The impact of IFRS adoption on value relevance accounting information: Evidence from Indonesia

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Abstract. The research objective is to examine the value relevance of accounting information during pre and post IFRS adoption of the banking industry in Indonesia. It utilizes an empirical analysis with panel data of 22 banks with a time period of 2 years before IFRS adoption and 4 years after the adoption. Ohlson's price model has been deployed to conduct the analysis. Results reveal that the value relevance on earnings increase after the IFRS adoption.

Keywords: IFRS adoption, value relevance, accounting information

1. Introduction

The investment conducted by the investor utilizes financial report as a measurement of analysis to evaluate the company’s operational and financial activities. The available information is in the form of numbers and hence it is known as secondary data. Therefore, it is referred to as accounting information. There is much information that could be obtained, but the financial report is the only resource that provides accounting information in general and investors could evaluate a company through that report.

Operational activities, financial position, and cash flows of a company are provided in a financial report that gives accounting information. Based on this report, the condition of a company could be captured, and the investors could conduct the analysis. The investment decision of an investor could be decided based on the analysis results of its financial report, in which they could decide either to invest their capital or even buy the stocks [1].

Hence, a question is raised that does the company's stocks return or the stock price could be decided based on the accounting information analysis that reported in the financial report. One of the earliest research examined the relationship between the utilization of accounting information in forms of numbers on financial reports and stock price in the market. They found that there is a significant impact between accounting numbers provided on the financial report and the return or prices of stocks [2].

Several research have been conducted by utilizing new indicators proving that there are relevant and obvious impacts between the return level of equity and the income of the company's book value with the return and price of stocks [3], [4], [5], [6], [7].

The analysis could be conducted if the provided accounting information on the financial report could be an accurate measurement in determining the price of stocks as one of the company's
evaluations. The ability of its accurate information in summarizing and describing a company based on the financial report is known as value relevance. The relevant level of good accounting information is considered based on the reflection of the stock price.

International Accounting Standard Board (IASB) is an organization that arranges the International Financial Reporting Standards (IFRS). IFRS is an international accounting standard and has been applied generally by providing the information and measure every number on the financial report based on the accounting standard in general. It is expected to be well maintained in terms of its consistency and comparability with the accounting standard [8].

There are two approaches based on IFRS as accounting standard, those are fair value accounting and principle-based. These two approaches explain the function of an accounting standard that should be fulfilled. The financial report provides complete information, fairness, accurate and transparency, no mistakes and could be proved. By applying IFRS, the quality of information will be better, and its increasing value relevance could be achieved through the adoption of IFRS.

Before the implementation of IFRS in Indonesia, the financial accounting standard is based on US GAAP. In the beginning, Indonesia was planning to implement IFRS in 2018, but it was postponed and been adopted since 1 January 2012. Financial accounting standard in Indonesia is arranged by Dewan Standar Akuntansi Keuangan – Institut Akuntan Indonesia (Board of Financial Accounting Standard – the Institute of Indonesian Accountant/DSAK-IAI), in which during the convergence process of Pernyataan Standar Akuntansi Keuangan (Declaration of Financial Accounting Standard/PSAK) to be IFRS is fully responsible by DSAK – IAI.

There are several PSAK that have been issued by DSAK before IFRS is officially fully adopted. One of them is PSAK 55 about the financial instrument that gives a big impact on the banking industry because the main asset of banking is financial instruments. This leads to the different calculation of allowance for impairment losses that changes in terms of its methods.

The case of banking industry that face a dramatic changes due to a new adoption of accounting standard implementation from Indonesia standard to be implemented the international standard, known as IFRS raise questions and doubt from several parties about the adoption of IFRS in Indonesia, it is either a right decision or not, especially to the banking industry. The adoption of IFRS is expected to have a better-quality standard of financial reports in providing the information and its value relevance could increase to have the right evaluation of a company. However, this occasion becomes a trigger of giving inaccurate information and the company's evaluation may not be based on its true condition. Therefore, further study needs to be conducted.

