The Effect of Accounting Disclosure, Concentrated Ownership, and Accounting Harmonization to Earnings Quality: The Case of Asia Pacific

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Abstract

This study aims to determine the influence of the level of disclosure and concentrated ownership on the quality of earnings in the context of differences in the degree of local standards to IFRS convergence between countries. This research was carried out against the companies listed on stock exchanges of Indonesia, Singapore, Hong Kong, and Australia. This study will use a multidimensional measure earnings quality using the five measures of earnings quality which are earnings predictability, earnings management, earnings response coefficients, and conservatism. In general, this study found that higher levels of disclosure by companies, the high quality of earnings reported by companies. In the context of increasingly high demand for convergence of accounting standards to IFRS, this study supports the role of convergence in improving the quality of corporate earnings. The use of accounting standards to IFRS convergence will strengthen the influence of the level of disclosure to earnings quality.

Key words: Disclosure, ownership, degree of convergence of local GAAP to IFRS.

1. Introduction

In the era of increasing levels of convergence of local accounting standards to International Financial Reporting Standards (IFRS), companies are required to perform financial reporting based on international standards. Implementation of principles based standards in one side will make the company better able to apply the standards according to their own characteristics, but on the other hand it will increase the possibility of using a subjective judgement, especially in the choice of accounting method, making estimation, and make a valuation that requires certain assumptions. The subjective judgement sometime used to generate the desired income (Lobo and Zhou, 2001). The consequences of such subjective judgement is that the company must improve disclosure of financial information

relating to the reasons for the selection of accounting methods, estimates and assumptions used, and the potential corporate risk.

The process of information disclosure by management plays an important role in overcoming the asymmetric information between owners as the principals and management companies as agent in accordance with the proposed agency theory by Jensen and Meckling (1976). In addition, with different degrees of convergence of local accounting standards with international accounting standards in each country, the level of disclosure reported by companies may vary among countries, so the consequences is that the quality of corporate financial reporting will also vary. This will make financial information difficult to compare and that may affect the reliability of information in decision-making by investors (Choi and Meek, 2005).

Another factor that may affect the quality of financial reports is the ownership structure. Ownership structures which vary across the state often become an important determinant in determining the quality of financial reporting. Mitton (2002) states that the concentration of ownership will negatively impact company performance. This is evident from studies of companies listed on stock exchanges of Indonesia, Malaysia, Korea, Philippines, and Thailand, which concluded that companies with higher levels of disclosure and higher level of concentration of public ownership will show better performance.

In the context of differences in the degree of convergence of a country's accounting standards to international accounting standards, research on the influence of the diversity level of disclosure and ownership structure on the quality of financial reporting is an interesting issue to be investigated. This study aims to determine the influence of the level of disclosure and concentrated ownership on the quality of earnings in the context of differences in the degree of convergence of local standards to IFRS between countries. This

research was carried out against the companies listed on stock exchanges of Indonesia, Singapore, Hong Kong, and Australia. Selection of four states because of the difference is quite prominent among the four countries, especially in accounting practices and ownership structure. This study will use a multidimensional measure earnings quality using the five measures of earnings quality which are earnings predictability, earnings management, earnings response coefficients, and conservatism.

This research is expected to contribute to the development of theory, especially theories related to financial accounting such as agency theory and the use of IFRS as the internationally accepted standards to improve the reliability of financial information and the protection of investors. In addition, research is also useful to see the impact of concentrated ownership on earnings quality, especially in some countries in Asia Pacific which has variety of characteristics in the structure of corporate ownership. Ownership Structure in Asia are usually in the form of concentrated ownership is usually controlled by family firms (Rajan and Zingales in Claessens and Fan, 2002). While the ownership structure of Australia is usually a relative spread of ownership. Given the concentrated ownership, reporting of information by the company becomes less transparent as the majority shareholder of the company's strong control and act in accordance with their interests (Fan and Wong, 2002). It is also hoped that this research can contribute to the measurement of earnings quality which use more comprehensive and multidimensional measurement.

2. Literature Review and Hypotheses Development

2.1. Earnings Quality

There are several definitions of earnings quality. Pratt in Giacomino (2005) defines earnings quality as the difference between net income reported by companies in the financial statements with the actual profit generated or its economic income. Schipper and Vincent (2003) defines quality of earnings as reported earnings accuracy in depicting changes in the economic assets of a company other than transactions with owners. Meanwhile, Teets (2002) states that earnings quality contributes to state economic performance of the company and also explains the accounting standards used in performance reporting. From the above definition, it can be concluded that the quality of reported earnings, earnings ability in describing the economic value of the company.

Teets (2002) states that earnings quality is a multidimensional concept. Because of the multidimensional nature of quality of earnings, Abdelghany (2005) recommends to measure earnings quality in many methods. Furthermore, Teets (2002) states that earnings quality contribute to state economic performance of the company and also explains the accounting standards used in performance reporting. This study uses most of the dimensions of the IFRS conceptual framework are: (i) predictive value, measured by earning-future cash flow relationship; (ii) neutrality, measured by earnings management; (iii) representational faithfulness, measured by Earnings Response Coefficient (ERC); and (iv) conservatism or prudence, measured by accrual conservatism.

2.2. Level of Disclosure

Development of financial and non-financial disclosures in the financial statements of the company is actually in line with the development of the accounting system itself. Level of disclosure is influenced by sources of financing, legal systems, political and economic situation, level of economic development, education, culture, and many other factors. In countries where capital markets became the main financing sources such as the United States and Western European countries, ownership is more dispersed and therefore the protection of investors in this case of protection to shareholders are very important. This situation makes a high level of disclosure required in a large scale. Meanwhile, in countries such as France, Germany, Japan, and developing countries, shareholders tend to be more concentrated and the bank (lender) becomes the main source of financing. In this condition, a broad and public disclosure is less necessary because the creditors and other parties (such as a family company) can assess such disclosures directly to the management (Choi and Meek, 2008).

