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Principles and Assumptions in Financial Reporting Based on IFRS

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Abstract

Financial reports are the language used by the business community. The business language was compiled from accounting standards which are measurement budgets for financial statements. This study aims to reveal the content based on the principle of conservatism contained in the financial accounting standards (GAAP) output of the converged International Financial Reporting Standards (IFRS). The use of the principle of conservatism is still controversial, but some studies actually justify the importance of applying these principles, especially in the face of environmental uncertainty. Justification of the importance of the inconsistent principle of conservatism using IFRS. Several research outputs state that IFRS does not recognize the principle of conservatism. With deep problems in this research is to reveal why IFRS does not recognize the principle of conservatism. The required output based on this research is the conservatism of the principle taxonomy structure and normative theory justification to standardize accounting treatment. The analytical method used is content analysis, which is analyzing the content of information against a set of regulatory accounting standards. The aspects evaluated are related to using accounting standards for accounting for companies in Indonesia, especially those that go public.

Keywords: IFRS, Principles, Financial Reporting Based.

1. INTRODUCTION

Financial reports are the language used by the business community. The business language was compiled from accounting standards which are measurement budgets for financial statements. In its development, there are still many and different accounting standards that apply as a result resulting in cases of comparability of financial statements. This condition can certainly be understood because the process of compiling accounting standards in a country cannot be separated from the effects of local factors of a country (Wolk et al., 2001) saying "economic conditions have an impact upon both political factors and accounting theory". This has resulted in disparities in accounting standards and practices in each country. Along with using the era of globalization driven by the development of information and communication technology that reformed global international as a village/borderless world, since this time cases of accounting standard disparities began to arise.

The development of economic activity and globalization demands the existence of an international accounting standard that can be accepted and understood internationally. Therefore, an international standard emerged, namely IFRS (International Financial Reporting Standard) which was later used as a guide for the presentation of financial statements in various countries. In Indonesia, through the Financial Accounting Standards Board created by the Indonesian Institute of Accountants, the Indonesian Institute of Accountants set the direction for the development of IFRS convergence to PSAK (Statement of Financial Accounting Standards).

Financial Accounting Standards are a framework of reference for implementing related mechanisms using the presentation of financial statements. SAK will make it easier for accountants at your company to create conceptual financial statements as well as a consistent presentation mechanism every year. In addition to SAK, in Indonesia itself there are accounting standards using the international level which are considered IFRS which is an abbreviation or abbreviation according to the International Financial Accounting Standard. Broadly speaking, IFRS and SAK are not much different, IFRS is also a guideline and mechanism for presenting a company's financial statements, only using international standards. Both have disparities in application and technical preparation. The most obvious difference between SAK and IFRS is that the forums involved have different standards in the drafting and ratification process. This results in a disparity of functions in its application between SAK and IFRS. In addition, in application, there are other disparities between SAK and IFRS. The following is a discussion of the disparity between SAK and IFRS.

The convergence includes: 1). The same PSAK using IFRS will be revised, or a new PSAK will be issued; 2). PSAK that is not regulated in IFRS will be removed; 3) Industry-specific PSAK will be abolished; and 4) PSAK derivatives according to government legislation are maintained. The roadmap for the IFRS convergence event is carried out in three stages. The first is the adoption term (2008 - 2011) which includes the adoption of all IFRS to PSAK, preparation of the necessary infrastructure, assessment and management of the effect of adoption on the applicable PSAK. The two final preparation terms (2011) are the completion of the required infrastructure.

The third is the implementation term (2012), which is the first application of PSAK that has adopted all IFRS and an assessment of the impact of implementing PSAK comprehensively. In accordance with the rodmap for the convergence of PSAK to IFRS (International Financial Reporting Standards), Indonesia has now entered the final preparation stage (2011) after previously going through the adoption period (2008 – 2010), after that, every January 1, 2012 Indonesia officially implements IFRS.

In order to welcome the implementation of Financial Accounting Standards that have fully used international accounting standards (IFRS Convergence) in the new year 2012, for global businesses it is necessary to take early steps, for example knowing rational arguments and the effect of IFRS convergence on financial and business reports. This is very crucial considering that the application of IFRS convergence is very influential in the global business climate in Indonesia. By making one accounting standard that is the same and used by all countries, it will increasingly encourage investors to enter all global capital markets, this is because the quality according to the financial statements obtained have high reliability, wider disclosure, relevant and thorough financial information and comparability and another very important thing is to be internationally acceptable and easy to understand.

