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# The Impact of International Financial Reporting Standards (IFRS) on Financial Performance of Banking Sector

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**Abstract**— The application of IFRS as a uniform of financial statements has the effect of changes in financial statement not only the content but also the figure. These changes raise questions for the users of financial statements to determine which direction these changes affect the financial performance. The purpose of this research is to analyze the financial performance of companies engaged in the banking sector after applying IFRS. The research method using literature studies by analyzing references relating to IFRS and Financial Performance. Basically the application of IFRS is not directly and explicitly intended to improve performance and the application of IFRS should have strict regulations in order to produce the actual company's financial performance and the quality of information.

**Keywords**— IFRS, Financial Performance, Bank, Fair Value, Loan Loss Provisioning

## I. INTRODUCTION

Globalization and rapid industrial development requires companies to be able to move in line with these developments. This will cause the company's activities become increasingly complex. Companies that *go public* is required to present financial statements in accordance with established standards, given that the information provided will give effect to the users in decision making.

A harmonization of standards are needed to reduce barriers to international capital flows. Quality accounting standards will affect the quality of the resulting report. Under the changes, the company should be able to improve the performance of the company to be able to provide added value to the company itself. The measurement of corporate performance is needed to evaluate the company, because through the measurement of the performance, the company can be assessed how far to move in a positive direction.

Financial statements is a language to communicate between the management company and the stakeholders. According to the Financial Accounting Standards issued by

IAI, the purpose of a financial statement is to provide information regarding the financial position, performance and changes in financial position of an enterprise that is useful for a large number of users in decision making.

Disclosure and presentation of accurate information is needed by the users of the financial statements. It is an attempt to provide information on their financial statements. In the disclosure and presentation of the information required of a rule or standard (Murni, 2011).

Accounting standards generally accepted as a rule, backed by sanctions for any non-compliance (Belkaoui 2006, in Chariri and Kusuma, 2010). Every company that *go public* are required to submit financial statements that have been prepared in accordance with Financial Accounting Standards and audited by a public accountant registered with Bapepam. Accounting Standard quality is very important in preparing and presenting financial statements that led to the creation of a systematic and accurate financial information is reliable, so it can help decision makers in making the right decisions for the survival of a business.

In relation to the investor in making an investment decision, investors require economic information from related companies. Quality accounting standards consist of comprehensive principles are neutral, consistent, comparable, relevant and reliable that is useful to investors, creditors and other parties to make capital allocation decisions (SEC, 2000, in Murni 2011). The need for quality standards directs the formation of international accounting standards into the domestic accounting standards to produce financial statements that have a high degree of credibility. (Qomariah, 2013)

Improvement of accounting standards that are currently at issue is the adoption of International Financial Reporting Standards (IFRS). IAS and IFRS is an accounting and financial reporting standards which is a product of the IASC (International Accounting Standards Committee) and the IASB (International Accounting Standards Board). International Financial Reporting Standards is a new version of the IASB product whereas the IAS is the old version of the IASC products.

## II. LITERATURE

GAAP within IFRS convergence is principle-based, not a rule-based, which allows people to apply proper accounting procedures in accordance with the rules set out. While the principles are based more subjective and can lead to problems in financial reporting. It requires professional judgment, so as to increase the competence should also be run in conjunction with increased integrity.

Implementation of IFRS convergence program conducted through three stages. The first stage of adoption (2008 - 2011) which covers the entire Adoption of IFRS to GAAP, preparation of necessary infrastructure evaluation and management of the impact of the adoption of SFAS applicable. The second stage of the preparation of the final (2011), namely the completion of the necessary infrastructure. The third phase of implementation (2012) is the first implementation that has adopted SFAS entire IFRS and evaluating the impact of adoption of SFAS comprehensively.

According to the Financial Accounting Standards Board (DSAK), the level of adoption of IFRS can be divided into 5 levels (Aristin, 2013):

1. *Full Adoption* in which an entire country adopts IFRS and translate it word for word.
2. *Adapted*, countries adopt all IFRS, but adapted to the conditions in the country.
3. *Piecemeal*, state only partially adopt IFRS numbers, ie the default, or a specific paragraph.
4. *Referenced*, the standards applied declares state refers to a particular IFRS but with language and paragraphs are compiled by standards-making body.
5. *Not adoption at all*, the state does not adopt IFRS at all.

