PERSISTENCE OF EARNINGS AFTER IFRS ADOPTION IN BANKING COMPANIES LISTED ON INDONESIAN STOCK EXCHANGE

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ABSTRACT

The aim of the study is to investigate whether adoption of the International Financial Reporting Standard (IFRS) enhances persistence of earnings in the banking sector. We choose 2010 as the central cutoff date before and after adopting IFRS. This study measures persistence of earnings using simple regression analysis and shows that profit regression coefficients after IFRS adoption seem to improve persistence of earnings. We indicate that profit quality after implementing IFRS is higher than before. However, the actual profit generated by companies after implementing IFRS seems to be less than the profit of companies which do not implement IFRS. Thus, the question should be carefully considered by investors.

Keywords: Profit Quality, Persistence of earnings, IFRS, Banking Sector, The Indonesian Stock Exchange.

INTRODUCTION

IFRS is a topic warmly discussed in the last few years (Beckman, 2016; Ebaid, 2016), especially in Indonesia, because Indonesia has been planning to implement full convergence on IFRS since 2012. To implement international-based accounting standards is to increase international acceptance, thus reducing risk in international investment and creating relevant, reliable financial reports (Bertin & Moya, 2013; Ismail, Kamarudin, Zijl & Dunstan, 2013; Joshi, Yapa & Kraal, 2016; Qu, Fong & Oliver, 2012).

One of the changes occurring as the result of IFRS adoption is the emphasis on fair value (Negakis, 2013). Fair value means that a presentation is relevant, recent and conditional on a reappraisal of corporate assets. Lantto (2007) conducted a survey of managers, financial report analysts and auditors in Finland about the utility of IFRS in increasing the value of accounting information. The results show that financial reports based on IFRS can be relevant and reliable. Accounting information can be called relevant when it is able to strengthen or change the expectations of decision makers and it can be called reliable when it is trusted and when users depend on it.

Financial details reported by a company are important information for investors especially are the earnings (Espinosa, Maquieira, Diaz & Abarca, 2015). Investors make decisions partly because the total earnings show the company's financial performance and the persistence of earnings becomes relevant in this way (Dawar, 2014; Doukakis, 2010; Nichols & Wahlen, 2004), because investors are able to use present income for predicting future earnings

(Bandi, 2012). In this way, investors have further information about corporate performance in the future and they are able to make better decisions on investment (Bandi, 2012).

This study is inspired by previous studies of IFRS, in particular, the work of Doukakis (2010), Atwood, Drake, Myers & Myers (2011) and Nicholas & Wahlen (2004). However, previous studies testing earnings persistence against IFRR show inconsistent results. Some studies of IFRS implementation have been conducted in developed countries. However, the implementation of IFRS has not been approached academically in Indonesia since its implementation in 2012.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

IFRS and Its Implementation in Indonesia

For more than a decade, discussion and implementation of IFRS has been a hot issue in more than 100 countries (Beckman, 2016). IFRS is an international accounting standard issued by the International Accounting Standard Board (IASB). These standards are arranged by four major world organizations including IASB, the European Commission, the International Organization of Securities Commission (IOSOC) and the International Federation of Accounting Commission (IFAC).

IASB, earlier known as the International Accounting Standard Committee (IASC), is an independent institution for setting up global accounting standards that are highly respected, easily understood and unambiguous (Nugroho & Siti, 2012).

According to (Joshi et al., 2016) , global business and the irrelevance of country borders as the result of free trade means that a company's internal standards of high quality and its internal framework of regulation are the keys to economic growth. Therefore, global adoption of IFRS will become mandatory, so that all companies' accounts have the advantage of financial reporting to international standards (Ebaid, 2016; Joshi et al., 2016).

Indonesia, from the initial development of its own accounting standards, now heads to convergence with IFRS (Source: Indonesian Accountant Association, 2008). In Indonesia, during Dutch colonization, used Dutch-style standard "Sound Business Practices". In 1974, the Indonesian Accountants Association adopted an American standard known as "Accounting Principal" and in 1984, it was renamed "Accounting Standard". At the end of 1984, Indonesia followed a standard originating from IASC, that is, Pernyataan Standar Akuntansi Keuangan (Indonesian: Statement of Financial Accounting Standards, PSAK) and since 1994, IAA has been committed to follow IASC (now IASB) and, of course, IFRS. In 2008, differences between PSAK and IFRS were resolved, so Indonesia was able to entirely adopt IFRS in 2012 (Joshi et al., 2016; Kenneth & Grazyina, 2013).