Level of disclosure made by management are very useful to overcome the asymmetric information between shareholders and management. This is consistent with research conducted by Glosten and Milgrom (1985) and Welker (1995). Furthermore, studies conducted by Lang and Lundholm (1993) concluded that companies that have a high level of disclosure has characteristics as big company, has a good performance, and in the capital market with a level of mandatory disclosure is not sufficient. This is also supported by subsequent studies conducted by Lang and Lundholm (1996) who concluded that companies with high levels of disclosure has the advantage that can be more easily predicted by analysts in the capital market.

Research conducted by Lobo and Zhou (2001) also showed that the disclosures made by management have a significant negative relationship to the actions taken by management such as earnings management which is one of the dimension of quality of earnings. Thus it can be formulated the first hypothesis of this research.

H1: The level of disclosure has positive influence on earnings quality.

2.3. Concentrated Ownership

The structure of ownership in the company can be divided into two kinds, namely dispersed ownership and concentrated ownership. In companies with concentrated ownership structure, shareholders can be grouped into two parts: the controlling shareholder and minority shareholders.

Hartzell and Starks (2003) measuring the level of concentrated ownership by the first group of shareholders who have ownership of more than 5% and then regrouped fifth-largest shareholder with ownership of more than 5% of. Mitton (2002) stated that the condition of concentrated ownership firm can negatively affect corporate performance. This is evident from studies of companies listed on stock exchanges of Indonesia, Malaysia, Korea, Philippines, and Thailand, concluded that companies with higher levels of transparency and level of concentration of ownership by outsiders is higher will show better performance.

Research conducted by Chirinko et al. (2001), concluded that companies with concentrated ownership structure do not significantly influence significantly on company performance. This is due to concentrated ownership in one side can reduce agency costs with management, but on the other hand increases the cost of agents in the event of expropriation of minority shareholders. Company ownership structure plays an important role in explaining the level of control that occurred in the company. Research conducted by

Bhojraj and Sengupta (2003) concluded that companies with concentrated ownership by financial institutions as the main controller has fewer levels of disclosure from companies with concentrated ownership largely owned by government and management. This evidence indicate that level of control by the shareholder will depend on the type of ownership of the company.

Conditions of ownership structure will further encourage shareholders to get personal access to company information, especially in countries with low legal protection (Nenova, 2003). With the higher personal access to information, concentrated shareholders would not require management to provide quality information and accessible to the public. In the condition where concentrated shareholders can exploited company information for their personal benefit, then concentrated ownership have a negative impact on the quality of reported earnings. So, to formulate the second hypothesis of this research is:

H2: Companies with concentrated ownership will have a lower earnings quality than companies with unconcentrated ownership.

2.3. Accounting Standard Convergence to International Financial Reporting Standards (IFRS)

Pressure to increase comparability of accounting and information disclosure by companies, especially multinationals arise from differences in the interests of all parties who participated in the international economy. Convergence to IFRS has an important role in international finance. With the same internationally accepted standard, the expected level of information disclosure and comparability of financial statements may be increased. While transparency and comparability of financial statements can be realized, the investor protection will also increase. This will cause the cost incurred by companies and users of

financial statements to ensure the reliability of the information in the financial statements can be further be reduced.

Here are the exposures concerning the level of convergence of four countries used in this study, Australia, Hong Kong, Indonesia, and Singapore, according to data obtained from PriceWaterhouseCoopers in 2010.

a. Indonesia: convergence process of local standards (GAAP) to IFRS is still ongoing and is expected to reach full convergence in 2012. Although intended to be fully convergent, there are certain differences with IFRS, particularly in the standards governing financial instruments.

b. Singapore: IFRS is allowed to be used as a standard for companies with special requirements. However, local accounting standards in force in Singapore alone have been the adoption of IFRS with minor differences in certain parts, such as cost.

c. Hong Kong: Financial Reporting in Hong Kong's emphasis on reporting is fair (fair value) and investor protection. The use of IFRS as the reporting standards in Hong Kong are allowed to the consolidated financial statements and the independent companies listed on Hong Kong stock exchange. However, companies are obliged to use local standards of financial accounting in Hong Kong that most are already converging with IFRS. Thus, companies that want to use the IFRS must ensure that the implementation of IFRS in accordance with local standards.

d. Australia: the application of IFRS as the financial reporting standards is a necessity for most companies both companies listed on the stock market and foreign companies. Actually, the financial accounting standards in Australia that has been used since 2005, most are already converging with IFRS, although not a direct translation of IFRS

The use of IFRS is more oriented to the interests of investors as financial reporting standards of a country can improve the quality of the information presented by the company. This is consistent with research conducted by Houqe et al. (2009) who concluded that the use of IFRS in one country can improve the quality of reported earnings. Research conducted by Wardhani (2009) also concluded that the higher level of convergence of local standards to IFRS, the higher the quality of reported earnings. Ashbaugh and Pincus (2001) conducted research on the relationship between the levels of convergence of local GAAP International Accounting Standard (IAS) with earnings predictability as measured by level of forcast error of analyst estimates. They conclude that the level of convergence of accounting standards with international standards enhances company's predictability of financial statements. Gassen and Sellhorn (2006) study the determinants and consequences of voluntary adoption of IFRS for companies in Germany. The result of their research shows that companies adopting IFRS have more persistent and conservative earnings than those using German GAAP. Barth et al. (2007) find that the quality of accounting numbers is more related to the use of IFRS than to the use of non-US domestic standards. They find that companies that adopt IFRS have better quality of accounting characteristics: lower earnings management, higher timeliness of loss recognition, and higher value relevance of earnings. Meulen, Gaeremynck, and Willekens (2007) show that U.S. GAAP and IFRS differ only in terms of predictive ability. However, this difference is not considered by investors ascan be seen from the value relevance of earnings that are not significant between U.S. GAAP and IFRS. Thus, it can be formulated the third hypothesis of this research are:

H_3: Degree of convergence of local standards to IFRS has positive influence on earnings quality.

