THE EFFECT OF GOVERNANCE SYSTEM AND DEGREE OF CONVERGENCE TO IFRS ON THE QUALITY OF FINANCIAL REPORTING : EVIDENCE FROM ASIA

Ratna Wardhani*, Sidharta Utama*, Hilda Rossieta*

Abstract

This research investigates the effect of governance system and degree of convergence to IFRS on financial reporting quality. With sample of Asian countries, this study concludes that country level and firm level governance systems, both at, and the degree of convergence have positive influence on financial reporting quality.The effect of degree of convergence of local GAAP to IFRS and corporate governance practice to financial reporting quality will be stronger for companies in countries with weak investor protection. Also, we find that in company with weak corporate governance practice, the adoption of international standards will increase the quality of financial reporting.The results indicate that the adoption of international accounting standard become more important in the countries and companies with weak governance system.

Keywords: Financial Reporting Quality, Financial Reporting Quality, Convergence, IFRS, Accounting Standards, Investor Protection, Corporate Governance, Cross-country Analysis, Asia

******Faculty of Economics and Business, University of Indonesia Depok 16424, Indonesia*
Tel: +62-21 78880745/47, +62-21 7270164
Fax: +62-21 78880745

1 Introduction

Governance system plays an important role in financial reporting process. Based on prior researches, rule on investor protection is a key institutional factor affecting corporate policy choices (see Shleifer and Vishny, 1997; La Porta et al., 2000). Recent researches find that country-level institutional factors are associated with the usefulness of accrual-based accounting information. Several international studies (Ali and Hwang, 2000; Ashbaugh and LaFond, 2003; Ball, Kothari, and Robin, 2000; DeFond, Hung, and Trezevant, 2004; Hung, 2001; Leuz, Nanda, and Wysocki, 2003) provide evidence of association between several financial reporting quality measurements (usually refer to financial reporting quality) and the degree of protection to investor from expropriation by controlling shareholders and manager. Their studies show that property of earnings is affected by the degree of investor protection.

Accounting standard is also serving as key determinant of high quality of financial statements. The harmonization of accounting standards that is happening today in the worlds affects various aspects of the corporate decision making. Prior researches show that the use of international accounting standards has impact on various financial aspects of companies such as price reaction, cost of capital, and accounting quality (Beatty et al.,1996; Ashbaugh and Pincus, 2001; Karamanou and Nishiotis, 2005; Cuijpers and Buijink, 2005; Barth et al., 2007). However, until now, there has been no empirical evidence on the effect of degree of convergence to financial reporting quality. Most of previous researches focus on whether firms or countries adopt or not adopt International Financial Reporting Standards (IFRS) without considering the degree of convergence of local GAAP to IFRS.

IFRS has been adopted in many countries with different degree of adoption. Many countries have fully adopted IFRS while many others still use local Generally Accepted Accounting Principles (GAAP) and claimed that the local GAAP is "based on" or "similar to" or "converged with" IFRS. Degree of convergence of local GAAP to IFRS shows how much IFRS has been adopted in local accounting standards or the extend of local GAAP refers to IFRS in a country. The convergence of local GAAP to IFRS will generate more comparable financial information across nation boundaries by minimizing, if not eliminating, differences in countries' local GAAP.

Provisions in accounting standards and investor protection at firm level may not be binding completely (Easterbrook and Fischel, 1991; Black and Gilson, 1998 in Klapper and Love, 2004). For instance, a firm could stand beyond country's provision in accounting standards and legal system by increasing quality of corporate governance. Previous

researches has also documented the relationship between corporate governance mechanisms to several financial reporting quality measurements such as earnings management (Dechow *et al.* 1996; Klein, 2002; Xie *et al.* 2003; Siregar, 2005; Dhaliwal *et al.* 2007), information content of earnings (Niu 2006 and Petra 2007), and accounting fraud (Beasley, 1996). These researches provide evidence that corporate governance mechanisms can increase quality of financial reporting .

In addition to the recent attention given to the importance of the convergence in accounting standards, another interesting empirical question is whether the accounting standards could be a substitute for or additional mechanism of governance system. One possibility is that when a company has bad corporate governance and/ or bad legal system, superior accounting standards (i.e. standards that converge to international standards) could enhance the quality of financial reporting (i.e., accounting standards could be a substitute mechanism to improve quality of financial reporting). Another possibility is that accounting standards play as an additional mechanism to improve quality of financial reporting. In this case if a company faces bad governance system, the accounting standards may not be effectively enhancing the quality of financial reporting. Daske *et al.* (2007) prove that IFRS is beneficial to countries with tight legal enforcement and good institutional environments, which provide higher incentive to high quality financial reporting.

The objective of this research is to investigate the effect of investor protection, and corporate governance as the governance system in country and firm level to several measurement of financial reporting quality which are earnings predictability, earnings management, reporting time lag, earnings respose coefficient, and conservatism. We also investigate the effect of degree of convergence of local GAAP to IFRS to financial reporting quality. To test whether the degree of convergence of local GAAP to IFRS matters more or less in countries with weak governance system (in terms of investor protection and corporate governance), and vice versa, we examine moderating role of those governance systems to the relationship between degree of convergence and financial reporting quality.

This study contributes to literature of international accounting standard, governance system, and financial reporting quality in several ways. First, this study provides empirical evidence on how the effect of governance system, both country level and firm level affect the financial reporting qualities and this study also provides empirical evidence on how the effect of the degree of convergence to IFRS to the quality of financial reporting in Asia. Prior studies on accounting convergence in Asia are quite limited, despite the interesting diverse characteristics among Asian countries and upcoming integration of capital market in Asia. Second, this research contributes accounting convergence literatures by developing indexes to measure degree of convergence of local GAAP to IFRS. This study develops an index of convergence based on 20 out of 32 standards of IFRS with four gradation degree of convergence. As far as our knowledge, there has not been any previous research on measuring degree of convergence in such way. Third, this research provides evidence on how governance system, both at corporate level and country level, moderates the effect of convergence on financial reporting quality.

2 Literature review and hypotheses development

2.1 Financial reporting quality

Financial reporting quality is a multidimensional concept that measures the usefulness of accounting information to the users. This research use several measurements of financial reporting quality which developed from most of dimension from IFRS conceptual framework which are: (i) earnings predictability which constructed from predictive value concept; (ii) earnings management which constructed from neutrality concept; (iii) reporting time lag which constructed from timeliness concept; (iv) Earnings Response Coefficient (ERC) which constructed from representational faithfulness concept; and (v) accrual conservatism which constructed from prudence concept.

2.2 Investor protection

La Porta et al. (2000) state that the primary key of the corporate governance mechanism is protection to outside investors (both shareholders and creditors) through both the legal system which includes aspects of regulation and law enforcement aspects. Related to the influence of investor protection to the quality of financial reporting , Leuz, Nanda, and Wysocki, (2003) examine the effect of investor protection to earnings management as one dimension of financial reporting quality measurement. They conclude that there is a significant negative relationship between earnings management to rights of minority shareholders and law enforcement. Their research results underline the importance of the relationship between investor protections with the quality of accounting earnings.