Persistence of Earnings Concept

Persistent earnings are earnings that can be used as indicator of future earnings. As defined by Penman (1992) the concept allows revision of earnings expected in the future (expected future earnings) to be based on the innovation of current earnings. More persistent earnings show more innovative earnings; in contrary, if earnings are less persistent, earnings are then less innovative (Tucker & Zarowin, 2006). When investors view corporate earnings as sustainable, expected dividend yield becomes steady (Fama & French, 2002).

Some writers show that measurements of earnings persistence are still different. For example, Lipe (1990) uses the regression coefficient between current period earnings and future period earnings as a proxy for the persistence of accounting earnings. Sloan (1996) referring to Freeman (1982) measures persistence of earnings from the relationship between current earnings and future earnings performance. Earnings are defined as operational earnings divided by total assets. Dechow and Dichev (2002) measure persistence of earnings based on accrual quality, where accrual quality is defined as error estimation from capital regression of accrual performance. Meanwhile, Francis, LaFond, Olsson & Schipper (2004) measure persistence of earnings from the slope coefficient of current earnings regression on lagged earnings. Earnings are defined as earnings from normal activities (net income before extraordinary items, NIBE).

Ecker, Francis, Kim, Olsson and Schipper (2006) measure persistence of earnings from regression of current earnings per share. All these measurements are based on a similar concept: That persistence of earnings can be used as future earnings indicator, Sunarto (2008). More persistent earnings show more informative earnings and in contrast, if earnings are less persistent, earnings become less informative (Tucker & Zarowin, 2006). Persistence of earnings as one measurement of earnings quality comes from the slope coefficient of current earnings regression on lagged earnings. Persistence of earnings is viewed as a measure of earnings quality (Sunarto, 2008).

RESEARCH METHOD

Secondary data of the listed banks that did not adopt IFRS in 2008 & 2009 and adopted IFRS for 2011 & 2012. Year 2010 is used as cut off year. The use of information before and after IFRS adoption gives reliable information on persistence of earnings.

Persistence of Earnings

According to (Sunarto, 2008), persistence of earnings is defined as earnings that can be used as a measure of future earnings; it is only one of the relevant components of earnings prediction. Information contained in earnings has an important role in evaluating corporate performance. To measure persistence of earnings, regression coefficients are used between current period earnings and future period earnings as a proxy, used by (Lipe, 1986), whose regression equation is $\mathbf{E_{it}= \beta_0+\beta_1 E_{it-1}+\varepsilon_{it}}$. $\beta1>1$ shows that corporate earnings have high persistence, $\beta1>0$ shows that corporate earnings are persistent whereas $\beta1 \leq 0$ means that corporate earnings are fluctuating and not persistent (Francis et al., 2004).

RESULT

Earnings in 2008 have an average value of Rp. 580547.3 billion and in 2009, of 1049843 billion SD in 2008 is Rp. 2245493 billion and in 2009 Rp. 2128902 billion. Minimum value of year 2008 is a loss of Rp. -7281150 billion decreasing to Rp. -134870.1 billion in 2009. The maximum value increases from Rp. 5958368 billion in 2008 to Rp. 7308292 billion in 2009.

Later on, earnings in year 2011 average Rp. 2032130 billion and in 2012, Rp. 2488653 billion with SD in 2011 Rp. 3935608 billion and in 2012 Rp. 4772066 billion. The minimum in 2011 is a loss of Rp. -147253 billion and a loss of Rp. -29499 billion in 2012. The maximum increases from Rp. 15087996 billion in 2011 to Rp. 18687380 billion in 2012.