The effect of adopting IFRS in the company's financial statements is by adopting IFRS, the financial statements obtained have a high level of reliability. The purpose of IFRS convergence is that financial statements according to PSAK do not require reconciliation again using financial statements according to IFRS. Thus, it is necessary to increase investment activity globally, reduce the cost of capital and increase company transparency in the preparation of financial statements. On the other hand, the IFRS convergence event will have an impact on changes in the principles and methods of financial reporting in Indonesia.

Rahmany (2009) systematically stated several effects of the IFRS convergence program, among others, 1) Access to international funding will be more open because financial reports will be more easily communicated to global investors; 2) The relevance of financial statements will increase because more use of fair value; 3) On the other hand, financial performance (profit and loss statement) will be more volatile if prices fluctuate; 4) Smoothing income as it becomes increasingly difficult to use the balance sheet approach and fair value; 5) Principle-based standards may cause the comparability of financial statements to decrease slightly, namely if the use of professional judgment is overridden by using interests to manage profits (earnings management); 6) The use of off balance sheets is increasingly limited. Specifically, the IFRS convergence event has an impact on the measurement process on financial reporting. For example, total assets and book value of equity will form a higher value when adopting IFRS and finally, by adopting IFRS, profit management will be lower, and the recognition of losses or gains is not based on the principle of conservatism but rather refers to fair value to increase value relevance (value relevance) so that it is in sync using the actual situation. One of the interesting studies regarding the effect of IFRS convergence is the problem of applying the principle of conservatism.

Hellman (2007) states that Conservatism is a problematic accounting concept. Theorists do not like inspiration about under-reporting assets, overestimating debt, delaying revenue recognition, and prompting financing. However, Conservatism is recognized as one of the most influential principles in conventional accounting. The need for conservatism is often linked to the reliability of past incident reporting, which implies a focus on backward looking, stewardship, and auditor conduct. For auditors, the Conservatism reporter will avoid himself according to potential lawsuits.

However, on the basis of the latest future-oriented accounting standards, which aim to assist investors and stakeholders in making more relevant decisions, they will abandon the principles of Conservatism earlier. With regard to using it, the principle of Conservatism does not apply to IFRS. Financial statements based on IFRS must be understandable, relevant, reliable, and comparable, and without being followed by conservative bias. This is also reflected in the accounting method formulated by the IASB. For example, loss carry forwards result in deferred tax receivables being recognized, development costs being capitalized, and long-term contracts being treated under the percentage-of-completion method. Another example is the change in the Valuation Method for Temporary Investments from the Lower Cost Or Market (LCOM) Method to the Fair Price (Market) Method. This change means that if the market price increases, the company is obliged to increase the value of its investment, and has recognized a profit. Indeed, if viewed in terms of investment value, evaluation using fair value is in sync with current conditions. However, if viewed from the perspective of profits that have not occurred, because there is no sales transaction, then the principle of conservatism in investment evaluation is no longer valid. This is what means the decline in the principle of Conservatism in Accounting. That is one of the models of the influence of changes in SAK that points to IFRS.

2. LITERATURE REVIEW

Explanation of International Financial Accounting Standard (IFRS)

IFRS which stands for or stands for International Financial Accounting Standard is an international accounting standard published by the International Accounting Standard Board (IASB). In its preparation, International Accounting Standards (IAS) involved four primary global organizations, namely the International Accounting Standards Agency (IASB), the European Community Commission (EC), the International Organization for Capital Markets (IOSOC), and the International Accounting Federation (IFAC).

Advantages of Using IFRS

Implementing IFRS financial standards can increase the comparability of financial reports and put quality financial reports news on the international capital market. Another benefit that can be felt by applying IFRS to your company is that it can eliminate international capital flow constraints by reducing disparities in financial reporting requirements. In addition, IFRS can also reduce the use of multinational corporations' financial reporting portfolios and costs for financial analysis for corporate financial analysts. IFRS can improve the quality of your company's financial reporting towards best practice. So, although Indonesia is obliged to adjust financial standards using IFRS, it turns out that this will actually make financial reporting easier.

