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**MOST URGENT REVIEW FEEDBACK-CIBSSR-00408**

2 messages

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**GCBSS Committee** <gcbsscommittee@gmail.com>  
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Wed, Nov 21, 2018 at 2:03 PM

Dear Ms. Beatrice Marcellina,

We have received the review outcome and pleased to inform you that your paper titled "The Information Asymmetry in the Post IFRS Adoption: Evidence from Developing Countries " CIBSSR-00408 is considered suitable for publication, subject to satisfactory minor revisions in a regular issue of [GATR Accounting and Finance Review \(AFR\)](#). Please find the below review comments, authors instructions, similarity report, copyright and consent forms. You are advised to read comments carefully and submit the final version of the paper with required forms to me not later than **27th November 2018 at [gcbsscommittee@gmail.com](mailto:gcbsscommittee@gmail.com) and [admin@gcbss.org](mailto:admin@gcbss.org)**. After that day we will not entertain your paper for this journal. We appreciate your cooperation for timely publication AFR Vol 3 (4) online and print.

**REVIEW COMMENTS:**

This is a tropical paper, Some literature sources are not properly presented (lack of journal name etc.)

The author cites some sources from high rated Scopus journals.

Conclusion section is narrow, the author should improve the conclusion section and add future research and implication.

The Paper needs English proofreading – many errors

Decrease similarity ratio.

If you may have any query, please feel free to write at [admin@gcbss.org](mailto:admin@gcbss.org)

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## Information Asymmetry in the Post-IFRS

### Adoption Period: Evidence from Developing Countries

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#### ABSTRACT

**Objective** – The adoption of IFRS is predicted to reduce the level of information asymmetry as one of the goals of the standard. Some prior studies in developed countries proved that adoption of IFRS enhanced transparency and diminished information asymmetry. However, in developing countries that have a low level of openness, limited regulation, and more centralized ownership, the ability of IFRS adoption to reduce information asymmetry is still questionable. To address this issue, this study aims to investigate whether IFRS adoption will reduce information asymmetry in some developing countries in South East Asia.

**Methodology/Technique** – This research is applied in three developing countries, Indonesia, the Philippines, and Thailand. Information asymmetry is proxied by the cost of capital using Easton model (2004) and bid-ask spread. Listed firms from the three countries are selected as the research sample; there are 5.313 firm-years for the period of 2007-2016.

**Findings** – This study concludes that IFRS adoption decreases information asymmetry in developing countries. The finding confirms that the benefit of the adoption is the same as in developed countries, though the level of law enforcement in developing countries. Managers, standard setters, and investors need to note that IFRS conveys the benefit to the market, which appreciates the increase of transparency by asking lower returns and valuing the companies' stocks appropriately.

**Novelty** – This study examines the benefit of IFRS adoption in reducing information asymmetry in some emerging countries to enhance the generalization of prior studies that were mostly conducted in developed countries.

**Type of Paper** – Empirical

**Keywords** – bid-ask spread; the cost of capital; information asymmetry; IFRS adoption

**JEL Classification** – M41, M48

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## **1. Introduction**

Information disclosure plays an important role in the market because it can increase the credibility of a company (Healy and Palepu, 2001). Differences of information cause investors to lose their trust in the company, and consequently, they will ask for higher returns (Ballesteros, et al., 2016). The adoption of IFRS aims to reduce information asymmetry, thus increasing competition and efficiency of companies in capital markets and reducing the cost of capital (Covrig, et al., 2007; Daske, et al., 2008; Patro and Gupta 2014).

The relationship between IFRS and information asymmetry has been widely studied in some developed countries. It is characterized by high protection for investors and strong accounting standards supported by professionals (Leuz et al., 2003; Turki et al., 2017; Daske and Gebhardt, 2006; Chen et al., 2010). However, the research on the relationship between IFRS and information asymmetry in emerging countries is limited. According to Ball (2006), the implementation of IFRS is heterogeneous among countries. The effect will be smaller in countries that have fewer differences between local GAAP and IFRS. The most substantial effect is for countries with a considerable difference between local GAAP and IFRS (Daske et al., 2008).

Furthermore, Indonesia and some other developing countries such as the Philippines and Thailand have identical characteristics in that they have weaker and less mature capital markets (Gibson, 2003), limited regulation, and more centralized ownership (Claessens et al., 2000), all of which tend toward higher information asymmetry.

