IFRS Implementation and Financial Reporting Quality: Review of Evidences from ASEAN Countries

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Abstract

Emergence of the International Financial Reporting Standards (IFRS) has been one of the largest phenomena in the area of accounting and financial reporting. It has given rise to in-depth discussions among stakeholders and academicians on the benefits as well as consequences of IFRS adoption on economies. The study was aimed at analysing the available literature on IFRS implementation in the Association of South-East Asian Nations (ASEAN). The 10 nation association shares strong trade and investment relations with India. In the wake of international trade it is therefore important to ensure comparability of financial reports with those of trade partners. The study therefore is an attempt to understand the IFRS implementation of select ASEAN members. It also reviews the impact of IFRS on financial reporting quality among ASEAN members with special focus on the aspects of value relevance, information quality and earnings. The entire study was based upon the existing literature and secondary data available on IFRS implementation among ASEAN members. The findings of the study provide an understanding of the implications of IFRS and its adoption or convergence on economies.

Keywords: IFRS, ASEAN, financial reporting,

Introduction

Financial reporting is the process of summarising and presenting accurate information about a company's revenues, expenditures, profits, equity and cash flows to its stakeholders. These stakeholders include suppliers, customers, Government, lenders and more importantly the investors. The financial statements should therefore mirror the true and fair view of a company's financial position and operations and act as tools for informed investment decision-making. The primary purpose of financial reports is to enable investors make investment decisions (Omokhudu & Ibadin, 2015). Economies have followed local accounting standards or the Generally Accepted Accounting Principles (GAAP) for decades while preparing their financial reports. However a need was felt to create a common accounting language and harmonise the accounting standards globally to ensure better cross-border comparability of financial reports. This was achieved through the historic innovation of the International Financial Reporting Standards (IFRS) by the International Accounting Standards Board (IASB) in 2002.

Countries worldwide have either permitted or mandatorily adopted the standards since their inception. IFRS have been adopted successfully by thousands of companies in over 144 jurisdictions as of September 2018 ("Use of IFRS Standards around the world", 2018) while many others are converging their local standards with IFRS. Since its adoption by the European Union (EU) in 2005, IFRS has been supported as well as critiqued by researchers. It has sparked a curiosity among empirical researchers to understand the benefits and consequences of this rapidly growing trend across countries.

Around 27000 domestically listed companies on 88 major stock exchanges of the world use IFRS for reporting ("Use of IFRS Standards around the world", 2018). This covers jurisdictions across Europe, America, Africa, Middle East and the Asia-Oceania region.

Table1: Use of IFRS by jurisdictions as of April 2018

	Number of Jurisdictions	Percentage of total
Europe	44	27%
Africa	38	23%
Middle East	13	8%
Asia and Oceania	34	20%
Americas	37	22%
Totals	**166**	**100%**

Source: "Use of IFRS Standards around the world" (2018)

The Asian countries which are mainly considered developing economies are emerging more resilient and stable in the midst of global trends. The Asian Development Bank, in 2016, reported that Asia's intra-regional trade accounted for a total of 60% of total global trade which was second only to the EU's member countries at 69% ("Asia's Economic Integration against Global Disintegration", 2018). Associations like the ASEAN have played a significant role in this direction. It is also worthy to note that eight out of the ten ASEAN countries are also members of the Asian-Oceanian Standard-Setters Group (AOSSG).

India's interaction with ASEAN spreads across areas of defense, telecommunications, industry, agriculture, environmental concerns and tourism. It has strong bilateral connections with each of the 10 member countries. The Free Trade Agreement (FTA) between India and the ASEAN has created tremendous opportunities for trade and economic cooperation especially with powerful emerging economies like Singapore, Malaysia and Thailand.