Elements based on Financial Statements The financial position of a company is basically presented in the Statement of Financial Position (Statement of Financial Position). The elements include (1) Assets are the origin controlled by the company to be impacted based on past incidents and based on which future economic benefits are required to be obtained by the company; (2) Liabilities are current liabilities of the company that arise based on past incidents, the solution of which is required to cause outflows based on the origin of the company that contain economic benefits; (3) Equity is the residual interest in the company's assets after deducting all liabilities. The financial performance of a company is generally presented on a net income statement or profit and loss account. The elements based on the income statement or elements that measure financial performance are as follows; (4) Income (revenues) is an increase in economic benefits in an accounting period in the form of income or an increase in assets, or a decrease in liabilities that causes an increase in equity. However, it does not include donations made by equity participants, for example individual capital, partnerships, and shareholders; (5) Expenses are a decrease in economic benefits in the accounting period in the form of expenses, or a depletion of assets or the incurrence of liabilities as a result of a decrease in equity. An item is recognized in the financial statements if it is probable that the economic benefits associated with using the item will flow to or to the company, the poster says it has a value or cost that can be measured reliably, and is stable.

Conservatism can be defined as the tendency of an accountant with a higher level of verification to recognize profits (good news in earnings) than to admit losses (bad news earnings) (Hudzaifah et al, 2021). The higher the level of disparity in the evidence required for profit recognition versus loss recognition, the higher the level of accounting conservatism Fauzi et al (2021) explain that conservatism is a preference for accounting methods that create the lowest values for assets and income, ad interim the highest values for liabilities and costs, or create the lowest book values of equity. Conservatism is also defined as a prudent reaction to uncertainty, aimed at protecting the rights and interests of shareholders and debtholders who choose a higher standard of evidence to acknowledge good news than bad news (Lara and Penalva). 2005). One way to measure the level of accounting conservatism of a company is to use the market to book ratio (Beaver and Ryan, 2000). In several previous studies, researchers also used the market to book ratio for measuring the conservative level (Erkens et al., 2014; Ettredge et al., 2016; Francis et al., 2013). The formula based on market to book value is:

$$M/B = \frac{Closing\ price \times share\ volume}{Book\ Value\ of\ Equity} \ldots (1)$$

Information :

Closing Price : Stock price at year-end closing
Share Volume : Number of outstanding shares
Book Value equity : Total Assets – Total Liabilities

The higher the M/B value, it indicates companies apply orthodox accounting, where the company records more company value low by market value (Bearver & Ryan, 2000). IFRS Conservatism and Convergence. On in 2012, companies in Indonesia required to use SAK that has been adopt IFRS. This of course makes there are many changes to the preparation of the report finance (Indonesian Accounting Association, 2013). According to Hikmah (2013), the focus in accounting orthodox ones are reduced because of the IFRS which Principle Based **ad interim** US GAAP Rule based. According to Khairina (2009), there are several points which mentions the diminishing focus on the use of accounting that orthodox, namely, a) IFRS standards are more inclined on the use of fair value, especially for investment property, some intangible assets, assets finance. In this case it is also supported by (Hasibuan et al, 2020), b) Consequences the more principles-based features of IFRS, will more “judgment” is needed for choose how a financial transaction noted. In previous research as well shows that the level of conservatism accounting is reduced compared to using before IFRS convergence.

3. METHODS

In investigating the convergence of financial reporting standards to international financial reporting standards, the authors use content analysis as the reference for this study. Research using this method is an analysis of the concept. Concept analysis is making the existence and frequency of concepts which are generally presented in the form of terms in phrases that still exist in the text (in this case in the form of literature). The focus of this analysis is aimed at observing what and how the application of IFRS in financial reporting is believed to be crucial and supports the research objectives.