Mandatory IFRS adoption has proven more effective than voluntary adoption. Turki et al. (2016) found that IFRS adoption reduces information asymmetry. After mandatory IFRS adoption, the quality of the information environment increased more significantly for mandatory adopters than for voluntary adopters (Horton et al., 2012). Several studies have followed the effects of voluntary IFRS adoption on the cost of capital, using an estimate of the implied capital costs for the company. Buijink (2005) examined the adoption of IFRS or non-local GAAP by Europeans Union (EU) companies, but failed to document lower capital costs for IFRS adopters. Daske and Gebhardt (2006) sampled German companies with IFRS adoption for the period 1993-2002 and found higher capital costs for IFRS.

The similarity of characteristics in emerging countries on the one hand and the strength of the mandatory IFRS adoption on the other hand provide an exciting opportunity to examine whether mandatory adoption provides the same benefits for developing countries as for developed countries. By using three developing countries as research samples, Indonesia, the Philippines, and Thailand, this research aims to add empirical evidence regarding the mandatory power of IFRS adoption in reducing asymmetric information.

The remainder of this paper is as follows. A review of the literature and the development of hypotheses for this study are presented in the second section. The third section describes the research methods. The fourth section presents and discusses the findings of the study, and the fifth section concludes.

## **2. Literature Review**

### *2.1 International Financial Accounting Standards*

Changes from rule-based standards to the principle-based standards of IFRS answer the need for harmonization of financial information for users worldwide (Christensen et al., 2015). The International Accounting Standards Board (IASB) is an independent group tasked with coordinating national accounting standards to ensure harmonization of those standards around the world. Eight IFRS were issued by the IASB in 2006 (Kim and Shi, 2006).

IFRS is the accounting standard issued by IASB. Changes to international standards are the most significant changes in the context of financial information for more than 100 countries (Sellami and Slimi, 2006; Daske et al., 2008). Countries in the Asia Pacific began to adopt IFRS in 2005 (Cheong et al., 2010). At present, 166 countries use IFRS as their financial reporting standard in part or in full.

The IFRS standard demands high quality, transparent, and comparable information in financial statements and other reports to help investors in global markets and other users make economic decisions (Turki et al., 2016). The proponents of IFRS adoption state that it makes disclosure more valuable. Compared to local accounting standards in many countries, IFRS focuses on fair value. Therefore, IFRS can reduce the accounting flexibility allowed for financial reporting and incorporate the impact of economic events on a company's performance through financial statements in a more precise period (Kim and Shi, 2006).

## *2.2 Local GAAP in Indonesia, the Philippines, and Thailand*

Indonesia passed through several stages before deciding to converge with IFRS. In 1973, based on the published standards of the American Institute of Certified Public Accountants, the Indonesia Accounting Principles Committee issued Indonesian Accounting Principles (PAI) (Perera and Baydoun, 2007). In 1994, the committee was changed to the Financial Accounting Standards Committee, and it totally revised PAI. The new committee published interpretations of these standards in the Financial Accounting Standards (SAK) on October 1, 1994. In 1998, the Financial Accounting Committee was changed to the Financial Accounting Standards Board (DSAK) with autonomy to formulate and amend the Statement of Financial Accounting Standards (PSAK) and Interpretation of Financial Accounting Standards (ISAK). DSAK uses International Accounting Standards (IAS) as its primary reference in establishing the standards.

Starting in 2006, Indonesia planned to integrate its standards into IFRS. Indonesia actively revised most of its accounting standards until they fully converged with IFRS in 2012. In domestic settings, Indonesia continues to use local accounting standards, PSAK, despite substantial convergence to IFRS. The capital market in Indonesia also requires all listed companies to prepare financial statements following IFRS.

Unlike Indonesia, the adoption of IFRS in Thailand began on January 1, 2011. Thailand requires all companies listed on SET to report their financial statements under IFRS (Intharaprasiti et al., 2016). The adoption of IFRS, especially in Thailand, is useful for limiting financial reporting manipulation.

Thailand has local accounting standards, the Thailand Accounting Standards (TAS). The Federation of Accounting Professions, the board that sets and regulates accounting standards in Thailand, formerly known as the Institute of Certified Accountants and Auditors of Thailand (ICAAAT), publishes TAS as a local accounting standard (FAP). FAP announced the IFRS adoption timeline in Thailand. In 2011, the top 50 companies were registered in SET (Klose and Sabangban, 2011). Then in 2012, 100 companies listed on SET began adopting IFRS. The remaining companies that had not adopted IFRS did so in 2014. Thailand adopted IFRS in part, and the standard is called Thai Financial Report Standards (TFRS). SET also permitted companies that have been listed on the stock market to add or adopt IFRS, which has not been adopted as TFRS with additional disclosures

Before 1996, accounting standards in the Philippines were based mainly on US GAAP issued by the FASB. However, in 1997, ASC officially decided to move to IAS completely. In November 2004, ASC approved the issuance of the new Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS), directly following IAS and IFRS. The Securities and Exchange Commission (SEC) agreed to adopt

international accounting standards to enforce high quality and transparent financial reporting and increase credibility and competence in the capital market.