2.4. The Role of Disclosure in Improving the Quality of Financial Statements in the Context of Convergent Accounting Standards with International Financial Reporting Standards (IFRS)

Leuz and Verrecchia (2000) showed that the use of increasingly converging accounting standards with international standards had increase the number of disclosures made by companies in Germany. The existence of an international strategy requires companies to be more transparent with increased disclosure. Research conducted by Iatridis (2010) also concluded that the use of IFRS to improve the level of disclosure by companies and improving corporate performance. Thus, the four hypotheses can be formulated from this research is:

H4: Effect of level of disclosure to the quality of earnings depends on the level of IFRS convergence in the countries where it operates.

3. Research Method

3.1. Data and Sample Selection

The data used are secondary data in the form of financial statements and annual reports of companies listed on stock markets of four countries, Indonesia, Singapore, Hong Kong, and Australia during the period 2006-2008. The sample in this study are taken using purposive sampling method with sample criteria as follows:

1. Listed on stock exchanges in four countries, namely Indonesia, Singapore, Hong Kong, and Australia.
2. Includes company that belongs in the manufacturing industry that have the same characteristics in each country so that can be compared with the same measurement method.

3. There is a completeness of data in the period 2005-2009.

This research use 20 firms as sample in each of four countries, Indonesia, Singapore, Hong Kong, and Australia.

3.2. Model Development

This research will use models from Velury and Jenkins (2002) and Wardhani (2009) that measures the quality of earnings from several dimensions in accordance with the IFRS conceptual framework. Dimension of earnings quality, namely:

- **Earnings Predictability**

Model 1

$$CFO_{it+1} = \alpha_0 + \alpha_1 OPIN_{it} + \alpha_2 OPIN_{it} * DISC_{it} + \alpha_3 OPIN_{it} * CONC_{it} + \alpha_4 OPIN_{it} * IFRS_{it} + + \alpha_5 OPIN_{it} * IFRS_{it} * DISC_{it} + \alpha_6 OPIN_{it} * DEBT_{it} + \alpha_7 OPIN_{it} * LOSS_{it} + \alpha_8 OPIN_{it} * GROWTH_{it} + \alpha_9 DYEAR_{it} + \alpha_{10} DCOUNTRY_{it} + \varepsilon_{it}$$

Where:

CFO	:	cash flow from operation (divided by total assets) at end of year $_{t+1}$
OPIN	:	operating income before extraordinary items and discontinued operations divided by total assets
DISC	:	Firm disclosure score
CONC	:	dummy variable with the value = 1 if there direct ownership more or equal to 50% in one holding and value of 0 if other.
IFRS	:	degree of convergence a country with IFRS
GROWTH	:	percentage of change of total asset from previous year
DEBT	:	long term debt divided by total asset
LOSS	:	dummy variable with the value = 1 for loss firm and value of 0 if other.
DYEAR	:	dummy variable with the value = 1 for 2006 observation and value of 0 if other.
DCOUNTRY	:	dummy variable with the value = 1 for country where firm domicilate and value of 0 if other, where Indonesia as the country of reference

- **Earnings Neutrality**

Equation 1

$$TA_{i,t} / A_{i,t-1} = \alpha_i(1 / A_{i,t-1}) + \beta_{1i} (\Delta REV_{i,t} - \Delta REC_{i,t}) / A_{i,t-1}) + \beta_{2i} (PPE_{i,t}) / A_{i,t-1}) + \varepsilon_{i,t}$$

Where:

$TA_{i,t}$	:	total accruals, obtained from net income before extraordinary items minus cash flow from operation

$A_{i,t-1}$: total assets in period $t-1$
$\Delta REV_{i,t}$: change in revenue from period $t-1$ to period t
$\Delta REC_{i,t}$: change in receivable from period $t-1$ to period t
$PPE_{i,t}$: gross value from property, plant, equipment
$\varepsilon_{i,t}$: error level

Furthermore, the coefficient value generated from the above Equation 1 is put in Equation 2 to generate expected accruals value.

Equation 2

$$E(TA_{i,t}/A_{i,t-1}) = \alpha_i(1/A_{i,t-1}) + \beta_{1i}(\Delta REV_{i,t} - \Delta REC_{i,t})/A_{i,t-1}) + \beta_{2i}(PPE_{i,t})/A_{i,t-1}) + \varepsilon_{i,t}$$

Where:
$E(TA_{i,t}/A_{i,t-1})$: Expected accruals value divided by total asset in period $t-1$
$\Delta REC_{i,t}$: change in receivable from period $t-1$ to period t

Difference between the actual accruals value in Equation 1 and expected accruals value in Equation 2 is a value from abnormal accruals. This absolute value from abnormal accruals (ABNAC) will then be used to identify level of earnings management done by the management.

From the above explanation, thus a model can be formulated as follows:

Model 2

$$ABNAC_{It} = \alpha_0 + \alpha_1 DISC_{it} + \alpha_2 CONC_{it} + \alpha_3 IFRS_{it} + \alpha_4 IFRS_{it} * DISC_{it} + \alpha_5 GROWTH_{it} + \alpha_6 DEBT_{it} + \alpha_7 LOSS_{it} + \alpha_8 DYEAR_{it} + \alpha_9 DCOUNTRY_{it} + \varepsilon_{it}$$

- **Accounting Conservatism**

Model 3

$$CONV_{it} = \alpha_0 + \alpha_1 DISC_{it} + \alpha_2 CONC_{it} + \alpha_3 IFRS + \alpha_4 IFRS_{it} * DISC_{it} + \alpha_5 GROWTH_{it} + \alpha_6 DEBT_{it} + \alpha_7 LOSS_{it} + \alpha_8 DYEAR_{it} + \alpha_9 DCOUNTRY_{it} + \varepsilon_{it}$$

CONV : Average of accruals discretionary for 3 years with median in period t, multiplied by negative 1.