The data source of the data used is secondary data in the form of PSAK sheets (Statement of Financial Accounting Standards) output according to convergence according to IFRS. The data was publicly available in the form of a 2011 PSAK book. The data were collected using the observation method of the available documents using a predefined unit of analysis. This study uses secondary data using a synchronous list of manufacturing sector companies using sample selection criteria obtained according to FACT BOOK 2006-2016 which was downloaded from the official website of the Indonesia Stock Exchange. The conservatism level data variable, namely the market to book ratio, was also obtained according to FACT BOOK. This study uses one variable, namely market to book ratio (M/B) to measure the level of accounting conservatism of a company before IFRS convergence and after IFRS convergence. The higher the M/B value indicates that the company records using a conservative method, because the company records a lower company value according to its market value (Bearver & Ryan, 2000).

4. RESULT AND DISCUSSION

4.1. Result

The following is a table for the Road map for ratification of several PSAKs from 2008 – 2011:

Table 1. Road map for ratification of several PSAKs from 2008 – 2011

No	Type	Contens
1	PSAK 13	Investment Properties
2	PSAK 16	Fixed assets
3	PSAK 30	Rent
4	PSAK 19	Intangible Assets
5	PSAK 14	Website Fee
6	PSAK 23	Income
7	PSAK 7	Related Party Disclosure
8	PSAK 22	Business Combination
9	PSAK 10	Foreign Currency Transaction
10	PSAK 1	Presentation of Financial Statements
11	PSAK 2	Cash flow statement
12	PSAK 3	Interim Financial Report
13	PSAK 4	Consolidated Financial Statements and Reports Separate Finance
14	PSAK 5	Operating Segment
15	PSAK 7	Related Party Disclosure
16	PSAK 12	Participation in Joint Venture
17	PSAK 15	Investment in Associates
18	PSAK 19	Intangible Assets
19	PSAK 22	Business Combination
20	PSAK 23	Income
21	PSAK 25	Accounting Policies, Changes in Estimates Accounting and Error
22	PSAK 48	Impairment of Assets
23	PSAK 57	Provisions, Contingent Liabilities and Contingent Assets
24	PSAK 58	Non-Current Assets Held for Sale and Discontinued Operations

4.2. Discussion

Development of Accounting Standards in Indonesia.

In the 1973-1984 period, the Indonesian Accounting Association (IAI) had formed the Indonesian Accounting Principles Committee to establish accounting standards, which was then known as using the

Indonesian Accounting Principles (PAI). In the period 1984-1994, the PAI committee fundamentally revised the 1973 PAI and then published the 1984 Indonesian Accounting Principles (PAI 1984). Towards the end of 1994, the Committee on Accounting Standards initiated a major revision of Indonesian accounting principles by announcing additional standard accounting statements and issuing interpretations of these standards. The revision formed 35 standard statements of financial accounting, most of which conform to the IAS issued by the IASB.

In the period 1994-2004, there was a change of Qibla based on US GAAP to IFRS, this was shown. Since 1994, it has become a policy under the Financial Accounting Standards Committee to use International Accounting Standards as the basis for establishing Indonesian financial accounting standards. And in 1995, IAI made a major revision to implement new accounting standards, most of which consistently used IAS. Some standards are adopted under US GAAP and others are self-established. In the 2006-2008 period, which was the convergence of IFRS Phase 1, from 1995 to 2010, the Financial Accounting Standards (SAK) were continuously revised, both in the form of improvements and the addition of new standards.

The revision process was carried out six times, namely on October 1, 1995, June 1, 1999, April 1, 2002, October 1, 2004, June 1 2006, September 1, 2007, and the version on July 1, 2009. In 2006 at the X IAI congress in Jakarta, that the full convergence of IFRS will be completed in 2008. The target at that time was to fully comply with all IFRS standards in 2008. However, the journey has not been easy. Until the end of 2008 the number of IFRS adopted has only reached 10 IFRS standards based on a total of 33 standards.

IFRS Convergence Road Map

In accordance with the roadmap for the convergence of PSAK to IFRS (International Financial Reporting Standards), Indonesia has now entered the final preparation stage (2011), previously completed through the adoption period (2008 – 2010). It's only been a year since IAI (Indonesian Institute of Accountants) has targeted this final preparation period, because it was officially completed as of January 1, 2012 Indonesia to implement IFRS. In Indonesia, there are also Government Accounting Standards (SAP) which still refer to the old PSAK. Most likely the completion of the convergence of PSAK to IFRS will follow changes in SAP. Not all of the IFRS standards above were completely copied and changed as PSAK, that's why IAI chose convergence according to adaptation & adoption.

