pearson.
14. Easley, D., & O'Hara, M. (2004). Information and the cost of capital. *The Journal of Finance, 59*(4), 1553–1583. https://doi.org/10.1111/j.1540-6261.2004.00672.x
15. Institute of Indonesia Chartered Accountant, Financial Accounting Standards (Standar Akuntansi Keuangan) Effective January 1, 2022.
16. Setiawan, D., & Hartono, J. (2003). Pengujian Efisiensi Pasar Bentuk Setengah Kuat Secara Keputusan: Analisis Pengumuman Dividen Meningkat (Studi Empiris pada Bursa Efek Jakarta Selama Krisis Moneter). *Jurnal Riset Akuntansi Indonesia, 6*(2).

17. Sugiarto, A. (2011). Analisa Pengaruh Beta, Size Perusahaan, DER dan PBV Ratio Terhadap Return Saham. *Jurnal Dinamika Akuntansi, 3*(1), 8–14.
18. Mayuni, I. A. I., & Suarjaya, G. (2018). Pengaruh ROA, Firm Size, EPS, dan PER Terhadap Return Saham pada Sektor Manufaktur di BEI. *E-Jurnal Manajemen, 7*(8), 4063–4093. https://doi.org/10.24843/EJMUNUD.2018.v07.i08.p02
19. Sari, K. N. Y. (2018). *Pengaruh Rasio Keuangan Terhadap Expected Return: Studi pada Sektor Food and Beverages* [Sarjana thesis, Universitas Brawijaya].