- ***Representational Faithfullness***

Model 4

$$CAR_{it} = \alpha_0 + \alpha_1 DEPSP_{it} + \alpha_2 DEPSP_{it} * DISC_{it} + \alpha_3 DEPSP_{it} * CONC_{it} + \alpha_4 DEPSP_{it} * IFRS_{it} + \alpha_5 DEPSP_{it} * IFRS_{it} * DISC_{it} + \alpha_6 DEPSP_{it} * DEBT_{it} + \alpha_7 DEPSP_{it} * LOSS_{it} + \alpha_8 DEPSP_{it} * GROWTH_{it} + \alpha_9 DYEAR_{it} + \alpha_{10} DCOUNTRY_{it} + \varepsilon_{it}$$

Where:

CAR : cumulative abnormal return from 12 months from a 3-month period after fiscal year.

DEPSP : change in net income before extraordinary items and discontinued operations per share from period$_{t-1}$ to period$_t$, scaled with market price for each share.

3.3 Variable Operationalization

- Level of Disclosure

Level of disclosure in this study were measured from a list issued by CIFAR (Center of International Financial Analysis and Research). This list consists of 85 variables contained in the company's annual report that details can be found in Appendix 1. The company's annual report is divided into seven main sections: general information, statement of financial position, income statement, management accounting policies, the information of shareholders, cash flow statement, and additional reports. Each variable included in the annual report the company will get the value of one, while the variables that are not contained in the annual report will have a value of zero. The score will then calculate the percentage based on the number of variables that can be applied on condition that company.

- **Concentrated Ownership**

Concentrated ownership is measured using dummy variables with the value of 1 if the company has any direct ownership more than 50%. This data is taken from OSIRIS data base.

- **Degree of Convergence of Local GAAP with IFRS**

Variable degree of convergence of local GAAP to IFRS measures the level of similarities of local accounting standards to the international accounting standards. Twenty international accounting standards are employed as a basis for measuring degree of convergence[1]. In measuring degree of convergence, this study uses a scale of 1 to 4 with gradations: (i) there is no equivalent standard of local GAAP (1 point); (ii) there is an equivalent standard in the local GAAP but not the same as IFRS (2 points); (iii) there is an equivalent standard in local GAAP and same with IFRS with certain exceptions (3 points); (iv) and there is an equivalent standards in local GAAP and same with IFRS for all material aspects (4 points). Degree of convergence is the average score value of the 20 standards used as mentioned above. This measurement is based on the reports of similarities and differences between of local GAAP to IFRS issued by Big 4 public accounting firms such as Ernst & Young, Pricewaterhouse Cooper, Deloitte, and KPMG.

3.3. Empirical Test

To test the hypotheses this study use Ordinary Least Square (OLS) with Dummy Variables for year and countries to accommodate the variability of earnings qualities among year and countries. For Dummy Year we use 2006 as year of reference, and for Dummy Countries we use Indonesia as country of reference. The use of OLS require us to test the BLUE (*Best Linear Unbiased Estimate*) requirement. One of the problems that we face is

[1] The standards are as follows: (1) Presentation of Financial Statements; (2) Inventories; (3) Cash Flow Statement; (4) Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies; (5) Events after Balance Sheet Date; (6) Segment Reporting; (7) Property, Plant, and Equipment; (8) Leases; (9) Employee benefit; (10) The Effect of Change in Foreign Exchange Rate/ Foreign Currency Translation; (11) Business Combination; (12) Related Party Disclosures; (13) Consolidated Financial Statements and Accounting for Investment in Subsidiaries; (14) Accounting for Investment in Associate; (15) Earnings Per Share; (16) Interim Financial Reporting; (17) Impairment of Assets; (18) Intangible Assets; (19) Revenue Recognition; and (20) Financial Instrument.

multicollinearity from several interaction variables. We use centering technique to address this problem. Centering, developed by Conbranch (1987), is one of the methods to solve multicollinearity especially for regression with interaction variables (Aikea *et al*., 1991). With this method the variable Xi is subctracted by its average. Then the interaction variable is the multiplication of variable that has been centered.

3.4. Sample Selection

Sample selection procedure can be seen in Table 1. Sample in this reseach consist of 20 companies in each of sample country. Observation is considered an outlier and is deleted if it is outside the range of the average ± three times the standard deviation for each variable in each research model. Based on sample selection procedure we obtain 217, 221, 222, 225 concecutively for earnings predictability, netrality, concervatism, and representational faithfulness model.

Tabel 1.
Sample Selection Procedures

The number of listed companies in:	
- Indonesia	375
- Singapura	606
- Hongkong	216
- Australia	1798
The number of manufacturing companies in	
- Indonesia	155
- Singapura	276
- Hongkong	54
- Australia	333
Total sample before excluding outlier	80
Outliers:	
- Earnings Predictability Model	(7)
- Netrality Model	(10)
- Conservatism Model	(6)
- Representational Faithfulness Model	(13)
Number of sample companies:	
- Earnings Predictability Model	74
- Netrality Model	76
- Conservatism Model	78

- Representational Faithfulness Model	79
Firm Years Observations (2006-2008)	
- Earnings Predictability Model	217
- Netrality Model	221
- Conservatism Model	222
- Representational Faithfulness Model	225

4. Analysis of Result

4.1. Descriptive Statistic

4.1.1. All Variables

Tabel 2 shows the descriptive statistics of the variables. Based on Table 2, variable CFO yields the average positive value with a high level of variation. This means that most of the sample firms have positive cash flow during the years of observation. OPIN variable also showed positive results in average with a high level of variation. This means that on average the sample firms show positive year-end earnings during the years of observation. On average ABNAC variables have high values with high standard deviation also showed a high level of variation for that variable. This indicates that the sample firms on average generate high discretionary accruals. Variable CONV on average shows a negative value. This means that on average the sample firms have a tendency to apply non conservative policy.