This research is continuing research from previous research that results in the value relevance on EPS increasing but not on BVPS, and overall value relevance is decreasing after IFRS adoption. The research claimed that the result occurred since Indonesia is including as code law countries where countries with weak investor protection, lack of law enforcement, and banking oriented, therefore IFRS could not increase the value relevance [9]. Based on this research, the researcher tries to narrow the object of research only on the banking industry to assess whether value relevance exists after IFRS adoption in Indonesia specifically in the banking industry.

The adoption of IFRS also conducted by foreign researchers with the purpose to increase the value relevance for its accounting information provided on the financial report. The increase of value relevance of accounting information could be measured by the adoption of IFRS at Greece firms [6]. Similar results are also proved at Turkey firms [5] and at the banking industry that listed in Nigeria [4]. It reveals that the quality of information becomes better with the adoption of IFRS. A real reflection regarding the firm's value could be achieved with the existence of a better value relevance upon its accounting information provided on the financial report.

The exposure draft PSAK 71 is officially validated by DSAK IAI regarding the financial instrument on 14 September 2016 that adopted from IFRS 9 which is about “Financial Instrument”. PSAK 71 is the replacement of PSAK 55 by doing a justification based on the development and will be effectively applied on 1 January 2020. Therefore, the research about the impact of IFRS adoption on the value
relevance of the banking industry should be conducted to anticipate the action from the stakeholders could be executed with its IFRS convergence.

2. Literature review

The efficient market hypothesis (EMH) is a market where the price of traded securities reflects all available information [10]. The information contains all financial and non-financial information (political, social, and environmental). In the concept of an efficient market, all information available and appearing in the market is used to estimate the share price [11]. Historical price changes cannot be used as an accurate reference for calculating future share price changes. Therefore, in an efficient market, the investor alone as a market participant cannot influence the price of a security.

The company provides the necessary information to stakeholders in the financial statements [12]. Financial statements are written reports provided by management to give quantitative information on the achievement of the company during a certain period. The information contained in this financial statement will be used by investors to assess a company. Therefore, it can be concluded that financial statements can greatly influence one's investment decisions.

Value Relevance is the ability of accounting information presented in financial statements to describe the value of the company [5]. The three main factors that influence a company's value are profit, growth, or risk. The Ohlson Price Model provides an association relationship between a firm's market value with two or more accounting variables [13]. This model connects the company's market value with accounting data which are income, book value, and dividend.

There has been a research on the value relevance of accounting information. The results show that there is a significant relationship between information in financial statements with share price and stock returns. The research also became the basis for other researchers to examine the value relevance [2]. Share price can be explained using fundamental accounting variables, earnings, and book value [14]. Then, other studies about the relationship of accounting information in financial statements with share prices in the market also being conducted [4], [5], [6], [7], [8]. These research results also mentioned a real relationship and relevance between company earnings, book value, and the rate of return on equity with share prices and stock returns. However, some contradictory results also occur that there was no increase in value relevance, instead a decrease in value relevance in their observed market in the period of 2005 to 2010 [15]. Additionally, there is a higher value relevance before the adoption but not after IFRS was adopted [16].

The relationship between earnings and returns in Code Law countries compared to Common Law countries was being examined [17]. The result stated that the relevance of financial statement values is weaker in Code. Accounting standards are set by private sector bodies for Common Law countries. With the aim of setting, standards are to meet the information needs of investors. Whereas for Code countries, standards are influenced by the government. Accounting functions as a measure to share profits among group stakeholders. Accounting standards will be influenced by the legal systems of a country [18]. The various study has conducted about the impact of IFRS adoption in common and code law countries, but the results obtained are still diverse and conclusions, in general, cannot be obtained about the relationship between value relevance and accounting quality among those orientations. This area of research is criticized by Karampinis & Hevas (2009) argued that regardless of the quality of the standards, incentives are needed in preparing financial reports to produce high qualified financial reports [6]. Some of the previous research also has been conducted regarding the relationship between reporting incentives and value relevance of IFRS adoption [19], [20].

International Financial Reporting Standards (IFRS) are prepared to regulate the presentation of information and measurements of each number in the financial statements. IFRS as a global accounting standard aims to ensure that the financial statements prepared contain quality information so that it will produce financial reports that are transparent and understandable for users and can be compared during certain periods of different countries (comparability). IFRS uses the principle of fair value in measuring financial instruments and their presentation in financial statements [9]. Indonesia itself officially adopted IFRS on January 1, 2010.
Banking companies in Indonesia handled a significant impact from the implementation of the Indonesia Accounting Standard in 2010. It occurred since most banking company assets consisted of financial instruments. The main impact was the transformation in the method of calculating the allowance for impairment losses on financial instruments.