In 2005, ASC adopted IFRS issued by the IASB and a revised version of the previously adopted IAS. Then in 2006, the Financial Reporting Standards Council (FRSC) was established as the successor of ASC. FRSC carried out a decision by ASC to converge Philippine accounting standards with IFRS standards. It took a while for companies to understand the new accounting standards (Fajardo, 2008). In domestic settings, the Philippines maintains the use of IFRS-based local standards, namely, the Philippine Financial Reporting Standards.

### *2.3 Mandatory IFRS Adoption and Cost of Capital*

In economic theory, the high cost of information asymmetry translates to high capital costs, illiquid markets, and suppressed investment activities. IFRS supporters find a basis in the mandated part of the IASB goal, which requires high quality, transparent, and comparable information. They argue that IFRS will encourage the development of capital markets. The IASB has been tireless in promoting IFRS at the political level, and its efforts have paid off very well in matters ranging from endorsement to mandatory adoption (Ball, 2006).

Mandatory IFRS adoption will reduce the cost of equity capital because this standard requires more financial information disclosure than most local accounting standards (Ashbaugh and Pincus, 2001). With appropriate implementation and empowerment, IFRS adoption can reduce capital costs by improving the quality and comparability of financial statements. This is supported by the findings of many previous studies that document that increasing disclosure has reduced the cost of equity (Easley and O'Hara, 2004; Lambert et al., 2007; Armstrong et al., 2010). This leads to Hypothesis 1.

H1: Information asymmetry that is proxied by the cost of capital will be lower after the adoption of IFRS.

### *2.4 Mandatory IFRS Adoption and Bid-ask Spread*

Empirical studies of the effects of mandatory IFRS adoption on capital markets are still not conclusive. Previous research suggests that the economic consequences of IFRS adoption must increase market liquidity around the time of mandatory IFRS adoption, especially in countries that have strong law enforcement and managerial incentives for those who disclose transparently. Daske et al. (2008) examined the economic consequences of mandatory IFRS adoption in twenty-six countries and found that market liquidity increased around the time of mandatory IFRS adoption. The mandatory application of IFRS in EU countries has increased the accuracy of analysts' estimates, and this impact is increasingly evident in countries with strong law enforcement (Christensen, Lee, and Walker, 2009; Byard, Li, and Yu, 2011). This leads to Hypothesis 2.

H2: Information asymmetry that is proxied by the bid-ask spread will be narrower after the adoption of IFRS.

## **3. Research Methodology**

### *3.1 Model of Analysis*

The model of analysis to test the two hypotheses of this study is shown below. We add some control variables that have been previously proven as the determinants of the cost of capital and bid-ask spread.

#### Model 1.1

$$CoC_{i,t} = \beta_0 + \beta_1 IFRS_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 GROWTH_{i,t} + \beta_4 LEV_{i,t} + \beta_5 CFO_{i,t} + \beta_6 EPS_{i,t} + \varepsilon_{i,t} \quad (1)$$

Model 1.2

$$SPREAD_{i,t} = \gamma_0 + \gamma_1 IFRS_{i,t} + \gamma_2 SIZE_{i,t} + \gamma_3 GROWTH_{i,t} + \gamma_4 LEV_{i,t} + \gamma_5 CFO_{i,t} + \gamma_6 EPS_{i,t} + \varepsilon_{i,t} \quad (2)$$

### 3.2 The Operationalization of Variables

This research measures information asymmetry using two proxies, cost of capital and bid-ask spread. Cost of capital is calculated according to Easton's (2004) model, which uses earnings per share data for the coming year and the next two years. The following is a regression of cost of capital.

$$CoC_{PEGi,t} = \sqrt{\frac{E_0(eps_2) - E_0(eps_1)}{P_0}} \quad (3)$$

where:

$CoC_{PEG}$  = Cost of capital for companies i and year t

$eps_1, eps_2$  = Earnings per share in year t and year t-1

$P_0$  = Share price at the beginning of the year

The second proxy of information asymmetry is bid-ask spread, as the difference between the bid price and ask price, calculated using the following formula.

$$Spread_i = \left[ \sum_{t=1}^n \frac{Ask_{it} - Bid_{it}}{(Ask_{it} + Bid_{it})/2} \right] / N \quad (4)$$

where:

$Spread_i$  = Average difference between the bid and ask during the stock trading period i

$Bid_{it}$  = The last price offered on the day t of the stock i

$Ask_{it}$  = The last price requested on day t of the stock i

$N$  = Number of stock trading days in a year

### 3.2 Control Variables

This study includes several control variables in the model of analysis: firm size, growth, leverage, cash flow from operating, and earnings per share.