Variable CAR shows an average negative value. This means that on average the sample firms have lower rate of return than the capital market as a whole. Furthermore, the variable on average DEPSP also showed a negative value. This means that, on average, sample companies has decreased the value of earnings per share prices from time to time. This may be due to observational data taken during the 2006-2008 with the largest number of observations in the year 2008 when the global economic crisis. DISC variables also show the average value is quite high with low variation. This means most of the sample companies already have a good level of disclosure. CONC variable indicates that the majority of the

sample firms are companies with nonconcentrated ownership. For the degree of convergence index, in average four Asia Pacific countries in this study show relative high convergence of their local GAAP to IFRS.

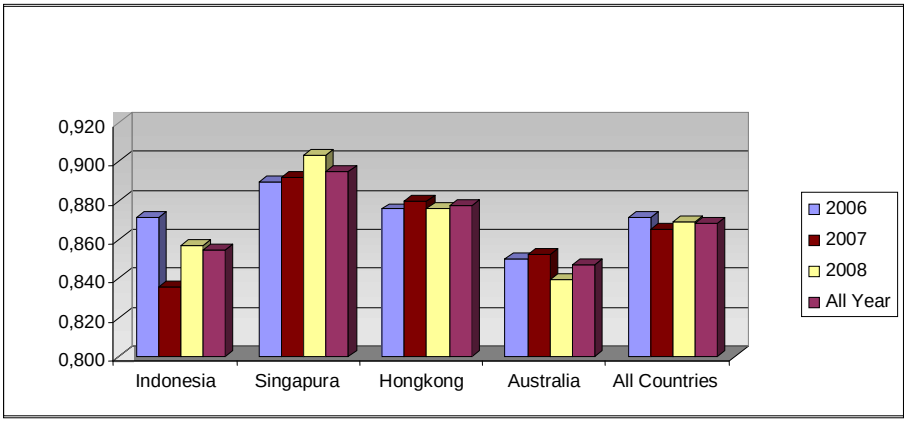
Tabel 2
Descriptive Statistic

Nama Variabel	Mean	Minimum	Maximum	Std.Deviation
CFO	0,0432	-0,6826	0,5304	0,1499
OPIN	0,0175	-1,1075	0,3899	0,1792
ABNAC	0,0986	0,0000	0,6278	0,1067
CONV	-0,0088	-1,0803	1,1889	0,1557
CAR	-0,0419	-2,0559	3,0995	0,8378
DEPSP	-0,0632	-7,5000	2,0000	0,5684
DISC	0,8711	0,6842	0,9867	0,0639
IFRS	3,5173	3	3,9	0,2942
DEBT	0,1871	0	0,8137	0,1588
GROWTH	0,2357	-0,8638	7,4499	0,7184
	Proportion of Dummy 1		**Proportion of Dummy 0**	
CONC	27.65%		72.35%	
LOSS	25.81%		74.19%	

4.1.2. Level of Disclosures

Variable levels of corporate disclosure measure the completeness of the information presented in corporate annual reports. This variable was measured by using 85 variables measured by scoring index develop by CIFAR. Based on measurement results, we obtained an average level of disclosure in each country in 2006-2008 as shown in Figure 1.

Figure 1
Level of Disclosure for Sample Firms in Indonesia, Singapura, Hongkong, dan Australia from 2006-2008



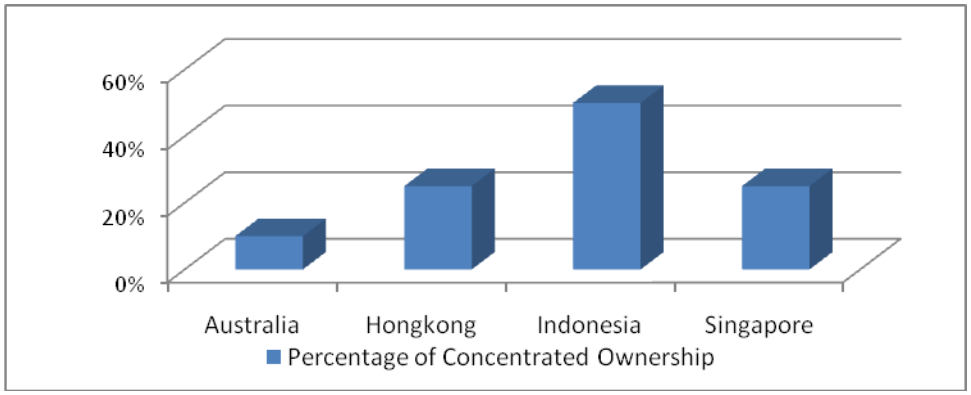
In Figure 1, we can see that the highest level of disclosure is owned by Singapore followed by Hong Kong. This is probably due to the capital markets in both countries have advanced enough so that it requires a comprehensive level of disclosure as a form of investor protection. Disclosure made by companies in Singapore is prepared in the format of the same order making it easier for users of financial statements in making judgments and comparison. Level of disclosure made by firms in Indonesia are higher than the company in Australia. However, the annual reports of companies in Indonesia do not have uniformality format and too much stressed on the qualitative description compared to the company in Australia that provides information that is more important. Based on data about the level of disclosure, can be seen that the large-scale firms usually provide a higher disclosure to meet the needs of stakeholders for more information (Lang and Lundholm, 1996). However, the sample of firms in Singapore with the highest level of disclosure is actually made up of firms with a smaller size than the average size of companies in three other countries. This means that the level of disclosure required in the state of Singapore is more extensive than the

three other countries, because every company even with a small size must provide adequate disclosure.