India is also on its path towards a phase-wise convergence with IFRS. It formulated the IFRS converged Indian Accounting Standards (IndAS) and allowed its voluntary implementation from financial year 2015-16. The same were made mandatory since 2016-17 for companies with a networth of Rs. 500 crore and above and from 2017-18, for all listed companies as well as unlisted companies with a networth of Rs. 200 crore and above (except banks, insurance companies and NBFCs) which will be brought under the system in the subsequent financial years ("Indian Accounting Standards (IFRS converged)", 2018). Since India is in its initial phases of IFRS implementation it is necessary to take a look at the benefits and consequences of the standards on its trade partners. This study has therefore been undertaken to review the academic literature and compile the available empirical evidences on the effects of IFRS adoption on ASEAN economies. The study presents the documented effects of IFRS adoption along a variety of dimensions such as value relevance, information quality and earnings. It also highlights the implementation process of IFRS in the member countries of ASEAN.

Research Objectives

The paper reviews the available empirical literature on the effects of IFRS implementation on the financial reporting of the selected sample. The study was undertaken with the following objectives:

a) To study the IFRS implementation among ASEAN members with reference to domestic companies, foreign companies and SMEs.

b) To review the impact of IFRS on financial reporting quality among firms of ASEAN members with special focus on the aspects of value relevance and earnings management.

Research Methodology

The study follows a qualitative approach and is primarily based on secondary data. It involves a review of the available literature on the implementation of IFRS in ASEAN. The data for objective one has been mainly compiled from the information available on the official websites of the IFRS and IAS organisation. It highlights the implementation process followed by the countries in terms of public domestic companies, foreign companies and SMEs in the respective economies. The second objective focuses on the impact of IFRS on accounting information quality with respect to value relevance and earnings management. For this section, the available research on the said aspects was reviewed. Most of the research evidence is found for economies like Malaysia, Singapore, Thailand, Philippines and Indonesia.

Overview of IFRS implementation in ASEAN

The Association of South East Asian Nations (ASEAN) is an association that today consists of 10 Southeast Asian countries. In 1967, Indonesia, Thailand, Malaysia, Philippines and Singapore founded ASEAN. The aim was to improve economic, political and social cooperation. In 1995, other countries like Vietnam, Cambodia, Laos and Myanmar joined the Association. There is a rising concern for uniformity in the accounting standards followed by these countries and the ASEAN members are under the pressure to converge their local standards with the IFRS at the earliest (Yapa, Joshi, & Kraal, 2011) .

The IFRS implementation process of the ASEAN members has been discussed in detail as follows:

(a) IFRS requirement for domestic companies in ASEAN

Indonesia

The country has followed the convergence approach towards IFRS implementation wherein it attempts to maintain its local GAAP also known as the Indonesian Financial Accounting Standards (IFAS) or Pernyataan Standar Akuntansi Keuangan (PSAK) and gradually converge them with IFRS wherever possible ("Indonesia – IAS Plus", 2012). All domestic companies whose securities are publicly traded are required to follow the PSAK and do not have the option to fully comply with IFRS voluntarily.

Malaysia

The Malaysian Accounting Standards Board (MASB) has approved and applied financial reporting standards for the business entities in the country as follows:

- Public entities:

All non-private entities in Malaysia are required to follow the Malaysian Financial Reporting Standards (MFRS) which are fully compliant with and are substantially equivalent to the IFRS. However an exception is made for a subset of public companies known as Transitioning Entities (TEs) which include agriculture and real estate companies as defined by the standards ("MASB extends transitional period", 2012). The MFRS framework was mandatorily applied to such entities for annual periods beginning on or after 1st January 2018.

- Private Entities:

With effect from financial beginning on 1st January 2016, private entities are required to apply the Malaysian Private Entities Reporting Standards (MPERS) which are similar to the IFRS for SMEs.

Singapore

Singapore has followed the convergence path towards IFRS by incorporating nearly all the IFRS into Singapore Financial Reporting Standards (SFRS) with a few exceptions and with different effective dates for implementation. In case a domestic company is listed on both – a stock exchange in Singapore as well as on an exchange outside Singapore – then the company is permitted to use IFRS to comply with the requirements of the said foreign stock exchange.

