CHAPTER I
INTRODUCTION

1.1 Background

Historically, accounting standards have been developed by each country according to different standards process, mainly from academics, professional accountancy bodies, regulators, businessmen, politicians, labor leaders, and governments. This perspective is reinforced by the fact that accounting is shaped by economic and political forces (Watts, 1977; Watts and Zimmerman, 1986). These national standards which application stopped at the borders of a country made sense as long as companies raised capital nationally and investors themselves were also national.

The developments of strong international financial reporting Standards has been of longstanding interest to and elicit frequent commentaries which lead to significant changed of these phenomena. Investors sought investment opportunities worldwide, in other hand, the other listed companies wanted to raise their capital at the lowest cost. Choi and Meek (2008) developed a model of accounting system development to explain observed differences in financial reporting worldwide. These arguments have been used to support the adoption of International Financial Reporting Standards (IFRS) for financial reporting for consolidated listed entities in European Union (EU) member states (EC 1606/2002). Other jurisdictions have cited similar reasons for adoption of IFRS. Brown (2011), reflecting the demand for high quality standards that can improve the quality and comparability of financial reporting and promote the development of national capital markets and the integration of markets internationally.

Lack of homogeneity of financial information provided to investors and the cost for companies of presenting consolidated financial statements according to the country of reference in which they wish to be listed have necessitated the emergence of international accounting standards. Transition countries initiated changes in their system, which is the transformation from planned economy to market economy (Berrios, 2003; Colin, 2009).

The existence of an accounting Esperanto could be used on stock exchanges around the world which is based on the principles of comparability and transparency making it possible to strengthen the confidence of capital providers to reduce the cost of preparation of financial information and the cost of capital for companies. In this context, the IFRS Foundation and the IASB 1, from 2001 to recast the IASC established in 1973, have set a goal to develop a single set of high quality of financial reporting standards, understood, and
agreed to bind vocations in the world-based on clearly articulated principles. Two factors favored the development of IFRS: the attractiveness of European and Asian markets and the financial scandals of the early 2000 in the US, such as Enron or WorldCom, which questioned the primacy of US accounting standards, US GAAP.

IFRS is based on principles not rules, the volume and detail of the information to be published in the notes. It is indeed stepped in heritage and not an economic vision of accounting, with an application of the accounting principle of "substance over form", from overall, the adjustment effort was made by all stakeholders and the transition went smoothly in financial markets. Stock exchanges around the world are based on the principles of comparability and transparency. But in developing countries such as south American countries, Asian and African countries which are striving to full adoption after they has started with a gradual application of IFRS by convergence their national GAAP are facing some challenges.

Irvine and Lucas (2006); Faraj and Akbar (2010); Michas (2010); and Siddiqui (2010) all highlight that there needs to be further studies about IFRS in developing countries. Gyasi (2010); Laga (2012); and Hibbard (2012) all draw attention to the specific need to focus on IFRS in emerging countries in particular. Several researchers including Mohamed (2014); Kholeif (2008); and Braun and Rodriguez (2014) have suggested that there is a need to undertake more researches to examine the challenges that face implementation of IFRS in developing nations. More basically, the issue here is about the soundness of an application of the IAS/IFRS standards to countries belonging to the worldwide accounting trend. Indeed, the diffusion of these standards is not one of the history hazards. Accounting always refers to a socio-economic “ecology” (Colmant and Hubner, 2005). The reason why the adoption of accounting standards reflects the power exerted by a dominant figure is because the shareholder model has imposed itself in the economies. Consequently, the introduction of the international IAS/IFRS standards in developing countries comes together with the use of a new accounting evaluation system focusing on shareholder’s welfare, and trustfulness of the company by its stakeholders by providing high quality of financial information and accounting statement. In this document, we will focus on challenges and obstacles that face IAS/IFRS adoption and application in emerging country; cases study of Indonesia.

1.2 Problem Statement

According to Hans Hoogervorst, chairman of the International Accounting Standards Board (IASB) in his speech at the International seminar on “IFRS Dynamics 2013
and Beyond: Impact to Indonesia” organized by the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia, IAI), encouraged all companies in Indonesia to follow a gradual convergence process to fully embrace of IFRSs. In this mission, the standard-setting body in Indonesia is the Financial Accounting Standards Board (Dewan Standar Akuntansi Keuangan or DSAK) under the Indonesian Institute of Accountants (Ikatan Akuntan Indonesia or IAI). Under Indonesian law, was announced that all companies either public or private must comply with accounting standards, issued by the DSAK-IAI. However with this gradual converge of IFRS which was announced early 2012 by Indonesian government; both Indonesian companies public and private are facing some difficulties in IFRS implementation in their annual financial reporting. Nevertheless, the lack of research and limited research has been undertaken in understanding the pathway of the transition towards the use of the financial common language IAS/IFRS in this country.

Despite all the progress and obstacles in IAS/IFRS implementation in Indonesia in recent years, and limited studies focused on the gradual convergence of Indonesian accounting standards during the IFRS transition period, some previous study such as Perera and Baydoun (2007) examined the accounting ecology in Indonesia, and highlighted the prospects for the adoption of IFRS in the country. Whilst Perera and Baydoun’s study is important in providing a description of the Indonesian accounting environment and the structural issues that may prevent the country from adopting IFRS, which only focuses on the particular period leading up to the IFRS convergence programs; Agus and Parmod (2014) study the progress of Indonesian IFRS implementation; EnggarDiah, (2013) develop his research on IFRS and the quality of financial statements in Indonesia. The present study will seek the challenges and obstacles that Indonesian companies face in IFRS application by focusing on extra-financial factors analysis.

1.3 The Purpose of the Research

The main objective of this research is to focus on IAS/IFRS adoption and application in the context of Indonesia by Indonesian companies; seeking the obstacles and challenges relating to that. Specific objectives are the following:

1. To analyze the problems regarding the adoption and application of IAS/IFRS in the context of Indonesia; an emerging country.
2. To present some policy recommendations for adoption and implementation of IAS/IFRS for ensuring good financial reporting.
1.4 The Advantages of the Research

The results from this research will be useful not only in Indonesia but rather worldwide as following:

1.4.1 In Indonesia

a. These results will be helpful to Indonesian Financial Accounting Standards Board and Indonesian Accounting institute (DSAK-IAI) to take into account extra-financial factors in their interpretation and application of IAS/IFRS in order to know more about the challenges and obstacles that companies face in their IAS/IFRS application.

b. The results will allow to local investors and local business owner to know the impact of extra-financial factors on their IAS/IFRS application.

c. The results will allow company’s managers and accountants to have qualified Performance and good understanding of IAS/IFRS standards in Indonesian context in establishing and interpreting their financial annual reporting.

1.4.2 In the worldwide

a. The research may allow to international investors to know the level of IAS/IFRS application in Indonesian and to know the quality of financial reporting and accounting statements of Indonesian companies.

b. The research will allow to know deeper the obstacles and challenges that Indonesia companies face in their adoption and application to IAS/IFRS in Indonesian context

1.4.3 In general

The research will be as reference material for those who will carry out more research on this issue.