Research related to IFRS adoption on the value relevance of financial statement accounting information has been carried out in various countries, such as in Greece [6], Turkey [5], and Nigeria [4]. Several research also conducted in Indonesia. The value relevance improvement only appears on earnings [21]. While, a conducted research not only for banking, but also for insurance and finance companies, stated that the value relevance of accounting information has gradually increased over the period of adoption [22]. However, the value relevance is found in companies with high traded stock ratios and companies with illiquid shares. Cash flow is added as the proxy of value relevance, found that value relevance fluctuates between adoption and implementation periods, and it is found that value relevance increases during implementation rather than adoption period. Furthermore, earnings has a higher value relevance compared to book value and cash flow for the manufacturing and financial industries in Indonesia [23].

Based on previous research whose results are still contradictory, this study was conducted to examine the value relevance in Indonesia before and after the adoption of IFRS specifically in the banking industry. Why banking industry? Indonesia is categorized as a code law country where banking functions are generally more dominant than capital markets in providing the funding needs. It is also expected that with IFRS convergence, banks will present better quality accounting information to shareholders and stakeholders, which of course will have an impact on banks sustainability. Banks are important to sustain because they are the pillars of a country’s economy to drive the real economy that can increase the GDP, which will indirectly support the sustainability development goals of Indonesia.

Therefore, the research question: is IFRS adoption improving the value relevance of banking industry in Indonesia?

3. Research design

3.1. Data

The population in this study is the banking sector listed on the Indonesia Stock Exchange in 2008 - 2013. Analysis of the effect of IFRS implementation on banking companies in Indonesia was conducted 6 years of observation. It consists of 2 years before IFRS implementation (2008 - 2009) and 4 years after IFRS implementation (2010 - 2013). The implementation of IFRS for the Indonesian Accounting Standard was effective on January 1, 2010.

This study uses a purposive sampling method in determining the number of samples to be taken. The number of samples is determined based on certain criteria. The criteria used are banking companies listed on the Indonesia Stock Exchange (IDX) for the period 2008 – 2013. Those companies should also publish an audited annual financial report and report positive book value and earnings. Hence the sample used was 22 banks, resulting in a total of 132 financial statements observed in this study.

3.2 Empirical model

This research uses panel data and the random effect model. A data analysis method that will be used in this research is a multiple regression method which refers to the empirical model of the Ohlson Price Model to analyze the value relevance of accounting information. Earnings per Share and Book Value per Share is independent variables in this study, while the stock price is the dependent variable.

The value of a company can be determined through a formula related to the company’s earnings and book value. The regression equation model is as follow [14]:

\[ P_{t+1} = a_0 + \beta_1EPS_{t,t} + \beta_2BVPS_{t,t} + \varepsilon \]  

(Regression Model 0)

To obtain more robust results, this research will run several models of regression.
3.2.1. Regression model I
In this model, the control variable used is company size (SIZE) which measured by total assets. The regression equation that will be used in this study is:

\[ P_{t+1} = a_0 + \beta_1 EPS_{i,t} + \beta_2 BVPS_{i,t} + \beta_3 SIZE_{i,t} + \epsilon \]  

(Regression Model I)

Where:
- \( P_{t+1} \) = Share price
- \( EPS_{i,t} \) = Earnings per Share of the company i for the year t
- \( BVPS_{i,t} \) = Book Value per Share of the company i for the year t
- \( SIZE_{i,t} \) = Company Size i pada of the company i for the year t
- \( \epsilon \) = Error Term

3.2.2. Regression model II and III
Regression models in this study are influenced by 2 separate independent variables, Earnings per Share and Book Value. To see the contribution of each of these variables to the firm's value in the regression model 1, a regression model 2 and 3 were formulated, as follows:

\[ P_{t+1} = a_0 + \beta_1 EPS_{i,t} + \beta_2 SIZE_{i,t} + \epsilon \]  