IAI's efforts on running the road the map was starting to appear in the validation several PSAK starting from 2008 – 2011. (in table 1) Broadly speaking, there are four main things set out in accounting standards. The first relates to using the definition of elements financial statements or other facts that related. Definition used in standard accounting to determine whether transactions exclusive must be recorded and grouped to on assets, liabilities, equity, income and cost. The second is the measurement and evaluation. This guide is used for select a value according to a report element financially good at the time of the transaction finance is also in the presentation financial statements (in off balance sheet). Thing The third that is loaded on the standard is recognition, namely the criteria used to recognize elements of financial statements As a result, the element can be presented on the financial statements. The last one is presentation and disclosure of reports finance. This fourth component is used to select the type of fact and how was the fact presented and disclosed in the financial statements. Something facts can be presented in the body of the report (Balance Sheet, Profit/Loss Statement) or in the form of explanation (notes) accompanying the report finance (Chariri, 2009).

Accounting conservatism in IFRS

Moving on to the adoption of International Financial Reporting Standards (IFRS) as a guide in the preparation of financial statements is a form of rejection and criticism of the principle of accounting conservatism. The principle used in IFRS is fair value, this is what causes it to be inconsistent with using accounting conservatism. The principle of fair value emphasizes relevance, this is in contrast to using the principle of conservatism which emphasizes reliability. Indonesia fully adopted IFRS starting in 2012, which is required to apply the principle of fair value in the presentation of its financial statements in every company listed on the Indonesia Stock Exchange.

According to Safiq (2010), this is because accounting conservatives are believed to be less relevant to decision making. Companies that use accounting conservatism have low profit quality (Penman and Zhang in Safiq 2010). The principle of Conservatism does not apply to IFRS. Financial statements according to IFRS must be understandable, relevant, reliable, and comparable, and without being followed by conservative bias. This is also reflected in the accounting method formulated by the IASB. For example, loss carry forwards result in deferred tax receivables being recognized, development costs being capitalized, and long-term contracts being treated under the percentage-of-completion method.

Another example is the change in the Valuation Method for Temporary Investments based on the Lower Cost Or Market (LCOM) Method to the Fair Price (Market) Method. This change means that if the market price increases, the company is obliged to increase the value of its investment, and has recognized profit. Indeed, if we look at it based on the value of the investment, evaluation using fair value is in sync with the current conditions. However, if it is observed based on the profit side that has not occurred, because there is no sales transaction, then the principle of conservatism in investment evaluation is no longer valid. This is what means the decline in the principle of Conservatism in Accounting. This is one of the models of the impact of changes in SAK that points to IFRS. Based on the literature analysis, the reason for the non-applicability of the principle of conservatism in IFRS is the difference in the conceptual framework between SAK using IFRS at each level: namely level 1: the purpose of financial statements, level 2: qualitative characteristics and elements of financial statements, and level 3: Basic assumptions, Principles and obstacles.

Table 2. Level 1 Purpose of Financial Report

US GAAP	IFRS
➢ Provide useful information for investment decision making and credit. ➢ Provide useful information to predict the amount, time, and uncertainty of future cash flows company	➢ Provide coverage regarding financial position, performance and changes the financial position of a company useful for a large number of users on economic decision making. ➢ Users are investors, employees, givers loans, suppliers and business creditors others, customers, governments and public

Table 3. Level 2: Qualitative Characteristics of Accounting Information

US GAAP	IFRS
Relevance consists of: ➢ Predictive value – helps users predicting output based on mass incidents past, present and future. ➢ Feedback value – helps users confirm and correct values previous predictions. ➢ On time – available before loss of capacity for hypnotize decision	Relevance consists of: ➢ Predicted value ➢ Confirmation value ➢ Materiality

Trustworthy – consists of: **1.** Served using honest **2.** Neutral **3.** Can be verified	**Trustworthy – consists of:** 1. Served honestly 2. Neutral 3. Substance over form 4. Caution (where there is uncertainty, errors in providing information and guarantee conservatism. 5. Completeness
Comparable Consistent	Comparable

Table 3. Level 2: Elements of Financial Statements

US GAAP	IFRS
Asset Obligation Equity Owner investment Distribution to owners Comprehensive profit Income Profit Burden Loss	Asset Obligation Equity Maintenance of capital (derived from revaluation of assets and liabilities) Profit (Revenue and profit) Expenses (expenses and losses)

Conservatism is defined as 'the equality of accountants for requiring a higher degree of proof for profits than losses. The FASB's official definition of Conservatism is 'a cautious reaction to uncertainty to try to ensure that these uncertainties and inherent risks are adequately considered'. However, in the application of certain IFRS budgets, the accounting principle of conservatism is still maintained in various areas even though the international financial reporting standards (IFRS) imply that the principle of conservatism is no longer applied.