4.1.3. Concentrated Ownership

Figure 2 show number of companies that have concentrated ownership in the four countries. From the figure we can say that Australia is the country with smallest number of company with concentrated ownership. Only 10% of the sampel in Australia is a concentrated ownership firm. In the contrast, Indonesia is country with highest number of concentrated ownership firms. Out of the Indonesian sample, 50% is a firm with concentrated ownership. This figure explain varieties in the ownership among Asia Pacific countries.

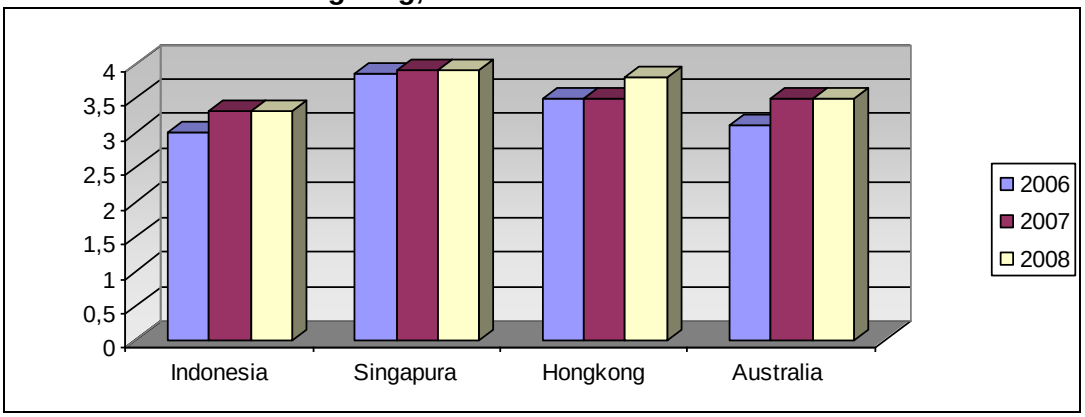
Figure 2. Percentage of Concentrated Ownership



4.1.4. Degree of Convergence of Local Standards to IFRS

Variable degree of convergence of local standard with IFRS measure the level of adoption of IFRS as international accounting standards in local accounting standards. This variable was measured by using the value ratio between 20 and accounting standards of each country with IFRS (Wardhani, 2009). Based on the measurement results, obtained an average degree of convergence to IFRS in the country as shown in Figure 3.

Figure 3.
Degree of Convergence of Local Standards to IFRS in Indonesia, Singapura, Hongkong, and Australia for 2006-2008



In Figure 3 we can see that Singapore has the highest level of convergence to IFRS during the 2006-2008 while Indonesia has the lowest level of convergence in 2006. The difference between the level of degree of convergence in each country caused by the different process of IFRS adoption, and time to began the adoption process. Singapore has the highest value of the level of convergence towards IFRS because adoption process already began in 2000 and the adoption process that occurs directly without translation process. The process of IFRS adoption in Hong Kong also occur directly, although the process began only in 2005. In Australia and Indonesia, IFRS adoption process occurs gradually and in Indonesia tha adoption start with translation process, causing the value of convergence rate in Indonesia is lower than the other three countries. However, the level of convergence of accounting standards in Indonesia showed a fairly high increase in 2006-2007. This is because in 2007, Indonesia has revised accounting standards is increasingly converging with IFRS.

4.2. Regression Result

The results of the regression models, which test the relation between accounting standards convergence to IFRS, investor protection, corporate governance, and also interaction among those variables, are presented in Tables 3–7. Table 3 presents the regression results for the effect of level of disclosures, concentrated ownership, accounting standards convergence to IFRS, and other control variabels on the earnings–cash flow relation that measure earning predictability. The results showed that the level of disclosure has positive influence on earnings quality as measured by the level of earnings predictability. With increasing levels of disclosure by companies, users of financial statements will be easier to make predictions for company earnings. This is consistent with research by Lang and Lundholm (1996) which states that firms with high levels of disclosure have the advantage of easily predicted by market analysts.

Table 3
Regression Result of Model 1:
Factors Affecting Predictability of Earnings

Dependent variable: CFO_{it+1}			
Independent variable	**Sign Expectation**	**Coefficient**	**Significance**
C		*0,074	0,000
$OPIN_{it}$	+	**-22,118	0,012
$OPIN_{it}$ * $DISC_{it}$	+	**28,660	0,011
$OPIN_{it}$ * $CONC_{it}$	-	*0,358	0,010
$OPIN_{it}$ * $IFRS_{it}$	+	*31,740	0,009
$OPIN_{it}$ * $IFRS_{it}$ * $DISC_{it}$	+	*-8,396	0,009
$OPIN_{it}$ * $DEBT_{it}$	+	0,004	0,944
$OPIN_{it}$ * $LOSS_{it}$	-	**0,542	0,016
$OPIN_{it}$ * $GROWTH_{it}$	-	-0,131	0,374
$DYEAR_{it}$	Included		
$DCOUNTRY_{it}$	Included		
F test Sign	0,000		
Adj R Square	0,510		

N	203

* Significant at α =1%
** Significant at α = 5%
*** Significant at α =10%

Based on the results of this study show that concentrated ownership have a significant positive influence on earnings predictability with the significance level of 1%. This is different to the study by Nenova (2003) for firms in countries with low law protection. Nenova (2003) state that concentrated ownership can negatively affect the quality of corporate earnings due to concentrated shareholders will use and exploit personal information for their own benefit. Inconsistent with that, our study show that firms with concentrated ownership have a more predictable income. These results indicate that concentrated owners might take a definite policy to secure the position and their holding, and they usually have long-term orientation so that the level of uncertainty in small. With smaller uncertainty it is more easier for investor to predict future cash flow from current earnings.