(Regression Model II)

\[ P_{t+1} = a_0 + \beta_1 BVPS_{i,t} + \beta_2 SIZE_{i,t} + \epsilon \]  

(Regression Model III)

3.2.3. R-square comparison method
R-square comparison method analyzes and compares the adjusted R-square changes of each study year. This Adjusted R-square comparison will be obtained from the regression results from models 1, 2, and 3. R-square is the coefficient of determination that will explain the control power of the independent variable against the dependent variable.

\[ R^2_{total} = INC_{EPS} + INC_{BVPS} + R^2_{common} \]  

(Equation I)

\[ INC_{EPS} = R^2_{total} - R^2_{BVPS} \]  

(Equation II)

\[ INC_{BVPS} = R^2_{total} - R^2_{EPS} \]  

(Equation III)

Where:
- \( R^2_{total} \) = R-square obtained from regression model I (Ohlson Model)
- \( INC_{EPS} \) = Increase in explanatory power from EPS
- \( INC_{BVPS} \) = Increase in explanatory power from BVPS
- \( R^2_{common} \) = The ability to explain interactions from EPS and BVPS.
- \( R^2_{EPS} \) = R-square results from regression model II for EPS
- \( R^2_{BVPS} \) = R-square results from regression model III for BVPS

3.2.4. Regression model IV
This study also aims to further analyze the effects of implementation on the value relevance of accounting information from companies and the quality of accounting information. Thus, the dummy variables (0 and 1) can be used to identify the impact before and after. Kargin (2013) modified the regression model by using a dummy variable of IFRS implementation indicator (score 0 for conditions before IFRS implementation, score 1 for conditions after IFRS implementation) [5]. Then, the
interactions of the independent variables and the dummy variables are analyzed. Therefore, the regression model is as follow:

\[ P_{t+1} = a_0 + \beta_1 D_{i,t} + \beta_2 EPS_{i,t} + \beta_3 BVPS_{i,t} + \beta_4 D_{EPS_{i,t}} + \beta_5 D_{BVPS_{i,t}} + \beta_6 SIZE_{i,t} + \epsilon \]

(Regression Model IV)

Where:
- \( D \) = Dummy variable of IFRS implementation indicator, score 0 for conditions before IFRS implementation and score 1 for conditions after IFRS implementation.
- \( D_{EPS_{i,t}} \) = Interaction variables between Earnings and dummy variables.
- \( D_{BVPS_{i,t}} \) = Interaction variable between Book Value and dummy variables.

4. Results and discussions

This study utilizes four model regressions derived from Ohlson Price Model and will be divided into two parts of analysis. The first part of the analysis is focusing on the analysis of IFRS impact on value relevance changes by contrasting R-square outcomes from regression models 1, 2 and 3 (as seen in Table 1, Table 2 and Table 3). R-square from models 2 and 3 will be used to support the result from model 1. The next part is analyzing the coefficient in the regression model to examine the effect of IFRS on value relevance. All the regression models are using panel data with a random effect model as a recommended model from Hausmann Test.

4.1. Analysis part I

| \( P_{n+1} = a_0 + \beta_1 EPS_{it} + \beta_2 BVPS_{it} + \beta_3 SIZE_{it} + \epsilon_{it} \) |
|---|---|---|---|
| Independent | \( \text{Pre-IFRS} \ 2008-2009 \) | \( \text{Post-IFRS} \ 2010-2013 \) |
| \( Intercept \) | Coeff. | \( p \)-value | Coeff. | \( p \)-value |
| \( EPS \) | -3.242 | 0.149 | -3.919 | 0.268 |
| \( BVPS \) | 1.465 | 0.031* | -0.093 | 0.610 |
| \( SIZE \) | 212 | 0.129 | 278 | 0.182 |
| \( N \) | 44 | | | |
| \( \text{Adjusted R2} \) | 0.228 | 0.004 | 0.324 | 0.000* |
| \( F \)-test | | | | |

*Significance at the level 5% level (two-tailed)