Thai et al. (2006) investigate the impact of investor protection against the quality of reported earnings, measured by accrual quality, earnings persistence, earnings predictability, and earnings smoothness. This study finds mixed evidence, and concludes that the institutional impact on earnings depends on the quality characteristic variables used to measure the quality of financial reporting . Bushman and Piotroski (2006) examine on how the institutional structure of a country such as the state legal system/

judiciary, capital market law, political economy, and the tax regime affect accounting conservatism. In general Bushman and Piotroski (2006) have shown that the institutional structure of state affects managerial decisions related companies with the principles of conservatism.

The explanations above suggest that legal system of investor protection can create an incentive for good behavior in financial reporting process which leads to higher quality of financial reporting . Therefore, we formulate the following hypothesis.

Hypothesis 1. Legal system of investor protection has a positive effect on the quality of financial reporting

2.3 Corporate governance

To minimize agency conflicts and the opportunity to expropriate minority shareholders, legal system of investor protection on the level of the state is not enough. Various provisions of the law on investor protection in a country are not entirely binding. This is due to the flexibility in the level of company that can be done by choosing to adopt an existing or lower level provisions, or adopt additional provisions which were not available in their legal system with the aim to provide value added for its stakeholders (Easterbrook and Fischel, 1991; Black-Gilson, 1998). Therefore there is a possibility that a company in a country with the same law enforcement would provide different investor protection (Klapper and Love, 2004). This shows that the company will implement the corporate governance at a certain level in accordance with the internal conditions. Furthermore, it will affect the quality of reporting of information generated by companies' management.

Several previous studies have documented the influence of corporate governance mechanisms, such as board characteristics (eg Dechow et al., 1996; Beasley, 1996; Klein, 2002; Zhou and Chen, 2004; Siregar, 2005), boards activities (eg Xie et al. , 2003; Zhou and Chen, 2004; Niu 2006; Petra 2007), and board expertise (eg Chtourou and Bedard, 2001; Xie et al., 2003; Dhaliwal et al., 2007) against some measure of financial reporting quality such as earnings management (Dechow et al., 1996; Klein, 2002; Xie et al., 2003; Siregar, 2005; Dhaliwal et al., 2007), the information contents of earnings (Niu 2006 and Petra, 2007), and the level of accounting fraud (Beasley, 1996).

Based on those study can be concluded that corporate governance mechanisms can increase quality of information to investors and the financial reporting quality. Therefore, we formulate the following hypothesis.

Hypothesis 2. Corporate governance implementation has a positive effect on the quality of financial reporting

2.4 Degree of convergence to IFRS

Previous studies in general find that the use of international accounting standards has a positive impact on financial reporting by increasing comparability and reliability of financial reporting. The use of international accounting standards has a positive impact on the quality of accounting numbers (Ashbaugh and Pincus, 2001; Gassen and Sellhorn, 2006; Barth et al., 2007; Meulen, Gaeremynck and Willekens, 2007). These studies compare the use of IFRS with U.S. GAAP or local GAAP in a country. In general, the results of these studies indicate that IFRS is more superior compared to U.S. GAAP or local GAAP of a country in the perspective of the quality of financial reports.

IFRS are principle-based standards. The advantages of principle based standards compared to rule based standards is that a company can implement the accounting standards in accordance to their special characteristics so the financial reporting will better to reflect the economic value of the company. Ashbaugh and Pincus (2001) and Barth et al. (2007) show that standards that converge to the international accounting standards have higher requirement of disclosure and the restrictions on the choice of accounting methods.

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) state 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 adopting 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 as can be seen from the value relevance of earnings that are not significant between U.S. GAAP and IFRS.

The results of previous studies above suggest that degree of covergence of accounting standards leads to higher quality of financial reporting. Therefore, we formulate the following hypothesis.

Hypothesis 3. Degree of covergence of local GAAP to IFRS has a positive effect on the quality of financial reporting

The influence of accounting standards to quality of financial reporting depends on institutional factors in the countries where the company operates. Legal system and law enforcement will greatly determine the effectiveness of accounting standards in improving the quality of corporate financial reporting. Daske et al. (2007) concluded that the quality of corporate accounting reporting shaped by many factors related to the institutional environment in a country, particularly those relating to reporting and enforcement incentives and standards. That is, when firms operate in countries with good legal systems, accounting standards will be able to play a role in improving the quality of financial reporting . The argument shows that the legal system relating to investor protection will increase the effect of accounting standards to financial reporting quality (coefficient for interaction between investor protection and the degree of convergence of local GAAP to IFRS will be positive).

On the other hand, the opposite argument is if a country's legal environment is not conducive; the existence of high-quality accounting standards will greatly contribute in improving the quality of financial reporting . That is, when legal investor protection is weak, the existence of accounting standards is more qualified to be a substitute for legal weaknesses, so the role of accounting standards for the financial reporting quality improvement will be even more important. The argument shows that the legal system relating to investor protection will decrease the effect of accounting standards to financial reporting quality (coefficient for interaction between investor protection and the level of convergence of local GAAP to IFRS will be negative).

Two different points of view above suggest that the level of investor protection in one country will affect the relationship between degrees of convergence of local GAAP to IFRS with financial reporting quality. Investor protection can either increase or decrease the effect of degrees of convergence to financial reporting quality. Therefore, we formulate the following hypothesis.

Hypothesis 4. The effect of degree of covergence of local GAAP to IFRS to financial reporting quality depends on countries' level of investor protection

The role of accounting standards in financial reporting is also influenced by the corporate governance system. As the legal system, corporate governance will also determine the effectiveness of accounting standards used in financial reporting process. This is mainly due to the nature of the IFRS which tend to be principle-based standards. When companies adopt good corporate governance, then the subjective judgement given by the management (intensively used in prnsiple-based standards implementation) will aim to provide information that reflects the real economic performance of the company. Therefore, with the higher degree of convergence of local standards to standards that more principle-based, IFRS, then the requirement to implement the principles of corporate governance will be higher, so that corporate governance will be able to contribute in improving the quality of financial reporting.

The explanations above suggest that with higher degree of convergence, the implementation of accounting standard will need more subjective judgement, so the quality of corporate governance implementation is more importance in determine the quality of financial reporting . Therefore, we formulate the following hypothesis.

Hypothesis 5. The effect of degree of covergence of local GAAP to IFRS to financial reporting quality depends on corporate governance implementation

The influence of corporate governance implementation to the quality of financial reporting will also be largely determined by the legal system in countries where the company operates. The better the legal environment of a country, the requirement to implement corporate governance principles will be higher. That is, when firms operate in countries with good legal system, corporate governance can play more roles in improving the quality of financial reporting . The argument shows that the legal system related to investor protection will increase the effect of corporate governance to quality of financial reporting (the coefficient for the interaction between investor protection and corporate governance will be positive).

On the other hand, there is the opposite argument that if the legal environment in a country is not conducive, the existence of good corporate governance becomes more important in improving the quality of financial reporting . Klapper and Love (2004) show that corporate governance is more important in improving corporate performance in countries with weak legal systems. The argument shows that the legal system related to investor protection will decrease the effect of corporate governance to quality of financial reporting (the coefficient for the interaction between investor protection and implementation of corporate governance will be negative).