This study shows that the degree of convergence of accounting standards with IFRS positive effects of on earnings predictability. With increasing levels of convergence to IFRS, the information will be presented more fairly and makes more sense so that profits can be more predictable by the users of financial statements. This is not consistent with a study conducted by Wardhani (2009) who concluded that the level of convergence of local standards to IFRS is not influence the predictability of earnings due to subjective interpretations of the application of IFRS that is more principle-based that make it difficult to be predictive performance of the company. Our result indicate that with the higher requirement of disclosure in IFRS, the principle based standards could enhance predictability of earnings.

Hypothesis 4 states that influence of level of disclosure on the quality of earnings depends on the level of convergence of accounting standards of the countries where it operates. The test results prove that the interaction variable is significant negatively effect on the level of significance of 1% of the level of earnings predictability. This shows that in countries with higher levels of convergence towards IFRS accounting standards, the influence level of disclosure to the predictability of earnings will be lower. This result indicate that accounting standard is a substitution mechanism of transparency in enhancing quality of financial report.

In predictability of earnings model, GROWTH variables showed no significant effect on earnings predictability. This indicates that the company's growth do not has influence on predictability of earnings. While the DEBT variable is significantly and positively on the level of earnings predictability. This shows that the higher level of long-term debt, current earnings can be more precisely predict future cash flow.This associated with strict requirements on the company's debt covenant. LOSS variable does not significantly influence the level of earnings predictability. This indicates that companies that have profits and losses have predictability that is no different.

The next model is to investigate the influence of independent variables on the neutrality of income as one measure of quality of earnings is shown in Table 4. Table 4 shows that the level of disclosure is negatively affecting earnings management as measured by the level of discretionary accruals. With the increased level of disclosure by companies, the information presented becomes more transparant so the opportunity to make earnings management is lower. This is consistent with the study by Lobo and Zhou (2001) whichalso showed that the disclosures made by management have a significant negative relationship

to the actions taken by management to manage earnings so that the value of income that is presented is more neutral and fair.

Moreover the results show that concentrated ownership is positively affect earnings management significantly. This is consistent with studies conducted Velury and Jenkins (2006) who conclude that concentrated ownership has a significant positive effect on the value of discretionary accruals. The results further showed that the degree convergence to IFRS accounting standards has positive influence on the value of discretionary accruals. This may be caused by characteristic of IFRS that is more principal based where management may use more subjective judgement so may increase the earnings management practices conducted by the company.

Hypothesis 4 states that influence the level of disclosure on the quality of earnings depends on the level of convergence of accounting standards of the countries where it operates. The test results of interaction variables between IFRS and DISC prove that hypothesis can be accepted by showing a significant negative effect on the 10% level of significance. This could mean that the use of accounting standards that converging towards IFRS could increase the influence of the level of disclosure on earnings quality by lowering the level of earnings management.

Table 4
Regression Result of Model 2:
Factors Affecting Earnings Netrality

Dependent variable: $ABNAC_{it}$			
Independent variable	**Sign Expectation**	**Coefficient**	**Significance**
C		0,003	0,988
$DISC_{it}$	-	**-0,243	0,019
$CONC_{it}$	+	**0,024	0,041
$IFRS_{it}$	-	***0,023	0,061
$IFRS_{it}$ * $DISC_{it}$	-	***-0,058	0,064
$GROWTH_{it}$	+/-	**0,024	0,036

DEBT$_{it}$	+/-	*-0,122	0,000
LOSS$_{it}$	+/-	*0,059	0,000
DYEAR$_{it}$	Included		
DCOUNTRY$_{it}$	Included		
F test Sign	0,000		
Adj R Square	0,147		
N	210		

* Significant at α =1%

** Significant at α = 5%

*** Significant at α =10%

For control variables, GROWTH showed a positive effect on the level of earnings management. This suggests that firms that experienced higher growth rates, tend to make higher discretionary accruals than firms that experienced lower growth rates. While DEBT showed that firms with a higher level of debt will conduct lower earnings management due to more strict debt covenant Then, LOSS showed a significant positive influence on the level earnings management. This shows that management in companies that suffered losses have more incentive to make policy for the purpose of conveying good information about the company's performance against the users of financial statements, regardless its true performance, which consider as earnings management.

Next, Table 4 shows the influence of the level of disclosure of test results, the concentration of ownership and the level of convergence to IFRS for the model of conservatism. Based on Table 4, it can be seen that the level of disclosure would negatively affect accounting conservatism at 10% significance level. This shows that with increasing levels of disclosure by companies, accounting conservatism is reduced. This may be because the companies that have a high level of disclosure is usually chosen to improve the

relevance of financial statements provide information that is recognized at fair value which tends to be less conservative.

Table 4
Regression Result of Model 3:
Factors Affecting Accounting Conservatism

Dependent variable: $CONV_{it}$			
Independent variable	**Sign Expectation**	**Coefficient**	**Significance**
C		-0,151	0,474
$DISC_{it}$	+	***-0,618	0,094
$CONC_{it}$	-	-0,570	0,569
$IFRS_{it}$	+	**0,043	0,018
$IFRS_{it}$ * $DISC_{it}$	+	**0,212	0,036
$GROWTH_{it}$	+/-	*-0,052	0,000
$DEBT_{it}$	+	***0,064	0,093
$LOSS_{it}$	+	*0,063	0,000
$DYEAR_{it}$	Included		
$DCOUNTRY_{it}$	Included		
F test Sign	0,000		
Adj R Square	0,251		
N	214		

* Significant at α =1%
** Significant at α = 5%
*** Significant at α =10%

In connection with the influence of the concentration of ownership of conservatism, test results show that concentrated ownership does not significantly influence accounting conservatism. This is result indicate that concentrated owner do not interfere the accounting policy to determine whether the management will choose aggressive or conservative accounting policies.

