5

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Conservatism Under IFRS In Indonesia

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Abstract: This research examines the effect of IFRS adoption its impact on the implementation of Unconditional and Conditional accounting conservatism prinsipal. The sample in this research is manufacturing listed industries for 2008-2015. By using purposive sampling, we get 32 samples and 256 obervation. The result shows IFRS adoption has negative significant impact on accounting unconditional conservatism. Futhermore, the adoption of IFRS has positive significant impact on conditional conservatism. The implication of the result is that financial report which implement IFRS is found more conservative in conditional consevatism.

Index Terms: Conservatism, Ex-Ante Conservatism, Ex-Post Conservatism, IFRS

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1 INTRODUCTION

As one step in increasing credibility and comparability of financial reporting, in 1994 the Indonesian Accounting Association (IAI) has implemented program of harmonization and adaptation of international accounting standard in order to develop its accounting standard. In 2008 IAI has announced the convergence plan for local accounting standards, namely Accounting Standards Statement (PSAK) with International Financial Reporting Standards (IFRS). Then in 2012 IAI has implemented IFRS and all companies are required to use IFRS as a financial reporting standard. In Indonesia IFRS adoption is done by convergence which is to adopt all IFRS but adjusted to the condition in a country. As for the benefits that obtained by doing convergence is to facilitate understanding about financial statement by using SAK which is internationally recognized, increasing global investment flow through transparency, reducing capital costs by opening fund raising through the capital market globally, and creating efficiency of financial statement.The successful of IFRS implementation, has benefit that exceed the cost, affects not only companies within the European Union, but also companies throughout the world, so that it can make IFRS increasingly become a global reporting standard (Capkun et al., 2008). The implementation of IFRS is claimed to be beneficial for improving the quality of financial statement. One of them is, IFRS convergence can increase the relevance of information from financial statement. The use of the fair value principle on IFRS focuses on relevance while the implementation of accounting conservatism can reduce the level of reliability (Januarsi et al, 2014).According to Juanda (2007), financial statement according to IFRS must be understandable, relevant, reliable, and comparable, and without being followed by a conservative bias. The Companies that use accounting conservatism have low profit quality (Penman and Zhang, 2009). Whereas according to Basu (1997) by using a conservatism principle in financial reporting, the resulting profit will has a high quality because it is assumed that conservatism requires a higher level of verification to recognizing profit compared to recognizing losses.Conservatism is generally understood in 2 types of conservatism. Those are conservatism which is identified as unconditional conservatism and conditional conservatism (chan et al, 2009). Unconditional conservatism is a conservatism based on accounting related to balance sheet, not related or dependent on the presence of news (good news and bad news). It means that this kind conservatism is independent of the presence of good news or bad news in the company environment.

Conditional conservatism is conservatism based on market conditions. related to earning and depending on the news, the purpose is that this form of conservatism is a reaction or response from companies that carry out different verification as the absorption of information contained in the business environment (Handojo, 2012). According to Basu (2005), the greater Unconditional conservatism can reduce the next conditional conservatism because cash expenditures are charged immediately, so that it will reduce expenditures to be recorded later. Zeghal (2016) examined the mandatory impact of IFRS adoption on accounting conservatism. Empirical studies were conducted on samples from 15 European countries, observed from 2000 to 2010. Analyzing uncoditional and conditional conservatism. The results of empirical studies confirm a significant reduction uncoditional and conditional accounting conservatism. during the IFRS adoption period. This reduction is influenced by the accounting model that applies in certain countries. While the research conducted by Hullenar (2011) states that there is no reduction in accounting conservatism for both uncoditional and condtional conservatism after the implementation of IFRS. For research on the impact of IFRS adoption in Indonesia, according to Januarsi et al (2014), states that IFRS convergence can reduce accounting conservatism in Indonesia. Whereas on the contrary, according to Yustina (2012) the existence of IFRS convergence does not affect accounting conservatism. The previous researchs still show inconsistent results regarding IFRS convergence on accounting conservatism. So the researcher wanted to re-examine about the impact of IFRS convergence on accounting conservatism. In addition, when the government requires the use of IFRS standard in financial statement, the study of how to apply conservatism principle under IFRS standard is an interesting issue, because conservatism can reflect financial reporting quality. Whereas according to Juanda (2007) in IFRS the existence of conservatism can actually provide a biased effect on the result of financial statement. The research about conservatism is indeed quite a lot, but the research that examines the impact of IFRS on conservatism that is unconditional and conditional is still very minimal nowadays in Indonesia. Based on that background, the researcher aimed to examine the effect of IFRS implementation on the value of relevance of accounting information as well as unconditional and conditional accounting conservatism in Indonesia (case studies on manufacturing companies listed on the BEI).