**Firm size (SIZE)** is measured by the logarithm of the equity market value at the end of the year, following Chae (2005) and Lafond et al. (2007).

**Sales growth (GROWTH)** is annual sales growth rate of the company. Companies with higher growth opportunities are more likely to have higher information asymmetry and bear higher adverse selection costs than companies with low growth opportunities (D'Mello et al., 2008; Krishnaswami and Subramaniam, 1999; Myers and Majluf, 1984).

**Leverage (LEV)** is measured by total debt scaled by the total equity. It indicates the amount of debt borne through the company's capital (Nguyen and Schubler, 2013; Komala and Nugroho, 2013; Abasari et al., 2013; Kose, 2011)

**Cash flow from operating (CFO)** is measured by cash flow from operating at the end of the year divided by total assets at the beginning of the year.

**Earnings per share (EPS)** shows the company's net profit that is ready to be distributed to all shareholders. EPS is measured by profit or loss before extraordinary items divided by the weighted average of shares outstanding (Mgbame and Ikhatua, 2013; Menaje, 2012; Sheetaraman and Raj, 2011; Perera and Thrikawala, 2010; Zhu, 2003).

### 3.3 Data

Three countries are selected as the research sample, Indonesia, the Philippines, and Thailand. These countries represent the emerging countries' characteristics and have similar backgrounds before they adopted IFRS as the mandatory standards. There are 5,313 firm-years for the period of 2007-2016. Data for this research are available in Bloomberg, the firms' websites, and the respective stock exchanges.

## 4. Results

### 4.1 The Profile of Sample

Table 1, Panel A presents the profile of the variables of this study. Also, we present the profile of each group of adoption, i.e., pre- and post-adoption. Panel B shows the comparison of the cost of capital and bid-ask spreads in each group.

Table 1. Profile of the Sample

Panel A						
	mean	min	max	stddev		
CoC	0,2015	0,0000	3,0663	0,2625		
SPREAD	0,0065	0,0000	1,1603	0,1045		
CFO	0,0763	4,6740	30,4000	0,4989		
EPS	585	-	465	2.830		
SIZE	12,1300	9,6666	21,6300	0,9049		
GROWTH	0,7021	3,4680	66,1000	13,1900		
LEV	1,8020	-64,0500	12,5100	19,3600		

  

Panel B						
	COST OF CAPITAL			BID-ASK SPREAD		
	PRE	POST	ALL	PRE	POST	ALL
Mean	0,20939	0,19087	0,20153	0,08341	0,05259	0,06453
Min	0,00000	0,00001	0,00000	0,00000	0,00000	0,00000
Max	2,86700	3,06630	3,06630	0,81444	1,16040	1,16040
Std dev	0,25041	0,27802	0,26252	0,12266	0,00897	0,10545



Table 1, Panel B shows that the mean of the cost of capital is lower post-adoption than pre-adoption. Bid-ask spreads as another proxy of information asymmetry is narrower post-adoption compared to pre-adoption. The profile of cost of capital and bid-ask spread implies that there is a reduction of information asymmetry post-adoption. Table 2 describes the profile of the sample in each industrial sector.

Table 2. Mean of Variables per Industrial Sector

Industrial Sector	COC	SPREAD	CFO	EPS	SIZE	GROWT	
						H	LEV
Consumer Goods	0.21419	0.06718	0.08145	635.8	11.96	0.2937	1.679
Infrastructure, Utilities, and Transportation	0.25401	0.05444	0.00529 6	126.4	12.15	0.7139	0.9044
Trade, Service, and Investment	0.17523	0.08172	0.07793	866	12	0.7049	1.145
Extraction	0.16601	0.02792	0.1939	439.3	12.55	3.62	6.477
Agriculture	0.28087	0.02955	0.09255	157.2	12.45	0.3789	2.44
Agro and Food Industry	0.082019	0.06141	0.08402	423.7	12.19	0.2464	1.963
Finance	0.23963	0.02294	0.02625	855.9	12.36	0.1398	2.583
Manufacturing	0.27334	0.02640	0.09059	610.2	11.7	0.1095	1.592
Resources	0.25575	0.00903	0.06923	794.2	12.64	0.1852	1.609
Technology	0.28214	0.01088	0.1226	756.9	12.32	0.08491	1.342

#### 4.2 Hypothesis Testing

Based on Table 3, the coefficient of PRE POST is negative and significant. This means that there is a significant decrease in the cost of capital after the adoption of IFRS. SIZE and COUNTRY act as the significant control variables that reduce the level of information asymmetry.