### A. Benefits of IFRS Adoption

According Zeghal and Mhedhbi (2006) in Aria (2011), an opinion why a country adopts IFRS:

1. Harmonization of international standards will improve the quality of financial information
2. Adoption of IFRS may improve the comparability of accounting information in an international perspective
3. Adoption of IFRS can support financial operations in scale so as to bring benefits to the international market globalization better capital

Giving IFRS adoption benefits, especially for developing countries to strengthen the integration and competitiveness of capital markets. According to Wolk, Francis and Tearney (1989) in Zeghal and Mhedhbi (2006), the international accounting harmonization bring benefits to developing countries as it provides better standards and accounting principles and the framework of the highest quality.

### B. Differences IFRS with GAAP

There are some differences in the use of international accounting standards (IFRS) with GAAP

(Generally Accepted Accounting Principles) (Qomariah, 2013), namely:

#### 1) *The Fair Value*

Before using international accounting standards (IFRS), use historical cost accounting to measure the transaction. Historical cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire the asset at the time of acquisition or construction, or where applicable, the amount directly attributable to the asset at the time it was first recognized in accordance with the specific requirements in SFAS other (IAS 19, revised 2009).

Weaknesses of historical cost is less reflect actual conditions. The advantages of historical cost that historical cost is more objective and more verifiable because it is based on the transaction, however, the management can take advantage of the weakness of historical cost to perform earnings management, for example when company performance is poor if the fair value of assets at the reporting date is greater than the value carrying the management will sell the asset so that there is benefit is recognized in the income statement (Ari, 2011).

When using international accounting standards (IFRS), accounting fair value (fair value). Fair value (fair value) is a number that can be used as a basis for the exchange of assets or settlement of liabilities between the parties understand (knowledgeable) and willing to make a reasonable transaction (an arm's length transaction) (IAI, 2009).

Gains in fair value are used items of assets and liabilities held more closely reflect the actual value at the date of the financial statements. However, there are arguments that reject the use of fair value which states that the use of fair value in the financial statements volatility and reduce prediction of earnings. However, if the use of the fair value of high volatility it is actually only reveal the actual economic reality (Siregar, 2010 in Ari, 2011).

#### 2) *Based Principal*

Before convergence to IFRS, FASB formulate US GAAP accounting standards which are used in Indonesia. US GAAP is rules-based standards (rule-based). Rules-based standards will increase consistency and comparability between companies and between time, but on the other hand may be less relevant because of the inability of standard economic events reflect different entities between companies and over time.

The more rules, then the rules will increasingly have a lot of gaps to be broken. This result will be more and more rules to cover other gaps. Detailed standards also provide incentives for management to set the appropriate transaction is expected to result in a rule-based standards. The auditor



also becomes more difficult to resist manipulation by management when there are rules that justify detail.

Besides the detailed standards can not meet the challenges of complex changes in financial condition and fast. The standard also presents the detailed rules (form) but does not reflect the underlying economic events substantially (Ari, 2011). While the principles-based IFRS accounting standards (Principal Based). Based Principal is setting at the level of principle that would cover everything underneath.

Based principal weakness that this base will require reasoning, judgment, and deep enough understanding of the reader in applying the rules. The advantages of this base is in the likely case managers select accounting treatment of transactions or events that reflect underlying economic, although the opposite may occur (Ari, 2011).

### 3) More Detailed Disclosure Requirements

IFRS requires disclosure of information about the risks of both qualitative and quantitative. Disclosures in the financial statements must be consistent with the data / information that is used for making the decisions taken by the management. The level of disclosure that is moving towards full disclosure (*full disclosure*) will reduce the degree of asymmetry of information (information asymmetry).

Information asymmetry is a condition in which managers have superior information than the other party (Ari, 2011). Therefore, *disfunctional behavior* will be done by conducting earnings management by managers, especially if the information is related to the measurement of the performance of managers.