16

2 THEORETICAL BASIS

Agency theory

Agency theory states that if there is a separation between the owner as principal and the manager as the agent running the company then agency problems will arise because each of these parties will always try to maximize the utility function (Jensen and Meckling, 1976). IFRS adoption has a big effect on the company's financial reporting and the company performance. The adoption of international accounting standard into domestic accounting standards aims to improve the credibility of financial statement, increase the requirements for disclosure items so that there will be an increase in company value, improve management accountability in running the company, produce financial statement information that is more relevant, accurate and comparable and also produce valid information for assets, debt, equity, income and expenses of the company (Petreski, 2007). According to Watts (2003), by applying conservative accounting can provide several benefits for the company. One of them is limiting manager in opportunistic behavior. Conservatism is a way to handlel agency problems that originate from information asymmetry between several parties who do the contract. For example, conservatism reduces the ability of manager to overestimate income and net assets to maximize their compensation plans (Hullenaar, 2011).

The Impact of IFRS Adoption on the Implementation of Unconditional and Conditional Conservatism

Previously PSAK that oriented on Generally Accepted Accounting Principles (GAAP), in the concept of recognition and measurement of items in financial reporting emphasizes the principle of historical costs that are said to be more reliable, because the value that used comes from transaction that have been realized and limits judgment from the management parties (Hendriksen, 2000). In GAAP, revenue recognition should consider the principle of conservatism which requires not to recognize income that is uncertain or still in the form of potential, on one side and recognize the costs even though they are still uncertain or still in the form of potential, on the other side. IFRS rejects the principle of accounting conservatism because the principle of fair value places more emphasis on accounting relevance and conservatism is not a principle stipulated in IFRS. IFRS introduces a new principle called prudence as a substitute of the principle of conservatism. Prudence in IFRS, especially with respect to revenue recognition is acceptable although it is still in the form of potential, insofar as it meets the provisions of recognition of income in IFRS. According to Piots et al. (2010) with the implementation of IFRS it is expected to reduce accounting slack and the assessment of net asset values that are too low, for the appropriate purpose of the economic conditions of the company. Referring to the rational expectations model, tightening in accounting standards (for example, IFRS adoption) must reduce accounting bias and improve the quality of profit by limiting manager's discretion over the accounting method. Therefore, it is expected that the decline that occurs in the implementation of unconditional conservatism may indirectly lead to an increase in conditional conservatism. The idea that IFRS should be able to reduce the value of unconditional conservatism is supported in several ways. To reduce the accounting bias in recording low asset values, IFRS contains three main provisions:

1. The changes from goodwill amortization, replaced by impairment and depreciation test (IFRS), make accounting treatment more influenced by news in case that do not benefit economic conditions (supporting the implementation of conditional conservatism);
2. The obligation to recognize the value of tangible assets (for example, development cost) that meet the activation criteria of IAS 38. Activation, only optional in most continental GAAP, provides a place for more depreciation in the future (supporting the implementation of conditional conservatism);
3. The abandonment of accelerated depreciation or "Fiscal" method of amortizing fixed assets must produce more economically relevant valuation of company assets. Also, to avoid unconditional conservatism through excessive liability, IAS 37 tends to limit the excessive use of provisions, especially by blocking provisions for future losses. Finally, IFRS standard completely prohibit "hidden" reserve constitutions.

Hellman (2008), explains that IFRS reduces unconditional and will be replaced with accounting practice that will provide more opportunities for the implementation of conditional conservatism. Piots et al. (2010) proved the existence of changes in conservatism after IFRS adoption. They found that the type of conditional conservatism that was assessed from asymmetric timeliness of bad vs good news declined after the IFRS adoption . Accounting conservatism will decrease when information asymmetry and accounting conservatism are interrelated (LaFond and Wats, 2006). The research conducted by Zeghal (2016) examined the mandatory impact of IFRS mandatory adoption on accounting conservatism. Empirical studies were conducted on samples from 15 countries in Europe, years of observation starting from 2000 to 2010. Analyzing both unconditional and conditional conservatism, which we measured each with the recognition of timely bad news compared with the recognition of good news and discretionary accruals. The results of empirical studies confirm a significant reduction of accounting conservatism in the period of IFRS adoption. This decline is influenced by the accounting model that applies in a particular country. In addition, the study shows a reduction in the gap between accounting unconditional and conditional conservatism during the post-IFRS adoption period. It means that there is significant influence on unconditional and conditional conservatism after the implementation of IFRS. Whereas Hullenar (2011), examined the impact of IFRS implementation on unconditional and conditional conservatism. This research used data in the form of 110 companies in Germany and 170 companies in the UK. The result of the research states that the level of unconditional and conditional conservatism has not changed significantly after the implementation of IFRS in the UK. In Indonesia, according to January et al. (2014), IFRS convergence can reduce accounting conservatism. Different from the result of the Yustina (2012) research which states that IFRS