Thailand

All public listed companies in Thailand are required to apply the Thai Accounting Standards (TAS) issued by their standard setter – the Federation of Accounting Professions (FAP). However the TAS have been substantially converged with the IFRS barring a few standards. Listed companies are allowed to use those IFRS which have not been adopted as TAS. For non-listed companies TFRS which are equivalent to IFRS 2006 have been applied ("Thailand – IAS Plus", 2012).

Philippines

Most IFRS have been adopted by the Philippines Financial Reporting Standards Council (PFRSC) with modification wherever necessary and the adopted standards are now known as Philippine Financial Reporting Standards (PFRS). These standards apply to all listed companies in the domestic domain of the country. Based on the criteria laid down by the SEC, certain domestic companies are also required to use PFRS even if their securities are not traded publicly.

Other members:

Of the other member nations, Myanmar and Cambodia have adopted IFRS for publicly traded domestic companies. Myanmar has adopted the 2010 version of IFRS as Myanmar Financial Reporting Standards (MFRS) and plans to adopt the latest IFRS from financial year 2022-23 ("Myanmar", 2012). Similarly Cambodia has adopted the IFRS fully without any modification as the Cambodia International Financial Reporting Standards (CIFRS). Despite the absence of a stock exchange, Brunei Darussalam requires IFRS for financial institutions, banks and insurance companies. It also plans to implement IFRS in future for other companies and has initiated IAS awareness programmes. Vietnam on the other hand has not adopted IFRS at all but applies the Vietnamese Accounting Standards (VAS) based on the 2003 version of International Accounting Standards (IAS). Laos or Lao PDR is the only member of ASEAN which has not established any formal process of implementing IFRS.

(b) IFRS requirement for foreign companies in ASEAN

Singapore classifies foreign listed companies into those with a primary listing and those which have a secondary listing on the Singapore Exchange. According to the listing rules of the exchange, foreign companies whose securities are primarily listed in Singapore have to mandatorily apply SFRS, IFRS or the US GAAP. However those which have a secondary listing may only reconcile their existing financial statements to the aforementioned standards. Application of IFRS is permitted for foreign companies whose securities are traded publicly in Malaysia. They have a choice between MFRS or any other set of international accounting standards recognized by MASB. Thailand permits IFRS for all foreign companies while foreign entities in Philippines and Indonesia are required to follow PFRS and SAK respectively. Cambodia requires

IFRS for foreign companies while Myanmar on the other hand does not have any foreign companies trading on its stock exchanges.

(c) IFRS requirement for SMEs in ASEAN:

Most of the members have issued standards for SMEs which are based on the IFRS for SMEs. These are applicable to firms which are defined as small entities according to the legal framework and criteria of the respective countries. Small and medium entities in Malaysia, Singapore, Thailand and Philippines are mandated to follow the MPERS, SFRS, TFRS and PFRS respectively which have been adopted from the IFRS for SMEs with a few necessary modifications. Indonesia requires the use of local standards for SMEs which have been developed by using IFRS for SMEs as a point of reference. Myanmar uses an older, 2009 version of IFRS for SMEs and plans to adopt the latest version from 2022-23. All SMEs in Cambodia are permitted to use IFRS for SMEs but it is mandatory for those SMEs which are subject to a statutory audit. Samujh & Devi, (2015) highlight the need for thorough research before implementing the global standards for SMEs to avoid the possibility of discouraging entrepreneurial activity which would in turn hamper national growth.

Impact of IFRS implementation on financial reporting quality in ASEAN

The EU was the first to adopt IFRS thereby making extensive research available on the effects of the adoption on financial reporting quality. IFRS adoption was found to have positively impacted the quality of financial information and reduced the scope for earnings management in countries like UK, Germany, France and Belgium (Almaharmeh & Masa'deh, 2018; Iatridis, 2010; Kouki, 2018). Developing countries in Africa and Asia were hit by the wave of IFRS adoption followed by the European and Australian continents. However very little attention was given to study the consequences of IFRS adoption on the value relevance of financial information in emerging economies like Kuwait and Turkey (El Shamy & Kayed, 2005; Kargin, 2013). This section provides a review of the research carried out mainly in the founding member nations of ASEAN.