Table 3. Cost of Capital and IFRS Adoption

Dependent variable: COC	Coef	p-value	
Const	1,20290	0,00010	***
PREPOST	- 0,02933	0,00720	***
CFO	- 0,00390	0,62860	
EPS	- 0,00000	0,12180	
SIZE	- 0,07436	0,00010	***
GROWTH	- 0,00022	0,50410	
LEV	0,00009	0,93820	
COUNTRY	- 0,04632	0,00010	***
R <sup>2</sup>	0,07283		
F	27,52470	0,00000	

Consistent with the results of Hypothesis 1, the results of Hypothesis 2 show that PREPOST is also negative and significant in reducing information asymmetry (Table 4). Firm size is also consistent as a determinant of the level of information asymmetry; however, it does not differ among countries.

Table 4. Bid-ask Spreads and IFRS Adoption

Dependent variable:			
SPREAD	Coef	p-value	
Const	0,52181	0,00010	***
PREPOST	- 0,02933	0,00010	***
CFO	- 0,00390	0,72370	
EPS	0,00101	0,89080	
SIZE	- 0,03679	0,00010	***
GROWTH	- 0,00009	0,40730	
LEV	- 0,00005	0,51250	
COUNTRY	- 0,00009	0,25360	
R <sup>2</sup>	0,13401		
F	51,95530	0,00000	

## 5. Discussion

The results support the argument that mandatory IFRS adoption has the same value in emerging countries as in developed countries. Mandatory IFRS adoption forces managers to comply with the standard; otherwise, they will be punished either by the user of financial statements or the government. When mandatory, IFRS demands more and better disclosure and thus is likely to reduce information asymmetry in an imperfectly competitive equity market. It then will produce a lowering effect in the cost of equity capital (Armstrong et al., 2010).

The results reinforce the prior studies that mandatory IFRS adoption has reduced information asymmetry (Turki et al. 2016; Easley and O'Hara, 2004; Lambert et al., 2007; Armstrong et al., 2010). The quality of information after mandatory IFRS adoption significantly increases (Horton et al., 2012). The arguments of the proponents of IFRS that adoption promotes high quality, transparent, and comparable information are supported.

IFRS demands wider disclosure of information compared to those required by previous standards (Ashbaugh and Pincus, 2001). Thus, the adoption of IFRS encourages transparency and comparative information and reduces the cost of capital.

IFRS adoption encourages companies to provide broader disclosures that convey the inside information to the outside. The disclosure increases information for investors. This will lead to a decrease in information asymmetry (Diamond and Verrecchia, 1991; Lopatta et al., 2015). The availability of more information enables investors to value the company appropriately. Investors who have more information using the provisions of the company will determine the price according to what is requested by others. This causes the gap between bid and ask to be narrower, or the bid-ask spreads to decrease.

## 6. Conclusion

The objective of this study is to determine the effectiveness of mandatory IFRS adoption in reducing the level of information asymmetry. By using three developing countries to represent the characteristics of developing countries, this study confirms that mandatory IFRS adoption has significantly reduced the level of information asymmetry. The finding shows the strength of mandatory adoption of IFRS. The results show the superiority of mandatory IFRS because it goes beyond the state aspects so it can be generally accepted.

The results of this study are of concern to the standard setters since they confirm the effectiveness of mandatory adoption. Mandatory adoption maintains the consistency of implementation so the benefit of this approach will

be sustainable. This research does not go into more detail about developing country factors such as governance level and investor protections that potentially influence the benefit of mandatory IFRS adoption. We also do not make a direct comparison with voluntary adoption; therefore, future research can explore these issues further.

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# EDITORIAL

## CERTIFICATE

**Authors:**

**Juniarti, Beatrice  
Marcellina, Alvita Angela**

**Document title:**

**The Information Asymmetry in the  
Post-IFRS Adoption Period: Evidence  
from Developing Countries**

**Date Issued:**

**2018-11-25**

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