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Analysis of Stock Returns in Financial Restatements

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ABSTRACT

When making an investment, investors of course first look at the condition of the company as reflected in the financial statements. Financial statements are prepared based on accounting standards where accounting standards follow existing developments so that changes occur. On the other hand, sometimes companies also prepare financial statements that do not reflect the condition of the company, this causes financial restatements to occur. The aim of this research is to analyze stock returns when a financial restatements occurs, namely before and after a financial restatements. The research object is a manufacturing company on the Indonesia Stock Exchange that carries out a financial restatements with an event window of three days before and three days after the announcement of the financial restatements. The research results show that there is no difference in stock returns before and after the announcement of the financial restatements, which shows that investors think that information on the causes of the financial restatements is not important information that can reduce or increase firm value so that it cannot influence investors' decisions in investing.

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1. INTRODUCTION

Investment is a commitment to funds or other resources that is made to obtain profits in the future, with investors buying a number of shares at this time and having the hope of gaining profits from increased share prices or dividends in the future, it can be said that the investment is a reward of the time and risks used currently (Syahyunan, 2015). Shares are a type of investment that is popular with investors(Indonesian Stock Exchange, 2022). If an investor wants to invest or is interested in investing in a company, the investor will definitely first analyze the condition of the company before investing. The condition of the company will influence whether the investment made can provide profits or not, because investors will feel safe investing when the company has prospects that can benefit investors when investing. When investors want to invest, what they will understand is the financial statements. According to the Statement of Financial Accounting Standards (PSAK) No. 1, Financial statements are a structured presentation of the financial position and financial performance of an entity(Indonesian Accountants Association, 2018b). The conceptual framework for financial reporting in Financial Accounting Standards (SAK) states that the purpose of financial statements is to provide useful financial information to investors, potential investors, lenders and creditors related to the reporting entity. This information makes it easier to make decisions regarding the procurement of resources for related entities. reporter(Indonesian Accountants Association, 2018a). Therefore, financial statements can be a source of company information that investors will definitely need to help in making decisions, because this information can support investors in investing their capital in the company. Financial statements must be trustworthy because these financial statements can be said to be a means for companies to communicate indirectly with investors. The financial information must be relevant and faithful representation. The usefulness of financial information can be increased if the information is comparable, verifiable, timely and understandable (Indonesian Accountants Association, 2018a).

The company that registered on the Indonesian Stock Exchange (BEI) has an obligation to report financial statements that have been audited by a public accountant as a form of accountability to stakeholders and the public regarding the company's operational activities for one year(Financial Services Authority, 2016), but sometimes there is still the potential for misstatement after the financial statements are issued. In PSAK No. 25 states that errors may occur in the recognition, measurement, presentation and disclosure of elements of financial statements. However, it also does not rule out the possibility that window dressing could occur by company management to get a positive response from shareholders(Indonesian Accountants Association, 2018c). According to Sahputra & Diantimala (2018) the presence of fraud or financial misstatements can cause the company to have to carry out a financial restatement

Financial Restatement considered as a correction to the financial statements because they do not comply with generally accepted accounting principles and are considered to be material errors for the company(General Accounting Office (GAO), 2002). When a company finds an error in a financial statements that has been published, the company must warn investors that the financial statements information that has been published is no longer reliable and will be reviewed for restatement because when there is fraud in the financial statements, it will mislead users, including investors. If there is a material misstatement in the financial statements will become irrelevant as a basis for decision making because the analysis carried out is not based on actual information. If a company carries out a financial restatement, it can be a signal that the company's previously presented financial statements cannot be trusted and are of low quality. Investors will also take into account the company's future prospects, so this calls into question the credibility of a company's managers. This condition is supported by Land (2010) where the research results show that there is a relationship between earnings restatement and the possibility of CEO replacement.

The restatement of financial statements in Indonesia is regulated in PSAK No. 25 explains that the main factors influencing financial restatement consist of 3 groups, namely fundamental errors, changes in accounting policies, and changes in accounting estimates. Of these 3 groups, only fundamental errors and changes in accounting policies can give rise to restatements, while changes in accounting estimates are treated prospectively(Indonesian Accountants Association, 2018c). According to General Accounting Office (GAO) (2002) financial restatement is the result of a change in accounting principles or an error in accounting records, whether intentional due to a mathematical error or intentional misuse of truth, which will affect the financial statements in the coming year. In Indonesia, one of the cases regarding financial restatements occurred at PT Garuda Tbk. who was deemed to have made an error in the 2018 financial statements regarding receivables worth IDR 2.9 trillion which were recorded as income from a cooperation agreement transaction providing in-flight connectivity services between PT Mahata Aero Teknologi and PT Citilink Indonesia which had not been realized, so that net profit increases. This makes PT Garuda Tbk. must restate its financial statements (Improving Financial Reports, Garuda Losses IDR 2.45T in 2018, 2019). With the financial restatements carried out, PT Garuda's share price fell to 0.51% to the level of IDR 394 per share compared to the previous day's closing level of IDR 396 per share.(Jayani, 2019). This shows that the financial restatements carried out by PT Garuda due to misuse of the truth could influence market reactions. The Securities and Exchange Commission (SEC) revealed that the existence of a financial restatements can be an easy clue in spotting accounting errors and can be a source of new investigations. Doubts will arise about the accuracy of decision making due to the use of previously unreliable information. Therefore, financial restatements that are carried out intentionally can be detrimental to users of financial statements in making decisions.