(a) Impact of IFRS on value relevance of accounting information

Adibah Wan Ismail, Anuar Kamarudin, van Zijl, & Dunstan (2013) measured earnings quality of Malaysian companies after the adoption of IFRS based accounting standards, using two different proxies namely, absolute value of abnormal accruals and value relevance. The results revealed that IFRS adoption significantly reduced the absolute value of abnormal accruals while it significantly increased the value relevance of the firm's earnings quality. Halim Kadri, Abdul Aziz, & Kamil Ibrahim (2009) adopted the market valuation and non-market valuation approaches to determine the effect of changes in the financial reporting regimes in Malaysia on value relevance. They found that there is a significant effect on value relevance of book value but not the earnings. The study also revealed that IFRS adoption did not have any significant impact on the relationship between earnings and operating cash flow.

Research in Indonesia by Hayati, Yurniwati, & Putra, (2015) revealed that Intellectual Capital could have positive and significant effects on value relevance of accounting information (earnings, book value and cash flows) of public manufacturing firms before and after the convergence of local standards with IFRS, with a few exceptions. It inferred that companies with larger Intellectual Capital can generate higher value relevance of accounting information.

Juniarti, Helena, Novitasari, & Tjamdinata, (2018) also add to the literature by studying benefits of IFRS adoption using longitudinal data of the same variables and conclude that value relevance of accounting information increases after IFRS adoption in case of manufacturing companies listed on Indonesia Stock Exchange (IDX). Further research by Prihatni, Subroto, Saraswati, & Purnomosidi (2016) on 70 manufacturing companies in Indonesia revealed that value relevance of book value and earnings is higher during the IFRS implementation phase while that of cash flows is lower.

The value relevance of earnings, book value and cash flows after IFRS adoption is also studied in Malaysia by Mirza, Malek, & Abdul-hamid (2019) who discovered that cash flows from operations are the most significant accounting information which investors prefer in decision making due to the focus on liquidity and survival of the firm in the long run.

(b) Impact of IFRS on earnings management

The impact of IFRS on earnings management is often studied from the point of view of absolute value of accruals. A study of 334 firms in Malaysia by Fourati & Ghorbel, (2017) showed a significant decline in absolute value of discretionary accruals in the partial IFRS convergence phase and a restrictive effect after the complete IFRS implementation. Adibah Wan Ismail et al., (2013) also found a lowered absolute value of abnormal accruals after IFRS adoption in Malaysia. In a unique study, Ayedh, Fatima, & Mohammad (2019) studied the influence of IFRS on earnings management practices in Malaysia during the 2008 financial crisis. It concluded that managers in such countries take advantage of the crisis period to manipulate earnings downwards. Abdullah, Maruhun, Tarmizi, & Rahman, (2018) also confirm that there is a significant relationship between the characteristics of Board of Directors and the levels of earnings management after the adoption of IFRS. In Indonesia, accrual earnings management was lower after IFRS as compared to before thus showing an improvement in earnings quality (Setiawan, Md. Taib, Phua, & Chee, 2019).

Mechanisms used by listed companies for Good Corporate Governance also have a positive impact on earnings management post convergence of IFRS with Indonesian Financial Accounting Standards (PSAK) according to Luthan, Satria, & Ilmainir, (2016). While composition of Independent Board, audit committee and audit quality showed a negative impact on earnings management, institutional ownership showed positive effects after IFRS convergence.