#### C. The purpose of IFRS

The aim is to produce IFRS financial statements more comparable and able to add more quality information internationally, and also reduce the differences in financial reporting provisions, in addition to the IFRS also able to assist multinational companies in reducing cost reporting and cost analysis and quality reporting can be improved (Nuaryanti, 2014)

### III. DISCUSSION

The impact of adoption of IFRS for companies will vary depending on the type of industry, type of transaction, the elements of financial statements that are owned, and also the accounting policy choices taken. Change can be very large to the changes in the operating system and the company's business and can also be simply related to accounting procedures.

The company's performance is an effort to improve the effectiveness and efficiency of the company that has been done at a certain time. One of the company's performance is financial performance which is a tool for measuring the health of the company (financial health). In addition, the

company's financial performance can be used as a medium of subjective measurements that illustrate the effectiveness of the use of the asset by a company to run its core business and increase revenue. (Ardhy: 2009). Measurement of financial performance can be measured through financial ratios such as liquidity ratios, profitability and solvency.

Khairany (2014) shows the results of this study using the Test Paired Sample T-test and significant level = 0.05 is known that there are differences in the company's financial performance before and after the adoption of IFRS on ROA, ROE, and CAR, but there is no significant effect from the application of IFRS standards adoption on firm performance. But Adzis (2012) find that there is evidence of more earnings volatility for the IFRS adopters after they have adopted IFRS. There are arguments that reject the use of fair value which states that the use of fair value in the financial statements resulting in volatility and reduced profit forecast. However, if the use of the fair value of the actual high volatility only reveal the actual economic reality (Siregar, 2010 in Ari, 2011).

In descriptive research, Nuaryanti (2014) found differences in the performance of bank were assessed from the *Loan to Assets Ratio, Return on Assets and Debt to Equity Ratio* between the period prior to the period after the IFRS conversion IFRS conversion. The performance difference between the period prior to the period after the IFRS conversion IFRS conversion is caused by the following things: the application of the principles of assessment assets using a *fair value* basis or the fair value for the period after conversion of IFRS, the recognition method of *research and development* costs are no longer capitalized. But no significant level calculated.

While research Nurisya (2013) found the performance of banks that have adopted IFRS do not differ significantly with banks that do not adopt IFRS. This is reflected in the absence of a significant difference from the ratios of variables in this study such as CAR, ROA, ROE, LDR, and NPL. Although the degree of difference was not significant, but the performance of the banks that have adopted IFRS better than banks that do not adopt IFRS. This is because with the global standards a comparability and exchange of information and financial statements can be universally recognized internationally that can improve the quality of financial statements of banks in Indonesia.

Performance can also be affected by earnings management. On agency theory (agency theory) suggested a conflict of interest (conflict of interest) between the parties concerned, it needed a way to reduce it. One is the standard equation or rules applicable to the application of IFRS in the financial statements. Cai et al. (2008) reveals one of the issues that the IASB is an international standard intended to simplify the accounting policy alternatives are allowed and expected to limit the consideration of policy management (management's discretion) to earnings manipulation so as to improve the quality of earnings. Cai (2008) found that management Earnings did decline at countries that have-adopted IFRS, with an important role for the level of enforcement. Tendeloo

(2005) found reduced IFRS Earnings Management company when audited by Big 4 audit company. However, some research results stating different things like Ton (2011) found there was not enough evidence that a high-quality standards as IFRS is associated with a lower level of earnings management. Heemskerk (2006) found that Earnings Management did not decline by companies that report in accordance with the voluntary IFRS. Lippens (2010) found Accruals-based accounting and real earnings management after implementation of both Increased IRFS. Jeanjean (2008) Earnings management did not Decrease after implementation of IFRS. In France is even an increase of a Measured in earnings management.

#### IV. CONCLUSION

Theoretically, bank's performance is affected some principles such as valuation of assets that use a *fair value* basis or the fair value for the period after conversion of IFRS, and also depends on the degree of smoothness of the credit given, more non-performing loans will decrease net income. On the other hand, there are studies that do not find the opposite result in a significant effect between the application of IFRS to the Bank's performance.

Basically the application of IFRS is not directly and explicitly intended to improve performance and application of IFRS should have strict regulations in order to produce the actual company's financial performance (not by earning management). But there is evidence of more earnings volatility for the IFRS adopters after they have adopted IFRS. (Adzis, 2012).

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