There are several model areas where the principle of accounting conservatism may still be maintained, for example:

1. Loss compensation resulted in the recognition of deferred tax receivables. Deferred tax assets are recognized for the carry forward of unused tax losses if it is probable that future taxable profits will be sufficient to use the unused tax losses. The probability criterion (possibility) is a subjective qualitative criterion where using the subjective judgment criterion there is an opportunity to apply conservatism.
2. Capitalization of development costs. One of the conditions of an existing intangible asset such as development costs (or based on development terms in an internal project) is recognized if it meets how the intangible asset will form the probable future economic benefits.

In a company updating its forecasts of future cash flows based on the development portfolio it capitalized, there may be an “ad interim impact” of conservatism that refers to the creation of hidden reserves that can then be reversed. In essence, the principle of "conservatism" remains in the application of IFRS. The principle of conservatism from IFRS is applied to an ad interim method of conservatism (changes in accounting estimates that are ad interim, such as understated net assets through the creation of hidden reserves that can then be reversed) rather than consistent conservatism (understated net asset evaluations).

This means that a lower focus based on consistent conservatism in IFRS implementation is replaced by a greater focus on ad interim conservatism. This has an impact on users of financial statements because the impact of applying the principle of ad interim conservatism (changed accounting estimates) has a more complex level in measuring profits than using the implementation of consistent conservatism. When the principle of conservatism is applied to the ad interim method, the company treats some activities conservatively (items that do not meet his criteria for recognition or other probabilities), ad interim others will be calculated in sync using IFRS. (items that meet probability requirements and other recognition criteria). The treatment of mixed accounting principles will also have an impact on users of financial statements.

Impact of IFRS Convergence on Tax

Regulators are urgently needed to make regulatory adjustments related to the use of financial reporting for taxation. Currently, there are several principle disparities between SAK using taxation are as follows: (1) The principle of estimation, namely financial accounting standards, requires there are estimates on various matters, such as impairment losses and provisions, while the tax principle only recognizes the realization not according to estimates; (2) The principle of fair value, namely: Financial accounting standards apply broadly to the reasonable value determination of permanent assets, investment properties and financial instruments, while taxation principles apply the principles of acquisition cost (cost). (3) The principle of substance over form, namely financial accounting standards apply this principle to finance leases and the definition of related parties, while taxes are based more on form over substance, in which the interpretation of something is based on have conditions that take into account **sah** status; (4) Principle based, namely accounting standards Finance applies principle based which is generally mastered in all matters, including related party transactions and determination of useful lives for permanent assets and intangible assets, while taxation places more emphasis on rule based, where everything is regulated according to the definition budget the details; (5) The concept of materiality, namely the financial accounting standards reflect the concept of materiality in depth, especially in the evaluation of a financial report, while in taxation does not recognize the principle of materiality.

5. CONCLUSSION

The application of IFRS in Indonesia at this time is a perfect step in preparing the Indonesian nation for the era of free trade, although it uses developing barriers, both technical and psychological in the form of the threat of foreign domination. Benefits based on the convergence needed will reduce investment constraints, increase company transparency, reduce costs associated with using financial statement preparation, and reduce capital costs because financial statements from PSAK do not require significant reconciliation using financial statements from IFRS. With the standard of the world, it allows comparability and universal exchange of news. Permanent accounting conservatism "plays" on the implementation of IFRS. The IASB standards (IFRS) do not explicitly refer to the principle of applying conservatism, because it is not appropriate to use IFRS number theory. However, conservatism does not disappear just because it is not "emphasized" in the standard. With uncertainty, there will be permanent application of conservatism in the presentation of financial statements.

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