With two different arguments, this study believed that the level of investor protection in one country will affect the relationship between corporate governance with financial reporting quality. Investor protection can either increase or decrease the effect of corporate governance to financial reporting quality. Therefore, we formulate the following hypothesis.

Hypothesis 6. The effect of corporate governance to financial reporting quality depends on countries' level of investor protection

3 Research method

3.1 Model development

3.1.1 Earnings predictability

Earnings predictability as an indicator of financial reporting quality indicates that earnings should be used in the process of equity valuation, which requires the estimation of expected future cash flows (Velury and Jenkins, 2006). This research will use the relationship between the current year earnings with future cash flow as a measure of earnings predictability (Dechow, 1994). The model used is as follows:

$$CFO_{i,t+1} = \alpha_0 + \alpha_1 INC_{i,t} + \alpha_2 INC_{i,t}*IP_{i,t} + \alpha_3 INC_{i,t}*GOV_{i,t} + \alpha_4 INC_{i,t}*CONVERGE_{i,t} + \alpha_5 INC_{i,t}*CONVERGE_{i,t}*IP_{i,t} + \alpha_6 INC_{i,t}*CONVERGE_{i,t}*GOV_{i,t} + \alpha_7 INC_{i,t}*GOV_{i,t}*IP_{i,t} + \alpha_8 INC_{i,t}*AQ_{i,t} + \alpha_9 INC_{i,t}*GROWTH_{i,t} + \alpha_{10} INC_{i,t}*DEBT_{i,t} + \alpha_{11} INC_{i,t}*LOSS_{i,t} + \alpha_{12} INC_{i,t}*DREG_{i,t} + \alpha_{13} INC_{i,t}*DYEAR_{i,t} + \alpha_{14\text{-}22} INC_{i,t}*DCOUNTRY_{i,t} + \varepsilon_{i,t}$$

Where:

$CFO_{i,t+1}$	Operating Cash Flow (scaled by total assets)
$INC_{i,t}$	Income before extraordinary item and discontinued operations (scaled by total assets)
IP	Score of investor protection consisting of *legal origin*, *corporate law & enforcement*, and securities law
GOV	Corporate governance index
CONVERGE	Score of degree of convergence of local GAAP to IFRS
AQ	Audit quality is measured using dummy variables, one if the firms audited by Big 4 accounting firm and 0 for non-Big 4. Includes in Big 4 accounting firms are accounting firms that have affiliations with foreign firms: Ernst & Young, Pricewaterhouse Coopers, Deloitte, and KPMG.
GROWTH	Percentage of sales growth from previous year
DEBT	Total debt (scaled by total assets)
LOSS	Dummy variable with value of 1 for loss company and value of 0 otherwise
DREG	Dummy variable with value of 1 for company in highly regulated industry and value of 0 otherwise
DYEAR	Dummy variable with value of 1 for year of observation 2006 and value of 0 otherwise
DCOUNTRY	Dummy variable for country with value of 1 for country which firm operates and value of 0 otherwise. Indonesia as country of reference.

i is for firm i and t is for year t

3.1.2 Earnings management

Previous studies have linked neutrality to earnings management. Absolute discretionary accrual often used in measuring earnings management. Model used to estimate the value of discretionary accrual in this study is the *Modified Jones Model* (Dechow, 1995), besauce it has the best ability to detect earnings management (Dechow et al., 1995). Model for earnings management model as follows:

$$ABSDAC_{i,t} = \beta_0 + \beta_1 IP_{i,t} + \beta_2 GOV_{i,t} + \beta_3 CONVERGE_{i,t} + \beta_4 CONVERGE_{i,t}*IP_{i,t} + \beta_5 CONVERGE_{i,t}*GOV_{i,t} + \beta_6 GOV_{i,t}*IP_{i,t} + \beta_7 AQ_{i,t} + \beta_8 GROWTH_{i,t} + \beta_9 DEBT_{i,t} + \beta_{10} LOSS_{i,t} + \beta_{11} DREG_{i,t} + \beta_{12} DYEAR_{i,t} + \beta_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,t}$$

Where:

$ABSDAC_{i,t}$	Absolute value of discretionary accruals for firm i in year t

Other variable definition is refer to Model 1.

3.1.3 Reporting lag

Reporting time lag measurement that are used in this study is the period between the date of the fiscal year end with the date the company announced their earnings to the public (submit financial reports to the capital market supervisory authority). The model is as follows:

$$REPLAG_{i,t} = \psi_0 + \psi_1 IP_{i,t} + \psi_2 GOV_{i,t} + \psi_3 CONVERGE_{i,t} + \psi_4 CONVERGE_{i,t}*IP_{i,t} + \psi_5 CONVERGE_{i,t}*GOV_{i,t} + \psi_6 GOV_{i,t}*IP_{i,t} + \psi_7 AQ_{i,t} + \psi_8 GROWTH_{i,t} + \psi_9 DEBT_{i,t} + \psi_{10} LOSS_{i,t} + \psi_{11} DREG_{i,t} + \psi_{12} DYEAR_{i,t} + \psi_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,t}$$

Where:

$REPLAG_{i,t}$	The period between the date of the fiscal year end with the date the company announced their earnings to the public (submit financial reports to the capital market supervisory authority).

Other variable definition is refer to Model 1.

3.1.4 Earnings response coefficient (ERC)

These dimensions can be measured by looking at the relationship between earnings and stock return. The measurement of earnings response embedded in stock return is called *Earnings Response Coefficient* (ERC). In this study, ERC is measured by regressing change in earnings (as measure of earnings surprise) from year t-1 to year t (as the independent variable) against Cummulative Abnormal Return (CAR) period t (as the dependent variable). ERC is coefficient values of the regression. The model is as follows:

$$CAR_{i,t} = \eta_0 + \eta_1 DEPS_{i,t} + \eta_2 DEPS_{i,t}* IP_{i,t} + \eta_3 DEPS_{i,t}*GOV_{i,t} + \eta_4 DEPS_{i,t}* CONVERGE_{i,t} + \eta_5 DEPS_{i,t}* CONVERGE_{i,t}*IP_{i,t} + \eta_6 DEPS_{i,t}*CONVERGE_{i,t}*GOV_{i,t} + \eta_7 DEPS_{i,t}* GOV_{i,t}*IP_{i,t} + \eta_8 DEPS_{i,t}*AQ_{i,t} + \eta_{10} DEPS_{i,t}*GROWTH_{i,t} + \eta_{11} DEPS_{i,t}*DEBT_{i,t} + \eta_{12} DEPS_{i,t}*LOSS_{i,t} + \eta_{13} DEPS_{i,t}*DREG_{i,t} + \eta_{14} DEPS_{i,t}*DYEAR_{i,t} + \eta_{15\text{-}23} DEPS_{i,t}*DCOUNTRY_{i,t} + \varepsilon_{i,t}$$

Where:

$CAR_{i,t}$ Cummulative Abnormal Return by using Market Adjusted Return during the period of 12 months ending 3 months after the fiscal year. Market Adjusted Return is measured as follows: Ari, t = Ri, t - Rm, t

$DEPS_{i,t}$ The difference between earnings per share before extraordinary item and discontinued operations in year t with year t-1 t for firm i scaled by stock price of year t-1.

Other variable definition is refer to Model 1.