Hypothesis Testing

The next thing to be done is a simple regression analysis looking at β1, the coefficient of regression between current earnings and future earnings as the proxy of accounting earnings persistence. If β1>1, corporate earnings are high persistence, β1>0 means corporate earnings are persistent whereas, β1 ≤ 0 means that corporate earnings are fluctuating and not persistent. If β1 before IFRS adoption is ≤ β1 after IFRS adoption, we may conclude that there is increasing persistence of earnings. The result of hypothesis testing can be seen in the Table 1 below:

Table 1
RESULT OF HYPOTHESIS TEST

BEFORE IFRS				AFTER IFRS			
N	Adj R2	C	Coefficient β1	N	Adj R2	C	Coefficient β1
30	0.62	616519.8	0.75	30	0.99	30471.87	1,21

Before IFRS Adoption

β1=0.75 before IFRS adoption, so persistence of earnings occurs. From Table 3, the linear regression equation gives this expression:

$$E_{it} = 616519.8 + 0.75\ E_{it-1}$$

Constant value obtained is 616.519.8 and this means that when there is no independent variable, the size of earnings occurring is 616.519.8. Whereas the regression coefficient value of current earnings with earnings t-1 is 0.75, this number shows that each unit increase of earnings in period (year) t-1 will increase earnings in the next year t by 0.75. Adj.R-squared is 0.62, with the level of significance 0.02 meaning that it is significant at the 5% level. It indicates that the independent variable affects the dependent variable by 62%, while the rest is affected by other factors outside the model.

After IFRS Adoption

β1 after IFRS is 1.21, showing that persistence of earnings occurs after IFRS. From this result, the linear regression equation looks like this:

$$Eit = 30471.87 + 1.21\ Eit\text{-}1$$

The constant value obtained is 30.471 and this number means that if there is no independent variable, the size of earnings occurring is 30.471. Whereas β1 is 1.21 for current earnings against earnings t-1. It shows that each one-unit increase of earnings t-1 will increase earnings t by 1.21. Adj.R-squared is 0.99 with the level of significance 0.000 meaning that it is significant at the 5% level. This number indicates that the independent variable affects its dependent variable by 99%, while the rest is determined by other factors outside the model of study. From the test result before and after IFRS adoption above, β1 before IFRS adoption is 0.75 and after IFRS adoption is s 1.21. By comparing the two results, then, it can be concluded that after IFRS adoption, the persistence of earnings is increasing; meaning that quality of earnings is increasing after IFRS adoption. Our hypothesis stating that there is increasing the persistence of earnings after IFRS adoption is accepted.

Our result supports (Ewert & Wagenhofer, 2005; Nepali, 2018), who state that more strict accounting standards can make earnings management easier and increase the quality of financial reporting. Latif (2012), testing the quality of information and information asymmetry before and after IFRS adoption in the EU, also shows that quality of information increases after IFRS adoption. More persistent earnings show more informative earnings and contrariwise, if earnings are less persistent, earnings become less informative (Tucker & Zarowin, 2006).

This result is different from that of Doukakis (2010), who tested persistence of earnings before and after IFRS implementation in companies listed on the Greek Stock Exchange. He shows that measurement and reports guided by IFRS do not increase the component of earnings and persistence of earnings. This different result may be caused by different regulations applied in Greece and different types of company sampled in the study.

CONCLUSION

This research is motivated by the implementation in January 2012 of full conformity with IFRS for all Indonesian companies listed in the Indonesian Stock Exchange. In particular, the aim of this study is to investigate whether earning persistence increased after IFRS adoption in Indonesia's banks. Our sample comprised banking companies which adopted IFRS in 2011 and 2012. We cut off the sample in 2010 and use the two years before IFRS, 2008 and 2009, as a baseline. Regression analysis shows that there is earning persistence after IFRS adoption and that earning quality after implementation of the Indonesian Financial Accounting Standard (PSAK, that is, IFRS) is higher than it was beforehand.

The results of this study contradict Doukakis (2010) who examined earnings persistence before and after the implementation of IFRS in Greece. The difference in results is probably due to differences of rules applied in Greece as well as differences in the type of company sampled in the study.

The implications of this current study are these: Firstly, it seems that there is an increase in the persistence of earnings after the adoption of IFRS in the Indonesian Banking Industries. Thus, this study will reassure decision makers that implementation of IFRS improves the earning persistence. Lastly, it is expected that the result of the study will validate previous studies of earnings quality before and after the adoption of IFRS.

Further study will lengthen the research period and use other proxies of earning quality. In addition, in order to increase the validity of using IFRS, further study is needed of other sectors such as manufacturing and the service sector. Lastly, further research can be applied to revise classical assumptions in order to get a Best Linear Unbiased Estimator.

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