17

convergence does not affect accounting conservatism. Based on the description described, it can take the research hypothesis as follows.

Ha$_1$: There is a decrease in the accounting unconditional conservatism after the IFRS adoption

Ha$_2$: There is an increase in accounting conditional conservatism after the IFRS adoption

3 Research Methodology

The population in this research were all companies listed on the Indonesia Stock Exchange. The population in this research were all companies listed in the 2008-2015 period on the Indonesia Stock Exchange (BEI). In this research, the samples were manufacturing companies found on the Indonesia Stock Exchange with the observation period 2008-2015. Manufacturing companies became The sample is due to Cahyonowati and Ratmono (2010) research that focused on testing samples in one industry can control confounding variable. The researcher's data used the annual financial statement obtained by downloading obtained from the Indonesia Stock Exchange website (www.idx.co.id). Apart from the Indonesia Stock Exchange, the data sources used in this research were obtained from www.finance.yahoo.com. The sample selection was done by purposive sampling method. And obtained the number of samples were 32 companies with a research year of 8 years (4 years before 4 years after), then the observations in this study were 256. In this research to determine the effect of the implementation of IFRS in Indonesia was used three research variables, namely the value of relevance of accounting information, accounting unconditional conservatism and conditional conservatism. Here are the definitions of each of those variables.

Accounting Unconditional Conservatism

One measure of measuring conservatism is the magnitude of accrual accumulation over time. The period in which net income is smaller than operating cash flow and is expected to be followed by period with negative accruals. The level of negative accrual accumulation is an indication of changes in the level of conservatism in the long term period (Givoly and Hayn, 2000). Consistent with the previous research, Hullenar (2011), unconditional conservatism in this research was measured by:

$$UNCONACC_{it} = a_0 + a_1 IFRS_{it} + a_2 LNSIZE_{it} + a_3 DR_{it} + a_4 CFO_{it} + e_{it} \quad (1)$$

Explanation :

$UNCONACC_{it}$ = Unconditional conservatism that measured by accrual value that was adapted from Givolyn and Hayn (2000).

$IFRS_{it}$ = Dummy (1 for after IFRS adoption and 0 before IFRS adoption)

$LNSSIZE_{it}$ = The total asset control variable which has a natural algorithm

DR_{it} = Debt ratio control variable (Leverage)

CFO_{it} = Operating cash flow control variable divided by total assets

e = error

Accounting Conditional Conservatism

Consistent with previous research, namely Zeghal (2016) conditional conservatism in this research was measured by using the Basu (1997) model modified by Zeghal (2016):

$$NI_{it} = a_0 + a_1 RN_{it} + a_2 R_{it} + a_3 RNR_{it} + a_4 IFRS + a_5 IFRSRN_{it} + a_6 IFRSR_{it} + a_7 IFRSRNR_{it} + a_8 DR_{it} + e \quad (2)$$

Explanation :

NI_{it} = Equity net profit each share (earnings per share) of the company devided by share price in opening t period

RN_{it} = Dummy (1 for negative return, and 0 for positive return)

R_{it} = Share Return (from share price March t_{+1})

RNR_{it} = Interaction variable between $RN_{it} * R_{it}$

$IFRS$ = Dummy (1 for after IFRS adoption and 0 before IFRS adoption)

$IFRSRN_{it}$ = Interaction Variable between $IFRS*RN_{it}$

$IFRSR_{it}$ = Interaction Variable between $IFRS*R_{it}$

$IFRSRNR_{it}$ = Interaction Variable between $IFRS*RN_{it}*R_{it}$

DR_{it} = Debt ratio control Variable (Leverage)

e = error

Basu (1996) states that under the interpretation of conservatism, profit reflects bad news faster than good news. The stock price reflects information received from other current sources of income. The stock price causes profit. The profit that is Predicted will be more tied to negative return, and negative return is proxied as bad news and otherwise positive return is proxied as good news. In order to learn about the impact of IFRS adoption at the level of conditional conservatism, it can be done by observing the variable coefficient of IFRSRNR (interaction of variable IFRS*RN*R IFRS*RN*R interaction makes it possible to assess the impact of IFRS on recognition of bad news compared to good news (Zeghal, 2016).