3.1.5 Accrual conservatism

This study will use a measure of conservatism based on the company's accrual. Givoly and Hayn (2000) state that conservatism will create persistent patterns of negative accruals. In measuring the level of conservatism, this research will also use the average value of discretionary accruals for three years with the period t as a center value, multiplied by negative one to ensure that a higher value indicates a higher conservatism. To test the conservatism measure, we use the following model:

$$CON_{i,t} = \zeta_0 + \zeta_1 IP_{i,t} + \beta_2 GOV_{i,t} + \zeta_3 CONVERGE_{i,t} + \zeta_4 CONVERGE_{i,t}*IP_{i,t} + \zeta_5 CONVERGE_{i,t}*GOV_{i,t} + \zeta_6 GOV_{i,t}*IP_{i,t} + \zeta_7 AQ_{i,t} + \zeta_8 GROWTH_{i,t} + \zeta_9 DEBT_{i,t} + \zeta_{10} LOSS_{i,t} + \zeta_{11} DREG_{i,t} + \zeta_{12} DYEAR_{i,t} + \zeta_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,t}$$

Where

$CON_{i,t}$ The average value of three year discretionary accrual wit year t as the median value for company i in the year t multiplied by -1.

Other variable definition is refer to Model 1.

3.2 Variable operationalisation

3.2.1 Investor protection

Investor protection is measured by legal tradition, corporate law and enforcement, and securities law (La Porta et al. 1998, 2006). Corporate law and enforcement consists of two components namely the anti-director rights index and rule of law. Value of index for the investor protection in this study is the sum of the values for each of the four components of investor protection. Those components are assessed by giving the value 1 for countries that are classified as countries with better protection for investors (classified into "high"), and the value of 0 for countries that are classified as countries with poor investor protection (classified into "low"). The maximum value is given to the state 4 and the minimum value is 0.

Legal origin of a country is measured by dummy variables with value 1 for common law countries and the value 0 for the civil law countries. Classification of countries by legal origin is taken from La Porta et al. (1998). Common law country is classified as a country that provides good protection for investors ("high" = value 1), and a civil law country is classified as a country that provide poor protection for investors ("low"= value 0).

Corporate law and enforcement measure investor protection in terms of corporate law which regulate the protection of the rights of investors and rule of law in a country, measure by anti-director rights index. This research uses the index values presented in La Porta et al. (1998). A country is classified as a country that provides good protection for investors ("high" = value 1) if the country's value of anti-director rights index is more or equal to 3, and the country is classified as a country that provides poor protection for investors ("low" = value 0) if the country's value of anti-director rights index is less than 3.

While the law enforcement measures for investor protection through enforcement of laws that cover the four aspects (La Porta et al., 1998), namely: (1) *Efficiency of the judicial system* (La Porta et al.,1998). (2) *Rule of law;* this value is the index generated by the International Country Risk (IRC) by using the average of the monthly index for one year during the study period. (3) *Corruption;* this study uses an index

value of level corruption in the country reported by the International Country Risk (IRC). (4) *Risk of expropriation;* this value is also an index value generated by the International Country Risk (IRC). A country is classified as a country that provides good investor protection ("high" = value 1) for country with score above 5 for average efficiency of the judicial system, law enforcement, corruption, and the risk of expropriation, 0 therwise.

Securities Law measures investor protection in terms of legislation governing the capital markets. These variables include the three aspects of investor protection that governed by the laws of capital markets (La Porta et al., 2006), namely: (i) the disclosure reequirement; (ii) litigation standards, and (iii) the public enforcement. Data of the Securities Law variable is taken from La Porta et al. (2006). A country is classified as a country that provides good investor protection ("high" = value 1) for country with score above 5 for average efficiency of the disclosure requirement, litigation standard, and public enforcement, 0 therwise.

3.2.2 *Corporate governance*

This variable measures the level of implementation of corporate governance at the company. This study uses the value of corporate governance made by the Asian Securities Credit Lyonnais (CLSA), as presented in the report that CLSA CG Watch 2005 and 2007. CLSA reports made periodically once every two years. Questions in the questionnaire include several categories such as management discipline, transparency, independency, accountability, responsibility, fairness, and social awareness. Corporate governance index value in 2004 refers to the index value of CLSA CG Watch 2005 and the value of corporate governance index in 2006 refers to the index value of CLSA CG Watch 2007.

3.2.3. Degree of Convergence of Local GAAP with IFRS

Variable degree of convergence of local GAAP to IFRS is a measure of level adoption of local accounting standards to the international accounting standards. Standard used as a basis for measuring degree of convergence of a country in this study 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) Earning Per Share; (16) Interim Financial Reporting; (17) Impairment of Assets; (18) Intangible Assets; (19) Revenue Recognition; and (20) Financial Instrument.

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 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. Based on the sample selection procedure, we obtained 330 sample companies. Observation was considered an outlier and deleted if it is outside the range of the average ± three times the standard deviation for each variable in each research model.

The number of sample firms in the study was relatively small compared to the number of listed companies in ten countries examined in this study. However, compared to the value of market capitalization of the ten countries examined in this study, then the sample companies have a fairly large proportion of market capitalization. Over all, the proportion of market capitalization of sample firms to total market capitalization for the ten countries is 40% and 45% in 2004 and 2006 respectively. While the average proportion of market capitalization of sample companies to total market capitalization for the ten

countries is 59% and 66% in 2004 and 2006. Based on high proportion of market capitalization, we can conclude that the sample companies can be considered to represent the company in the capital markets in ten countries in this study.

Table 1. Samples selection procedures

The number of listed companies in 11 countries	10.498
Number of firms surveyed by CLSA in 2004 and 2006	582
Number of companies in China are included in the CLSA survey	(60)
Companies in Finance, Real Estate, and Property Industry	(110)
Company with incomplete data	(82)
Total sample before excluding outlier	330
Outliers:	
- In Earnings Predictability Model	(29)
- In Earnings Neutrality (Earnings Management) Model	(22)
- In Earnings Timelines Model	(4)
- In Representational Faithfulness (ERC) Model	(10)
- In Conservatism Model	(18)
Number of simple companies:	
- In Earnings Predictability Model	301
- In Earnings Neutrality (Earnings Management) Model	308
- In Earnings Timelines Model	326
- In Representational Faithfulness (ERC) Model	320
- In Conservatism Model	312
Firm Years Observations (2004 and 2006):	
- In Earnings Predictability Model	602
- In Earnings Neutrality (Earnings Management) Model	616
- In Earnings Timelines Model	652
- In Representational Faithfulness (ERC) Model	640
- In Conservatism Model	624

4 Analysis of result

4.1 Descriptive statistic

Descriptive statistics and correlation matrix are shown in Table 3. Table 3 shows that on average firms have positive cash flow and positive profit. For earnings management measure, on average firms have small and high variability on ABSDAC value. The result shows that company on average publish their financial report in 125 days (anti log of 4.831) or around four months after balance sheet date.