The regression model 1 is using Earnings Per Share (EPS) and Book Value per Share (BVPS) as the independent variable. Based on the result in Table 1, it shows that only BVPS has significant value in the pre-IFRS period. Meanwhile, in the post-IFRS period, only EPS has a significant value. Furthermore, the adjusted square increase from pre to post-IFRS period.
**Table 2. Result of Regression Model 2**

\[ P_{n+1} = \alpha_0 + \beta_1 \text{EPS}_{jt} + \beta_3 \text{SIZE}_{jt} + \epsilon_{jt} \]

| Independent variables | Pre-IFRS 2008-2009 | Coeff. | p-value | Post-IFRS 2010-2013 | Coeff. | p-value |
|------------------------|---------------------|--------|---------|---------------------|--------|---------|
| Intercept              | -3849               | 0.099  |         | -3722               | 0.289  |         |
| EPS                    | 1.016               | 0.389  |         | 4.299               | 0.000* |         |
| SIZE                   | 273                 | 0.057  |         | 263                 | 0.201  |         |
| N                      | 44                  |        |         |                     |        |         |
| Adjusted R^2           | 0.145               |        |         | 0.329793            |        |         |
| F-test                 | 0.015               |        |         | 0.000*              |        |         |

*Significance at the level 5% level (two-tailed)

**Table 3. Result of Regression Model 3**

\[ P_{n+1} = \alpha_0 + \beta_1 \text{BVPS}_{jt} + \beta_3 \text{SIZE}_{jt} + \epsilon_{jt} \]

| Independent variables | Pre-IFRS 2008-2009 | Coeff. | p-value | Post-IFRS 2010-2013 | Coeff. | p-value |
|------------------------|---------------------|--------|---------|---------------------|--------|---------|
| Intercept              | -2771               | 0.209  |         | -10953              | 0.001  |         |
| BVPS                   | 0.689               | 0.056  |         | 0.202               | 0.289  |         |
| SIZE                   | 189                 | 0.169  |         | 719                 | 0.000  |         |
| N                      | 44                  |        |         |                     |        |         |
| Adjusted R^2           | 0.210               |        |         | 0.185               |        |         |
| F-test                 | 0.003               |        |         | 0.000*              |        |         |

*Significance at the level 5% level (two-tailed)

Regression model 2 and 3 (Table 2 and Table 3) are disaggregation from the Ohlson Price Model, displaying the effect of EPS (model 2) and BVPS (model 3). The coefficient from these 2 models will not be further examined as the model is developed only to support the Regression Model 1 to observe the incremental R-square. The R-square result for each regression is presented in Table 4.

**Table 4. R-square Results**

| R^2 | Pre IFRS (0809) | Post IFRS (1013) |
|-----|----------------|------------------|
| R^2 Total | 22.81% | 32.43% |
| R^2 EPS | 14.47% | 32.98% |
| R^2 BVPS | 21.03% | 18.47% |

Hereupon, the further analysis is needed to examine the incremental explanatory power of each independent variable of EPS and BVPS by deducting R-square from Regression model 1 (full model) with each R-square from model 2 and 3 (the disaggregated models). The results of the explanatory power in the Ohlson Price Model is displayed in Table 5.
Table 5. Explanatory Power of EPS and BVPS

|                      | PRE IFRS (2008-2009) | POST IFRS (2010-2013) |
|----------------------|----------------------|-----------------------|
| INC_EPS              | 1.77%                | 13.96%                |
| INC_BVPS             | 8.34%                | -0.55%                |
| R^2 COMMON           | 12.69%               | 19.02%                |
| R^2 TOTAL            | 22.81%               | 32.43%                |

Table 5 describes the result of R^2 total from Regression Model 1 indicates that EPS and BVPS can explain the market price of the share at around 23% pre-IFRS and 32% post-IFRS period. From this result, it is also can be revealed there is an increase in value relevance since the total and common R^2 is rising after IFRS adoption.

Before the IFRS adoption, total value relevance is around 23% affected by the incremental power of EPS and BVPS at 1.77%, and 8.34% respectively, and common explanatory power at 12.69%. After IFRS adoption, the R^2 total increasing to 32.43%. the incremental movement of value relevance is explained by incremental power of EPS and BVPS at 13.96% and -0.55% respectively, and 19.02% explanatory power of R^2 common.

From the first part of the analysis, it can be stated that Value relevance after IFRS adoption is increasing. Contrasting between the factors of EPS and BVPS, it can be seen that EPS is the variable that causes value relevance to increase. It also indicates that by IFRS adoption, investors see earnings as a factor in valuing a company. This could be caused by the belief that the existence of IFRS can reduce earnings management.