4 Discussion

The result of the descriptive data which can be outlined as follows. The average value of UnConDacc Variables which shows negative value indicates that the average value of the sample company accrual value is positive (because the accrual value is multiplied by -1 according to the formula used). The average value of the IFRS 0.5 variable indicates that the sample is divided evenly, 50% each before and after IFRS adoption. The total Asset, Leverage, Net Income, and Cash Flow from operation shows a positive value, which means that on average the company has a positive value of those variables. The positive average value of stock returns (R) makes the negative average return value (RN) be negative (minus), which and subsequently causes all IFRS interaction values to have a negative (minus) average.

Table 1. Descriptive Statistic

Variable	Unconditional		Conditional	
	Average	Std. Dev	Average	Std. Dev
UnConD Acc	-0.8502	0.1708		
IFRS	0.5000	0.5000	0.5000	0.5010
LnSIze	28.3990	1.8417		
DR	0.3754	0.1618	0.3754	0.1618
CFO	0.1280	0.1255		
NI			0.2519	0.6274
RN			-0.3807	3.6589
RRN			-0.5592	3.6242
IFRSR			-0.3808	3.5899
IFRSRR N			-0.4401	3.5793

Ket: UnConDacc: negative cccrual; IFRS: adopsi IFRS, DR:Leverage; LnSize: Log natural size; CFO: Operational Cash Flow; R: return saham ; RN: return negatif/positif; RRN: interaction R*RN; IFRSRN: Interaction IFRS*RN; IFRSRRN: interaction IFRS*R*RN. n = 258;

To answer Hypothesis 1 and 2, that is the effect of IFRS implementation on unconditional and conditional conservatism, the result of hypothesis testing with multiple linear regression model can be seen in Table 32 column (1) to (5). The result of testing for unconditional conservati sm can be seen in column (2) and (3), while the result of conditional conservatism tests in column (3) and (5).

Table 2 Impact of applying IFRS conservatism (unconditional / conditional):

Variable (1)	Unconditional Conservatism[1]		Conditional Conservatism[2]	
	Coeff. (2)	Prob.(3)	Coeff. (4)	Prob. (5)
C	5.3084	0.0000	-0.1049	0.3376
IFRS	-0.0576	0.0005	0.0501	0.7139
DR	0.1893	0.0023	0.2329	0.0000
LnSize	0.1714	0.0000		
CFO	0.8518	0.0000		
R			1.2428	0.0000
RN			0.2600	0.0476
RRN			-1.2283	0.0000
IFRSR			-0.8525	0.0248
IFRSRN			-0.2270	0.1932
IFRSRR N			0.8384	0.0289

Ket: [1]Variabel dependen: Negative Acccrual. [2]Variabel dependen: Net Income C = konstanta; IFRS: adopsi IFRS, DR:Leverage; LnSize:Ukuran perusahaan; CFO: Operational Cash Flow; R: return saham; RN: return negatif/positif; RRN: interaksi R*RN; IFRSRN: Interaksi IFRS*RN; IFRSRRN: internaksi IFRS*R*RN. n = 258; [1] adjusted R^2 = 0.7830, F= 0.0000; [2] adjusted R^2 = 0.2372, F= 0.0000

From Table 3 column (2) and (3) it can be seen that the IFRS probability value is significant (p value = 0,0005) which indicates that IFRS adoption has a significant impact on unconditional conservatism. The negative coefficient value indicates that the sample accrual value of the