Table 3. Statistic descriptive

Variables	Mean	Minimum	Maximum	Std. Deviation
CFO	0.100	-0.373	0.693	0.110
INC	0.080	-0.558	0.528	0.087
ABSDAC	0.078	0.000	0.405	0.073
LOGREPLAG	4.831	1.390	5.910	0.722
CAR	0.001	-1.486	1.597	0.488
DEPS	0.022	-0.614	0.541	0.075
CON	0.259	-0.379	3.419	0.696
CONVERGENCE	3.085	2.550	3.850	0.397
IP	3.115	1.000	4.000	0.877
GOV	59.472	14.300	96.200	16.475
GROWTH	0.262	-0.898	10.886	0.645
DEBT	0.532	0.043	4.090	0.230
	Proportion of Dummy 1		**Proportion of Dummy 0**	
AQ	73.33%		26.67%	
LOSS	5.45%		94.55%	
DREG	32.42%		67.58%	

Table 3 also shows that the company has an average value of CAR is positive and relatively high variation of these variables. While based on DEPS variable indicates that, on average, have a change of variation of positive corporate earnings and high pershare variables. For conservatism, the average sample firm has a positive CON values and high variation of these variables.

4.2 Regression result

The results of the regression models, which test the relation between investor protection, corporate governance, accounting standards convergence to IFRS, and also interaction among those variables, are presented in Tables 4–8. Table 4 presents the regression results for the effect of investor protection, corporate governance, accounting standards convergence to IFRS, and interaction among those variables on the earnings–cash flow relation.

Table 4. Regression result on earnings predictability model

Model 1				
$CFO_{i,t+1} = \alpha_0 + \alpha_1 INC_{i,t} + \alpha_2 INC_{i,t}*IP_{i,t} + \alpha_3 INC_{i,t}*GOV_{i,t} + \alpha_4 INC_{i,t}*CONVERGE_{i,t} + \alpha_5 INC_{i,t}*CONVERGE_{i,t}*IP_{i,t} + \alpha_6 INC_{i,t}*CONVERGE_{i,t}*GOV_{i,t} + \alpha_7 INC_{i,t}*GOV_{i,t}*IP_{i,t} + \alpha_8 INC_{i,t}*AQ_{i,t} + \alpha_9 INC_{i,t}*GROWTH_{i,t} + \alpha_{10} INC_{i,t}*DEBT_{i,t} + \alpha_{11} INC_{i,t}*LOSS_{i,t} + \alpha_{12} INC_{i,t}*DREG_{i,t} + \alpha_{13} INC_{i,t}*DYEAR_{i,t} + \alpha_{14\text{-}22} INC_{i,t}*DCOUNTRY_{i,t} + \varepsilon_{i,t}$				
Dependent Variable: CFO				
Independent Variables	**Expected Sign**	**Coefficients**	**Significance**	**VIF**
CONSTANT		***0.101	0.000	
INC	+	***0.586	0.000	2.594
INC*IP	+	***0.443	0.007	1.990
INC*GOV	+	*0.276	0.088	1.044
INC*CONVERGE	+	***2.216	0.005	5.366
INC*CONVERGE*IP	+/-	-3.095	0.122	3.532
INC*CONVERGE*GOV	+/-	*-2.394	0.083	2.534
INC*GOV*IP	+/-	**-0.830	0.039	2.407
INC*AQ	+	0.087	0.446	1.410
INC*GROWTH	+	***-0.494	0.005	1.759
INC*DEBT	+	0.120	0.694	1.966
INC*LOSS	-	***-0.910	0.000	3.983
INC*DREG	+/-	-0.023	0.844	1.427
INC*DYEAR	+/-	-0.143	0.313	2.290
INC*DCOUNTRY	+/-	INCLUDED		
F test Sign		0.000		
Adj R Square		0.134		
N		634		
***Significance at 1% ** Significance at 5% * Significance at 10%				

Model 1 shows that with more and better protection for investors in the country, financial statements will be more informative, and with higher certainty in legal system the predictability of financial statements will be enhanced. This study consistent with Ball et al., (2000) that show the level of investor protection will enhance the information value of reported earnings. The governance system in corporate level also gives positive effect on earnings predictability. Implementation of good corporate governance will ensure transparency and better disclosure from companies, so investors can more accurately predict earnings. This evidence is consistent with Niu (2006) and Petra (2007) which state that corporate governance will improve the quality of the information content of earnings. The result also shows a positive and significant relation between earnings and cash flows. Table 4 indicates that the convergence index level of local GAAP to IFRS has a positive impact on corporate earnings predictability. Consistent with Ashbaugh and Pincus (2001), with the high convergence of local accounting standard of a country against the international standard, the financial statements will become more informative and predictable.

For the interaction variables, the significance effect to earnings predictability only come from CONVERGE*GOV and GOV*IP. The CONVERGE*GOV shows a negative coefficient, which means that convergence of local GAAP to

IFRS can enhance earnings predictability in company with weak governance system. The GOV*IP also has significance negative effect to earnings predictability. Negative impacts indicated that corporate governance can better enhance the predictability of income in countries that provide weak protection for investors. If a country's legal environment is not conducive, the effectiveness of corporate governance in improving the quality of corporate earnings will be higher. These results are consistent with Klapper and Love (2004) which state that corporate governance is more important in improving firm performance in countries that have weak legal systems. Meanwhile, growth and loss has a negative effect on earnings predictability.

Table 5 presents the regression results for earnings management model. Result on Table 5 shows that investors' protection in one country will lower the ability of company to conduct earnings management. Empirical evidence is consistent with Leuz, Nanda, and Wysocki (2003) which show a significant negative relationship between earnings management with the quality of the rights of minority shareholders and law enforcement. Consistent with governance system in country level, corporate governance implementation also give a negative impact on discretionary charges generated by company. This evidence supports Dechow, etc. (1996), Klein (2002), and Xie et al. (2003) which show that corporate governance can reduce the level of earnings management.

The result also shows that the index level of local GAAP convergence to IFRS will have a negative impact of discretionary accruals generated by the company. Ashbaugh and Pincus (2001) state that by increasing the convergence of local GAAP to international accounting standards so that more disclosure requirements and restrictions on the choice of accounting methods are also more stringent. The consequence is that the ability of managers to manage the earnings will be limited by the standard. This evidence is consistent with Barth, et al. (2007) which state that companies that adopt IFRS will have better quality characteristics of accounting because of the quality of accounting can be improved by eliminating alternative accounting methods which are less able to reflect the company's performance and that can be used to manage earnings.