Full IFRS convergence in Malaysia was found to be effective in the short term but not in the long run as far as earnings management is concerned (Wong, 2018). It found that although the earnings management activities of the listed companies decreased in the first two years after full IFRS convergence, they increased during the third year. The findings highlight the importance of implementing IFRS in a way that it provides least motivation to companies to manipulate earnings management.

(c) Impact of IFRS on overall quality of accounting information

The impact of IFRS implementation on the overall financial reporting quality has been studied in terms of other factors like information asymmetry, corporate governance and transaparency practices.

Ebrahimi R. & Embong, (2014) observed a sample of 143 firms listed on Bursa Malaysia to find the association between adoption of IFRS and changes in information quality. The period under study was three years before IFRS and three years after its adoption during which no other changes had taken place in the financial reporting of the country's firms. They used the bid-ask spread as a proxy for information quality which was found to have decreased during the post-IFRS period as compared to pre-IFRS thereby implying an improvement in the information quality. On similar lines, Wong, (2018) studied the impact of full IFRS convergence on the financial statements and ratios of the Malaysian listed companies. The study investigated the differences three years before and three years after the full convergence with IFRS. It applied the agency theory and the signalling theory to predict that the quality of financial statements improves with full convergence. Significant differences were reported in financial numbers and ratios under IFRS and the local GAAP which suggested that there is a positive change in the disclosure and reporting quality.

The quality of IFRS complied financial reports was found to be positively associated with corporate governance and transparency practices of firms in Malaysia and Singapore by Hla & Md Isa (2015). They used multiple regression analysis on the data of firms listed on Bursa Malaysia and Singapore Stock Exchange (SGX) and also concluded that sustainable convergence with IFRS can be achieved in ASEAN countries by improving the areas of corporate governance and transparency.

Fitriany, Utama, Farahmita, & Anggraita (2017) studied mandatory IFRS adoption for listed companies in ASEAN countries and documented evidences of reduced information asymmetry. They suggested that regulatory authorities should oversee companies to promote full and fair disclosure especially in case of those companies which have a larger analyst following. The study also showed that better public governance and analyst following reduce cost of equity after IFRS.

Information asymmetry was found to be a mediating factor between IFRS and FDI inflows Yousefinejad, Ahmad, Salleh, Abdul Rahim, & Azam, (2018) . They conclude that IFRS adoption reduces information asymmetry thereby improving sreporting quality which is a strong determinant for FDI inflows and subsequent economic growth. The findings are therefore consistent with the signaling theory and support the choice of IFRS for ASEAN countries.

Conclusion

IFRS has been into existence for more than a decade and several researchers have attempted to understand its consequences on the accounting scenario across the globe. Despite the availability of extensive research in the European region, it is however observed that research on IFRS adoption in the Asian continent is limited. Countries in Asia, although often classified as developing or under-developed, have made numerous strides towards global trade. This is substantiated by the strong ties of organisations like ASEAN with powerful economies of the world. Cross border trade creates the need for easy comparability and harmonisation of financial reports. This has led to the rapid adoption of the IFRS which are dubbed as the common accounting language of the world. Both developed as well as developing economies have initiated and also successfully completed the process of implementing IFRS for their publicly listed firms. The member countries of the ASEAN have always played a significant role in improving their economic relations with the rest of the world and their implementation of IFRS is a right step in that direction. Majority of the countries have adopted IFRS as their own with minor modifications to suit their respective business environments. Foreign companies listed in most of these economies have the liberty to follow IFRS in its original form which is an important requirement to promote comparability of the financial statements. It is also interesting to note that the member nations are encouraging the use of IFRS for SMEs. However researchers are of the opinion that this requirement may discourage the start-up culture in their economies which is considered important for national growth. The reviewed literature also reveals that IFRS has played a significant role in improving the reporting quality and value relevance of financial reporting in the areas under study. It has been instrumental in reducing the earnings management activities of the firms thereby decreasing instances of corruption and manipulation which is known to be a common feature in developing economies. It has also significantly reduced information asymmetry which has further improved the financial reporting quality.

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