company decreases after IFRS adoption. The sample companie used less accruals. In other words, the result of this research supports the hypothesis that there is a decrease in unconditional conservatism after IFRS adoption. This finding is in line with previous research (Zeghal, 2016 and Piot, C., Dumontier & Janin, 2010), but not in line with Hullenaar's research (2011) study which states that IFRS adoption does not affect on unconditional conservatism. The implementation of the fair value principle in IFRS rejected the existence of a conservatism principle based on historical value. This result also confirmed the result in hypothesis 1 IFRS adoption increases relevance, because the principle of fair value places more emphasis on the relevance of financial statement values. As a substitute for conservatism, IFRS introducing a new principle called prudence. The adoption of IFRS as an international accounting standard into PSAK in Indonesia has an impact on the company's financial reporting and company performance in Indonesia. The result of this research also indicated the achievement of one of several objectives of adopting international accounting standard into domestic accounting standard, that were to increase the credibility of financial statement, increase the requirements for disclosure items, increase management accountability in running the company, produce more relevant financial statement information, accurate, and can be compared and produce information. The Profit predicted will be more tied to negative return, and negative return is proxied as bad news and conversely positive return is proxied as good news (Basu, 1997). As for the result of testing Hypothesis 2, namely the effect of IFRS adoption on conditional conservatism, Table 3 column (4) and (5) show the following results. In the table, we can see the value of accounting conditional conservatism before IFRS, which is the variable RNR (RN*R). Whereas in order to study about the impact of IFRS adoption on the level of conditional conservatism, according to Zeghal (2016), it can be done by observing the variable coefficient of IFRSRNR (IFRS*RN*R interaction. IFRS*RN*R interaction make it possible to assess the impact of IFRS on recognition of bad news compared to good news. From Table 3 it can be seen that the RNR variable has a significant negative effect on the profit (0,000 <0,05), which indicates that bad news will actually have an effect that increases profits. While under accounting conservatism, bad news is more quickly recognized and recorded so that the resulting profits can be smaller (conservative). That means, financial statement after IFRS are not conservative in terms of conditional conservatism in accounting. Table 2 also shows that the IFRSRNR variable has a significant impact on profit (0.0289> 0.05) and has a positive direction on profit. This stated precisely after IFRS adoption the bad news has a positive direction on accounting profit. This means that the greater the bad news, the lower the profit. That means it is precisely under IFRS that the principle of conditional conservatism is used in the preparation of financial statement. This research is inversely proportional to the result of the research (Zeghal, 2016) which states that conditional conservatism actually decreases after IFRS adoption. The implementation of accounting conditional conservatism after IFRS adoption can occur because in IFRS the principle of conservatism is not entirely lost, but has been replaced with prudence principles as explained in

the IASB framework, paragraph 37. According to Hellman (2008), there are views on conservatism presented in the IASB Framework, paragraph 37[1]. First, a deficiency in conservatism can be justified by increasing disclosure. Secondly, it must cover the level of caution in the implementation of judgments based on condition of uncertainty. In the standard, the latter will often be stated in term of assessing certain probability and other specific accounting estimates. Overall, paragraph 37 implies the use of stricter conservatism principle. Thus the 3rd hypothesis is supported. That is, there is an increase in the implementation of conditional conservatism after the adoption of IFRS. The result of the research the effect of IFRS on unconditional and conditional accounting conservatism in this research, accordance with the statement of Piot, C., Dumontier & Janin (2010) which states that IFRS is expected to reduce accounting slack and valuation of net asset that is too low, for the purpose according to the economic condition of the company. Referring to the rational expectations model, tightening in accounting standard (for example, IFRS adoption) must reduce accounting bias and improve the quality of profit by limiting manager's discretion over the accounting method. Therefore, it is expected that the decline that occurs in the implementation of nconditional conservatism may indirectly lead to an increase in conditional conservatism.

5 CONCLUSION AND SUGGESTION

This reserach aimed to determine the effect of IFRS adoption as well as its impact on unconditional and conditional accounting conservatism in Indonesia. The result of this sreserach showed that IFRS has a significant negative impact on unconditional accounting conservatism. And with the adoption of IFRS it has a positive impact on conditional conservatism. The apllication of accounting conditional conservatism after IFRS adoption can occur because in IFRS the principle of conservatism is not entirely lost, but has been replaced with prudence principles as explained in the IASB framework, paragraph 37. Financial statement is more conservative in term of conditional conservatism under IFRS implementation. Thus, all hypotheses in this research were accepted. This research still has limitation such as, in this research only used sample in the form of manufacturing company only. This was done to be able to better control the disturbing variable. However, because of this, the research was only able to provide an overview of the impact of IFRS adoption on the

relevance of accounting information, accounting unconditional and conditional conservatism for manufacturing company. While the adoption of IFRS is for all industrial sectors and will have a different impact on each of the existing industrial sectors. Based on the limitation that exist in this research, the researcher gives suggestion to the next researcher, to be able to expand the sample by adding several sectors of the company. So the results of further research can increase knowledge about the impact of adoption on other industries.

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[1] *The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability" (IASB Framework, paragraph 37)"*

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