Table 5. Regression result on earnings management model

Model 2				
$\mathbf{ABSDAC_{i,t} = \beta_0 + \beta_1 IP_{i,t} + \beta_2 GOV_{i,t} + \beta_3 CONVERGE_{i,t} + \beta_4 CONVERGE_{i,t}*IP_{i,t} + \beta_5 CONVERGE_{i,t}*GOV_{i,t} + \beta_6 GOV_{i,t}*IP_{i,t} + \beta_7 AQ_{i,t} + \beta_8 GROWTH_{i,t} + \beta_9 DEBT_{i,t} + \beta_{10} LOSS_{i,t} + \beta_{11} DREG_{i,t} + \beta_{12} DYEAR_{i,t} + \beta_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,t}}$				
Dependent Variable: ABSDAC				
Independent Variables	**Expected Sign**	**Coefficients**	**Significance**	**VIF**
CONSTANT		***0.074	0.000	
CONVERGE	-	*-0.047	0.063	1.206
IP	-	**-0.030	0.019	2.420
GOV	-	*-0.018	0.077	1.260
CONVERGE*IP	+/-	***0.375	0.000	1.225
CONVERGE*GOV	+/-	**-0.181	0.033	1.081
GOV*IP	+/-	-0.006	0.773	1.405
AQ	-	**-0.016	0.023	1.128
GROWTH	-	*0.020	0.066	1.041
DEBT	-	*0.028	0.098	1.042
LOSS	+	-0.013	0.363	1.094
DREG	+/-	0.007	0.261	1.026
DYEAR	+/-	-0.005	0.498	1.922
DCOUNTRY	+/-	INCLUDED		
F test Sign		0.000		
Adj R Square		0.060		
N		616		
***Significance at 1% ** Significance at 5% * Significance at 10%				

The interaction terms only significance for CONVERGE*IP and CONVERGE*GOV. CONVERGE*IP shows a positive coefficient. The positive coefficient indicates that convergence with IFRS will reduce earnings management in countries that provide weaker protection to investors. Arguments of this result is that if a country's legal environment is not conducive, then the existence of a

higher quality of standard in accounting can be a substitute for the weakness of law, so the role of the accounting standards to reducing the earnings management will be greater. On the other hand, CONVERGE*GOV shows a negative coefficient which indicates that higher convergence of local GAAP to IFRS can reduce earnings management in companies with strong governance system. For the control variables, the result shows that companies audited by BIG 4 will have lower earnings management compared to companies audited by non BIG 4. Other variables that have significant effect to earnings management are GROWTH and DEBT, which the effects are positive.

For the reporting time lag model, the result shows that the stronger legal environment of the company, the company will provide information in a timely manner. Based on the result, corporate governance implementation gives insignificant effect on reporting time lag. These result shows that transparency, which required by good governance system, is not through timely basis financial reports. Table 6 shows that the index of convergence of local GAAP to IFRS affects negatively to the company reporting lag. It does indicate that with higher convergence of local GAAP to IFRS, companies will become timelier in issuing its financial statements. In addition, hypothesis which states that the value of the investors' protection in one country would adversely affect the level of reporting timelag is accepted.

Variables CONVERGE*IP and CONVERGE*GOV both positively affect reporting time lag. Accounting convergence with IFRS accounting standards will be reducing reporting lag or accelerate the company's financial reporting, in a countries that provide a weak investor protection. The argument this result is that if the legal conditions in the country is not conducive, the existence of higher quality accounting standards will play an important role in enhancing the quality of financial reporting by accelerating financial reporting period. The argument also applies in considering the implementation of coporate governance. In a company that implements weak corporate governance the existence of higher quality accounting standards will play an important role in enhancing timeliness of financial reports. For the control variables, the result shows that variables AQ, LOSS, and DYEAR play significant role in reducing timeliness of financial reports.

Table 6. Regression result on reporting time lag model

Model 3				
$\mathbf{REPLAG_{i,t} = \psi_0 + \psi_1 IP_{i,t} + \psi_2 GOV_{i,t} + \psi_3 CONVERGE_{i,t} + \psi_4 CONVERGE_{i,t}*IP_{i,t} + \psi_5 CONVERGE_{i,t}*GOV_{i,t} + \psi_6 GOV_{i,t}*IP_{i,t} + \psi_7 AQ_{i,t} + \psi_8 GROWTH_{i,t} + \psi_9 DEBT_{i,t} + \psi_{10} LOSS_{i,t} + \psi_{11} DREG_{i,t} + \psi_{12} DYEAR_{i,t} + \psi_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,t}}$				
Dependent Variable: LOGREPLAG				
Independent Variables	**Expected Sign**	**Coefficients**	**Significance**	**VIF**
CONSTANT		***4.899	0.000	
CONVERGE	-	***-2.020	0.000	3.439
IP	-	***-0.490	0.000	2.319
GOV	-	0.070	0.417	1.195
CONVERGE*IP	+/-	***2.497	0.005	1.354
CONVERGE*GOV	+/-	***2.452	0.002	1.166
GOV*IP	+/-	0.001	0.994	1.353
AQ	-	**-0.156	0.016	1.030
GROWTH	-	-0.046	0.593	1.116
DEBT	-	0.196	0.150	1.135
LOSS	+	*-0.199	0.097	1.183
DREG	+/-	-0.070	0.179	1.071
DYEAR	+/-	***-0.287	0.004	4.367
DCOUNTRY	+/-	INCLUDED		
F test Sign		0.000		
Adj R Square		0.308		
N		652		
***Significance at 1% ** Significance at 5% * Significance at 10%				

Table 7 presents the regression results for the effect of investor protection, corporate governance, accounting standards convergence to IFRS, and interaction among those variables on ERC. The evidence indicates that there is a positive ERC in general. The result shows that legal system of investor

protection has a positive effect on ERC. This finding is consistent with Ali and Hwang, (2000) and Ball et al., (2000) stating that the relevance of earnings will be higher on companies that are in a country with stronger investor protection. The governance system in corporate level is also give positive effect on ERC. Implementation of good corporate governance will enhance the relevance of earnings to investor, consistent with Niu (2006) and Petra (2007). The convergence index level of local GAAP to IFRS has a positive impact on ERC. With convergence of local GAAP to IFRS the company will produce the financial statements will give higher value relevance. This evidence consistent with Barth et al. (2007) who conclude that companies adopt IFRS has higher value relevance of earnings.

Table 7. Regression result on ERC model

Model 4				
$\mathbf{CAR_{i,t} = \eta_0 + \eta_1 DEPS_{i,t} + \eta_2 DEPS_{i,t}* IP_{i,t} + \eta_3 DEPS_{i,t}*GOV_{i,t} + \eta_4 DEPS_{i,t}* CONVERGE_{i,t} + \eta_5 DEPS_{i,t}* CONVERGE_{i,t}*IP_{i,t} + \eta_6 DEPS_{i,t}*CONVERGE_{i,t}*GOV_{i,t} + \eta_7 DEPS_{i,t}* GOV_{i,t}*IP_{i,t} + \eta_8 DEPS_{i,t}*AQ_{i,t} + \eta_{10} DEPS_{i,t}*GROWTH_{i,t} + \eta_{11} DEPS_{i,t}*DEBT_{i,t} + \eta_{12} DEPS_{i,t}*LOSS_{i,t} + \eta_{13} DEPS_{i,t}*DREG_{i,t} + \eta_{14} DEPS_{i,t}*DYEAR_{i,t} + \eta_{15\text{-}23} DEPS_{i,t}*DCOUNTRY_{i,t} + \varepsilon_{i,t}}$				
Dependent Variable: CAR				
Independent Variables	**Expected Sign**	**Coefficients**	**Significance**	**VIF**
CONSTANT		-0.029	0.232	
DEPS	+	**1.307	0.041	6.208
DEPS*CONVERGE	+	**7.913	0.047	3.166
DEPS*IP	+	**7.156	0.043	2.158
DEPS*GOV	+	***0.181	0.005	8.134
DEPS*CONVERGE*IP	+/-	**-0.477	0.020	2.849
DEPS*CONVERGE*GOV	+/-	*-0.098	0.073	1.623
DEPS*GOV*IP	+/-	**-1.869	0.033	7.641
DEPS*AQ	+	0.737	0.147	1.456
DEPS*GROWTH	+	*2.675	0.079	1.487
DEPS*DEBT	+	-0.661	0.508	1.137
DEPS*LOSS	-	0.139	0.348	1.868
DEPS*DREG	+/-	-0.135	0.804	1.433
DEPS*DYEAR	+/-	**-0.095	0.015	1.018
DEPS*DCOUNTRY	+/-	INCLUDED		
F test Sign		0.000		
Adj R Square		0.341		
N		640		
***Significance at 1% ** Significance at 5% * Significance at 10%				