4.2. Analysis of part II
In this part, it will analyze the direction of the influence of IFRS adoption on value relevance by using regression model 4 which is a modified Ohlson Price Model. In this modified model, IFRS adoption will be placed as a dummy variable (1 and 0). The dummy variable will be interacted with each independent variable (EPS and BVPS) and will be treated as a moderating variable. The result of the regression model is displayed in Table 6.

Tabel 6. Regression Result of Model 4

|                         | Coefficient | t-statistic | p-value |
|-------------------------|-------------|-------------|---------|
| Intercept               | -4137       | -1.498      | 0.137   |
| D (Dummy)              | 44.395      | 0.182       | 0.856   |
| EPS                    | -1.491      | -0.913      | 0.363   |
| BVPS                   | 0.696       | 1.300       | 0.196   |
| D*EPS                  | 5.373       | 3.272       | 0.001^a |
| D*BVPS                 | -0.609      | -1.197      | 0.234   |
| SIZE                   | 284         | 1.710       | 0.090   |
| N                       | 132         |             |         |
| Adjusted R^2           | 0.477       |             |         |
| F-test                  |             |             | 0.000^a |

\(^a\)Significance at the level 1% level (two-tailed)
From Table 6, the result shows that all the independent variables EPS (t-stat = -0.913; p-value = 0.363), BVPS (t-stat = 1.300; p-value = 0.196), the dummy variable (t-stat = 0.182; p-value = 0.856), the moderating variable of D_BVPS (t-stat = -1.197; p-value = 0.234) do not have significant effect on market price except the moderating variables of D_EPS (t-stat = 3.272; p-value = 0.001). This result indicates that D_EPS variable is effective in moderating the relationship between EPS and market price. Moreover, D_EPS also has a positive coefficient which means that adoption IFRS only improves the value relevance of Earnings (EPS). This result is consistent with the result from an analysis I and similar to the result from the previous study of Sun & Sari (2016) who found that IFRS adoption can increase the value relevance on earnings. This study is also in accordance with the result of [21] that found that value relevance improvement only appears on earnings.

5. Conclusion
This research is conducted to understand the impact of IFRS adoption on the value relevance of the banking industry in Indonesia. We use data from the pre-IFRS period (2008-2009) and post-IFRS period (2010-2013) and examine the impact by two-part of analysis. At Part I analysis, we examine the impact of IFRS adoption on value relevance changes by comparing the result of R-square from regression models 1, 2 and 3. The result from regression model 1 shows that BVPS has a significant value relevance pre-IFRS period, while EPS has a significant one during the post-IFRS period. Afterward, regression models 2 and 3 (disaggregation model from Ohlson Price Model) are employed to assess the incremental R-square. From the R-square analysis, it is found that R-square total is increasing from pre to post-IFRS at 22.81% to 32.43%. It is also confirmed that the incremental movement of value relevance is influenced by the increasing movement of EPS incremental power.

On the analysis part II, we use regression model 4 (a modified Ohlson Price model) to assess the impact of IFRS adoption by using dummy variables (0 and 1 as pre and post IFRS period) that will interact with each independent variable (EPS and BVPS). The result reveals that only the moderating variable of D*EPS has a significant value towards share price, which means that the dummy variable of IFRS adoption is effective in moderating the relationship of EPS and share price.

From two parts of analysis, it can be concluded that as the adoption of IFRS is effectively applied in 2010, the investors start to value the stocks based on EPS instead of BVPS in the banking industry. The result is half contradicting with the previous research. The increase of value relevance in earnings is lower than decrease in book value, so the overall value relevance is decreasing [8]. The difference result with the previous studies occurred since we use different research objects, where this study only focuses on the banking industry which is considered as a highly regulated institution in code law countries such as in Indonesia. By IFRS adoption in the banking industry, investors believe that IFRS can improve the value relevance of earnings. This result is consistent with the result of research by Devalle et. al and Chalmers et. al [24], [25]. The value relevance of earnings is increasing might due to the investor perspective that IFRS adoption will improve accounting quality [26], [27] and reduce earnings management [28], [29].

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