Table 4 also shows that the degree of convergence of accounting standards has positive influence on accounting conservatism is significant at the 5% significance level. This shows that with higher degree of convergence of accounting standards used in the state to IFRS, management will be more careful in the preparation of financial statements and more conservative companies in consideration for the choice of accounting policies adopted by management. Furthermore, test results showed that the level of disclosure will have a positive impact on accounting conservatism in firms operating in countries that have increasingly converging with IFRS. This is because the company will be more careful in conducting the assessment and selection of accounting policies in force in accordance with the standards set out in IFRS which is more principle-based as well as more careful in making full disclosures.

Tests on the control variables indicate that firms with positive growth rates have a tendency to perform aggressive accounting policies, the company that has a long-term debt levels are high will have a more conservative accounting policies to avoid the risk of claims from outside parties when presenting information and companies that suffer losses will choose conservative accounting policies in order to avoid reporting an overvalued condition from actual conditions.

The results of testing Model 4 which examines the effect of disclosure level, concentration of ownership, and the convergence rate of ERC presented in Table 5. The test results showed that the level of disclosure has positive influence on earnings response coefficients. This shows that with increasing levels of disclosure by companies, market participants respond positively to corporate earnings that create stock price and increase shareholder value. Then, the concentrated ownership negatively affect earnings response coefficients. This is because the majority of shareholders who hold concentrated ownership

in the long term and not actively engaged in transactions in the stock market. This makes other investors respond negatively to the situation and become reluctant to invest into the company.

Table 5
Regression Result of Model 4:
Factors Affecting Earnings Response Coefficient

Dependent variable: CAR_{it}			
Independent variable	**Sign Expectation**	**Coefficient**	**Significance**
C		0,682	0,496
$OPIN_{it}$	+	-21,922	0,631
$OPIN_{it}$ * $DISC_{it}$	+	***30,183	0,088
$OPIN_{it}$ * $CONC_{it}$	-	**-1,230	0,034
$OPIN_{it}$ * $IFRS_{it}$	+	***6,877	0,068
$OPIN_{it}$ * $IFRS_{it}$ * $DISC_{it}$	+	**8,419	0,017
$OPIN_{it}$ * $DEBT_{it}$	+	***-0,991	0,064
$OPIN_{it}$ * $LOSS_{it}$	-	-0,233	0,832
$OPIN_{it}$ * $GROWTH_{it}$	-	-0,139	0,661
$DYEAR_{it}$	Included		
$DCOUNTRY_{it}$	Included		
F test Sign	0,001		
Adj R Square	0,191		
N	212		

* Signifikan pada level 1%
** Signifikan pada level 5%
*** Signifikan pada level 10%

While the level of convergence of accounting standards has positive influence on earnings response coefficients. This shows that companies using accounting standards that increasingly converging towards IFRS, received in response to a more positive earnings from market participants. This is caused by the use of IFRS to improve comparability of financial statements that enables investors to evaluate company performance. Further, this

research showed that in the context of higher degree of convergence to IFRS the level of disclosure by companies can affect the market in a more positive response. For control variables, this test shows that the GROWTH has the only significant influence on ERC. The results showed that the growth rate negatively affect investor response to earnings. Growth can be viewed as risk by investor because highly growing firm will tend to take high risk project and this condition is responded negatively by investor.

5. Conclusion

5.1. Conclusion and Limitation

In general, this study found that higher levels of disclosure by companies, the high quality of earnings reported by companies. This study also shows that firms with concentrated ownership will have a lower quality of earnings, although only supported by two out of four model used. In the context of increasingly high demand for convergence of accounting standards IFRS, this study supports the role of convergence is in improving the quality of corporate earnings. The use of accounting standards to IFRS convergence will strengthen the influence of the level of disclosure of earnings quality.

Several limitations of this study are: (i) This study used methods of measuring the level of disclosure that is prepared by first assessing the completeness of 85 CIFAR composition of the company's annual report. However, the component is more focused on the completeness of financial information and not separate the level of disclosure is mandatory or voluntary. This can cause a decrease in the sample variation in the level of disclosure because most of the basic components that make up the financial statements. In addition, this measure only describes the completeness of the information presented without seeing the quality of their disclosures. Suggested authors for future research is the best method

developed to measure the level of disclosure which includes the completeness and quality of financial and non financial information and the information required and voluntary information to get the value of that better reflect the level of disclosure, (ii) This study uses the level of measurement towards convergence of IFRS was first developed by Wardhani (2009). This method may be subjective and less comprehensive. Suggested authors for future research to better measure the level of convergence towards IFRS done comprehensively by comparing a country's accounting standards with IFRS directly, (iii) the research conducted by taking samples from the four countries in the Asia Pacific region namely Indonesia, Singapore, Hong Kong and Australia with the number of observations 80 companies in the manufacturing industry during the years 2006-2008. Suggestions for future research is to multiply the number of observations so that the data obtained can be more representative and had no difficulty in doing statistical treatment. In addition, further research can use the sample of countries that have the characteristics of a more varied to obtain empirical evidence as a whole, (iv) This study has the problem of multicollinearity in the regression model testing that has been trying to cope with the method of centering. Subsequent research can use other treatment methods that can overcome the problem of multicollinearity.

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