For the interaction variables, all interaction variables have negative effect on ERC. The results show that convergence of local GAAP to IFRS can enhance earnings relevancy in company with weak governance system, both at country or firm level. The GOV*IP also has significance negative effect to ERC. Negative impacts indicated that corporate governance can better enhance the relevance of earnings in countries that provide weak protection for investors. If a country's legal environment is not conducive, the effectiveness of corporate governance in improving the quality of corporate earnings will be higher. For the control variables, the result shows that variables GROWTH (positive) and DYEAR (negative) has significant effect to ERC.

Table 8 presents the regression results for the conservatism model. Institutional structure of a country will affect the company's managerial decisions related to the principles of conservatism. At firm level, the index of corporate governance also has a positive impact on the level of conservatism. This research supports Ahmed and Duellman (2007) which states that companies with good corporate governance mechanisms will require a higher conservatism so that can reduce agency costs arised from asymmetric information between managers with other parties. These results also support the argument of Ball (2001) suggests that conservatism will facilitate the implementation of governance through its role as the company's monitoring function to investment policy. The convergence index level of local GAAP to IFRS positively affects company's conservatism. This finding is consistent with Gassen and Sellhorn (2006) and Barth et al. (2007) which states that companies that adopt IFRS is more conservative. From governance system perspective, the result shows that

investor protection positively affects level of conservatism. This evidence is consistent with Bushman and Piotroski (2006) who conclude that companies located in countries that have a high quality of the judicial system will tend to be more conservative.

For the interaction variables, CONVERGE*IP and GOV*IP shows significant negative effects to conservatism, whreas CONVERGE*GOV shows a significant positive effet to conservatism. The negative interactions indicate that in countries that provide weak protection for investors the role of accounting standards that converge to IFRS and implementation of good corporate governance is more important in increasing accounting conservatism. The positive interactions indicate that role of accounting standards that converge to IFRS will be higher in companies with better corporate governance implementation. For the control variables, the result shows that variables DEBT, DREG, and DYEAR are negatively effect conservatism.

Table 8. Regression result on conservatism model

Model 5				
$\mathbf{CON_{i,t} = \zeta_0 + \zeta_1 IP_{i,t} + \beta_2 GOV_{i,t} + \zeta_3 CONVERGE_{i,t} + \zeta_4 CONVERGE_{i,t}*IP_{i,t} + \zeta_5 CONVERGE_{i,t}*GOV_{i,t} + \zeta_6 GOV_{i,t}*IP_{i,t} + \zeta_7 AQ_{i,t} + \zeta_8 GROWTH_{i,t} + \zeta_9 DEBT_{i,t} + \zeta_{10} LOSS_{i,t} + \zeta_{11} DREG_{i,t} + \zeta_{12} DYEAR_{i,t} + \zeta_{13\text{-}21} DCOUNTRY_{i,t} + \varepsilon_{i,}}$				
Dependent Variable: CON				
Independent Variables	**Expected Sign**	**Coefficients**	**Significance**	**VIF**
CONSTANT		***0.894	0.000	
CONVERGE	+	***0.690	0.000	2.456
IP	+	***1.112	0.001	3.665
GOV	+	**0.108	0.028	1.498
CONVERGE*IP	+/-	***-5.856	0.000	5.220
CONVERGE*GOV	+/-	***1.444	0.000	1.355
GOV*IP	+/-	***-0.289	0.003	1.476
AQ	+	0.021	0.537	1.329
GROWTH	+	-0.048	0.384	1.166
DEBT	+	**-0.174	0.024	1.140
LOSS	-	-0.046	0.490	1.088
DREG	+/-	***-0.075	0.009	1.073
DYEAR	+/-	***-0.278	0.000	4.351
DCOUNTRY	+/-	INCLUDED		
F test Sign	0.000			
Adj R Square	0.786			
N	624			
***Significance at 1% ** Significance at 5% * Significance at 10%				

5 Conclusion

5.1 Conclusion and implication

This research examines the impact of governance systems, both at the country level and firm level, and accounting standard convergence to financial reporting quality. We use five measures of financial reporting quality, which are earnings predictability, earnings management, reporting time lag, ERC, and conservatism. Our study concludes that the governance systems, both country level and corporate level, and degree of convergence of local GAAP to IFRS generally positively effect on financial reporting quality.

This study proves that the effect of degree of convergence of local GAAP to IFRS to financial reporting quality will be greater for companies in countries with weak investor -protection. Accounting standards that converge to international standards will substitute the weakness of the legal system of the county. The study also proves that in general the impact of corporate governance to improve the quality of financial reporting is higher also in countries with weak investor protection. In general, this study also proved that in company with weak corporate governance, the adoption of international standards will increase the quality of financial reporting. The results indicate that the convergence to IFRS support the governance system in increasing the quality of financial reporting and that the adoption of international accounting standard become more important in the countries with poor governance system.

5.2 Limitation and suggestion for future research

Several limitations of this research are: (i) subjective judgement in developed a measure of the level of convergence of local GAAP to IFRS with comparisons between the local GAAP to IFRS for 20 accounting standard. For future research subjectivity could be decrease by conducting Focus Grop Discussion to asses the degree of convergence; (ii) this study uses data investor protection taken from La Porta et al. (1997, 1998, and 2006). The disadvantage is that data is not up to date. Even though this data still relevance to measure investor protection, further research could use other up dated data to measure investor protection; (iii) the sample of companies in this study is the companies included in the CLSA survey. Companies selected as the respondent on that survey is a large-scaled company and companies with high analyst following. Therefore, these results may not be generalized for small-scale firms; (iv) this study uses only two-year study period, which is 2004 and 2006. Further research sould expand the research period.

References

1. Ahmed, A.S., Duellman, S., 2007. Accounting conservatism and board of director characteristics: An empirical analysis, *Journal of Accounting and Economics*.
2. Aikea, Leona S., Stephen G. West, dan Raymond R. Reno. 1991. Multiple regression: testing and interpreting interaction. *Mathematics*.
3. Ali A., L. Hwang, 2000. Country-specific factors related to financial reporting and the value relevance of accounting data. *Journal of Accounting Research* 38, 1-23.
4. Ashbaugh, H. dan M. Pincus., 2001. Domestic Accounting Standards, International Accounting Standards, and the Predictability of Earnings. *Journal of Accounting Research* 39: 417- 434.
5. Ball, R., S. P. Kothari, dan A. Robin., 2000. The effect of international institutional factors on properties of accounting earnings. *Journal of Accounting and Economics*, 29, 1–51.
6. Barth, M., W. Landsman, dan M. Lang., 2007. International Accounting Standards and Accounting Quality, *Working paper, Stanford University and University of North Carolina.*
7. Basu, S., 1997. The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics* 24, 3–37.
8. Beasley, M. S., 1996. An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud. *The Accounting Review*, vol. 71 no. 4 (Oct.), pp: 443-465
9. Becker, L. Connie, L.D. Mark, J. James, dan K.R. Subramanyam, 1998. The Effect of Audit Quality on Earnings Management. *Contemporary Accounting Research*. Vol. 15, No. 1, 1-24.
10. Bushman, R. dan J. Piotroski, 2006. Financial reporting incentives for conservative accounting: the influence of legal and political institutions, *Journal of Accounting and Economics*, 42(1-2), pp. 107-48.
11. Cuijpers, R., dan W. Buijink, 2005. Voluntary Adoption of Non-Local GAAP in the European Union: A Study of Determinants and Consequences. *European Accounting Review*, Vol. 14, pp. 487-524.
12. Daske, Holger., Luzi Hail, Christian Leuz, dan Rodrigo Verdi., 2007. Mandatory IFRS Reporting Around the World: Early Evidence on the Economic Consequences. *Initiative on Global Markets, Working Paper 12 The University of Chicago, Graduate School of Business*
13. DeFond, Mark L., dan M. Hung, 2004. Investor protection and corporate governance: evidence from worldwide CEO turnover. *Journal of Accounting Research* 42, 269–312.
14. DeFond, Mark L. dan Mingyi Hung, 2007. Investor Protection and Analysts' Cash Flow Forecasts Around the World. *Working Paper Leventhal School of Accounting Marshall School of Business University of Southern California.*
15. DeFond, Mark., Mingyi Hung, dan Robert Trezevant., 2004. Investor protection and the information content of annual earnings announcements: International evidence, *Journal of Accounting and Economics* 43, 37–67
16. Dechow, P.M., 1994. Accounting earnings and cash flows as measures of firm performance: the role of accounting accruals. *Journal of Accounting and Economics*, 18, 3–42.
17. Dechow, Patricia M., Richard G. Sloan, dan Amy P. Sweeney., 1996. Cause and Consequences of Earnings Manipulation: An Analysis of Firm Subject to Enforcement Actions by the SEC. *Contemporary Accounting Research*, Vol 13 no. 1, 1-36.
18. Dhaliwal, Dan, Vic Naiker, dan Farshid Navissi., 2007. Audit Committee Financial Expertise, Corporate Governance and Accruals Quality: An Empirical Analysis. *Working Paper*.
19. Easterbrook, F., dan D. Fischel, 1991. The Economic Structure of Corporate Law. *Harvard Univ. Press, Cambridge, MA.*
20. Francis, Jere R.., Inder K. Khurana, dan Raynolde Pereira., 2001. Investor Protection Laws, Accounting and Auditing Around the World, *Working paper College of Business University of Missouri-Columbia.*
21. Francis, Jere R., dan Dechun Wang., 2006. The Joint Effect of Investor Protection and Big 4 Audits on Financial reporting quality Around the World. *Working paper College of Business University of Missouri-Columbia.*
22. Gassen, Joachim. dan Thorsten Sellhorn., 2006. Applying IFRS in Germany – Determinants and Consequences. *Working paper Universität zu Berlin*.
23. Givoly, D., C. Hayn, dan A. Natarajan, 2007. Measuring reporting conservatism. *The Accounting Review* 82, 65–106.
24. Hope, O. -K., J. Jin, dan T. Kang, 2006. Empirical evidence on jurisdictions that adopt IFRS. *Journal of International Accounting Research*, 5(2).
25. Hung, M., 2001. Accounting standards and value relevance of financial statements: an international analysis, *Journal of Accounting and Economics*, 30(3), pp. 401-20.
26. Klapper, Leora F., dan Inessa Love., 2004. Corporate governance, investor protection, and performance in

emerging markets *Journal of Corporate Finance* 10: 703– 728.
27. Klein, April., 2002. Audit Committee, Board of Director Characteristics, and Earning Management. *Journal of Accounting and Economics*, Vol. 33, 375-400.
28. La Porta, R., F. Lopez-de-Silanes, A. Shleifer, dan R. Vishny., 1997. Legal determinants of external finance. *Journal of Finance* 52, 1131-1150.
29. La Porta, R., F. Lopez-de-Silanes, A. Shleifer, dan R. Vishny., 1998. Law and finance. *Journal of Political Economy* 106, 1113-1155.
30. La Porta, R., F. Lopez-de-Silanes, A. Shleifer, dan R. Vishny., 2000. Investor protection and corporate governance. *Journal of Financial Economics* 58, 3-27.
31. La Porta, R., Lopez-De-Silanes, F., dan A. Shleifer., 2006. What works in securities laws? *Journal of Finance*, 61(1), pp. 1-32.
32. Leuz ,Christian., Dhananjay Nanda, dan Peter D. Wysocki., 2003. Investor Protection and Earnings Management: An International Comparison, *Journal of Financial Economics 69.*
33. Meulen, Sofie Van der., Ann Gaeremynck, dan Marleen Willekens., 2007. Attribute differences between U.S. GAAP and IFRS earnings: An exploratory study. *The International Journal of Accounting*, 42: 123–142
34. Niu, Flora F., 2006. Corporate Governance and the Quality of Accounting Earnings: A Canadian Perspective. *International Journal of Managerial Finance*. Vol. 2 No. 4, 302-327.
35. Petra, Steven T., 2007. The Effect of Corporate Governance on the Informativeness of Earnings. *Economics of Governance*. Vol. 8, 129-152.
36. Renders, Annelies., dan Ann Gaeremynck., 2005. The Impact of Legal and Voluntary Investor Protection on the Early Adoption of IFRS. *Working papers Department of Applied Economics Leuven-Belgium.*
37. Shleifer, Andrei., dan Robert Vishny., 1997. A Survey of Corporate Governance. *The Journal of Finance.* June, Vol. 52 (2), 737-783.
38. Teoh, Siew Hong dan T.J. Wong, 1993. Perceived Auditor Quality and the Earning Response Coefficient. *Accounting Review*. Vol. 68, 2, 346-366.
39. Thai, Kriengkrai Boonlert-U., Gary K. Meek, dan Sandeep Nabar., 2006. Earnings attributes and investor-protection: International evidence. *The International Journal of Accounting* 41: 327–357
40. Velury, Uma., dan David S. Jenkins., 2006. Institutional ownership and the quality of financial reporting . *Journal of Business Research* 59 1043–1051
41. Watts, R.L. 1993. A proposal for research on conservatism. *Working paper, University of Rochester* (presented at American Accounting Association national meeting, San Francisco, CA).
42. Watts, R.L., 2003a. Conservatism in accounting part I: explanations and implications. *Accounting Horizons* 17, 207–221.
43. Xie, Biao, Wallace N. Davidson III, dan Peter J. DaDalt., 2003. Earnings Management and Corporate Governance: the Role of the Board and the audit Committee. *Journal of Corporate Finance*. Vol. 9. 295-316.
44. Zhou, Jian dan Ken Y. Chen., 2004.Committee, Board Characteristics and Earnings Management by Commercial Banks. *Working Paper*.