Financial restatement what a company does can make the market react. This market reaction will cause changes in stock prices. Several conditions that have positive information content will advance domestic economic activity so that they will influence the company's ability to increase the welfare of its shareholders(Dewi, 2017). This is also supported by Sari & Harto (2019).On the contrary, events that have negative information content will hinder domestic economic activity so the companies cannot easily develop and ultimately reduce the value of the company in the eyes of investors (Pertamina, 2016; Sahputra & Diantimala, 2018; Sinaga, 2014). The behavior of investors who imagine and begin to recognize that share prices will experience a decline after a restatement is carried out(Bardos et al., 2010). The decline in stock prices will affect the level of stock returns. This rate of return on shares is called stock return. Stock returns are the results investors get when investing. In the principles of financial management, if an investment has a high potential risk, the higher the return generated, while an investment that has a low risk will result in a lower return.

Sinaga (2014)shows that low EPS information indicates that earnings reporting is not the main information for investors, because EPS does not contain the information used to determine stock returns, while CFPS is more important than after the restatement when the relationship between EPS and returns significantly decreases. Investors are only slightly aware of EPS and more about cash flow after restatement because investors lack confidence and do not trust the company's financial statements or management accounting policies. This is the same as research of Pertamina (2016) which shows that investors use information regarding income, operating expenses and net profit as reliable information, but when a restatement is announced, investors are not confident in information they receive so that investor confidence falls and results in a decrease in the abnormal return value. This is in line with Robbani & Bhuyan (2010) where financial restatements is negative information, thereby reducing stock returns. Gondhalekar et al. (2012) also shows that negative stock returns are significant for the three-day window surrounding the day of the financial restatements announcement. Sahputra and Diantimala (2018) shows that there is no difference in the average abnormal return between seven days before and seven days after the financial restatements. This is also due to the loss of investor confidence in companies that experience financial restatements events. This is also supported bySiregar & Rahayu (2018). Different from Dewi (2017) which shows contradictory results in Sinaga (2014); Pertamina (2016); and Sahputra & Diantimala (2018) that is, the market reacts positively to the restatement. This is because the market has not yet taken into account detailed information and requires further analysis. This difference in results can be concluded that the announcement of a financial restatement has an influence on stock returns. Therefore, this research aims to analyze differences in stock returns before and after financial restatement. The implications of this research can be used as a consideration for management to be careful in preparing financial reports because investors will react, and for investors to be careful about investing in companies that carry out financial restatements.

According to Brigham & Houston (2019) signal theory can be interpreted as actions used by companies as a way for investors to be able to carry out the company's prospects well. Signal theory states the importance of information provided by companies in investment decisions. Information is an important element for investors and business people because it can provide information, notes and a picture of the past and future of the company and the capital market. Capital market investors need complete, relevant and accurate information to analyze before making a decision to invest. Information published as a notification will provide signals for investors in making investment decisions. If the notification contains positive value, it is hoped that the market will provide a good response. Way used for report use is also found in signal theory, namely in the form of promotions or other information that makes the company look better than other companies. Companies that have profitable prospects will try to avoid selling shares, companies will also try to use other methods for any new capital needed, conversely if the company’s prospects are not profitable then the shares in the company will be sold (Sinaga, 2014). The formation of positive clues will make investors view this information as good news. On the contrary, if investors view the information as bad news, a negative signal will occur. After reviewing signal theory, it has two main elements, namely the signal itself, as well as the signal giver and receiver or what can also be called signaler and receiver. When a company carries out a financial restatement due to an error in the financial report, the company can be considered a signaller, but when there is a change in reaction by investors due to a financial restatement, this reaction is considered a signal receiver. With a signal in the form of a financial restatements announcement made by the company, investors will react so that the return that occurs after the financial restatements will be different from before.

Return are the results obtained when investing, while shares are proof of ownership of part of the capital in a company. So what is meant by stock return is the return received by investors for the investments they make (Legiman et al., 2015). The goal of an investor investing both long and short term is to obtain profits, either directly or indirectly, this is called return. The two components for calculating stock returns are dividends and capital gains/loss. Dividends are part of the company’s profits to be distributed to shareholders. Dividend distribution is usually only carried out during certain periods in accordance with company management regulations. This makes company management gain the trust of shareholders, while capital gain/loss is the difference in profit or loss because the current share price tends to be high or low compared to the previous period experienced by shareholders. So before making an investment, investors will consider two things contained in alternative information, namely risk and expected return. When investors make investments, investors will rely on the company’s financial reports as information because the financial reports are a benchmark for the level of return on profits that investors will get, but when the company carries out a financial restatement this will reduce investors’ perceptions of the reliability of the company’s financial report information and becomes a negative signal for the market and will then affect the stock returns obtained by investors.

Financial restatements is a restatement of financial statements that have been reported due to changes in accounting principles or incorrect accounting records. When a company's published financial statements experiences a financial restatement, it will give a signal that the financial statements cannot be trusted and is of relatively low quality and the existence of a financial restatements can cause investors to reconsider their assumptions about the company's future prospects, not only that. Financial restatements also raises questions about the credibility of a company's managers (Pertami, 2016). Financial restatements can be caused by an auditor's error in making the financial statements that has been reported corrected again, there are errors in carrying out accounting practices and systems due to changes in policy taken by the company, it can also be caused by certain alibis whose causes are unknown (Akadiati, 2018).

According to PSAK 25, companies carry out financial restatements due to two things, namely (Indonesian Accountants Association, 2018c): (1) Changes in accounting policies. This change is required only when PSAK requires it or this change creates financial statements that contain more reliable and relevant information regarding the impact of events, transactions and other conditions on the financial position, financial performance and cash flows of the entity. The new accounting policy for events, transactions and other conditions will be implemented by the entity as if the policy had already been implemented, it will cause the entity to have to carry out a financial restatement, it is concluded that the change is applied retrospectively. (2) Accounting errors. Matter this occurs when recognizing, measuring, presenting, or disclosing elements of financial statements. The financial statements will be declared not in accordance with SAK because the financial statements contains material or immaterial errors, whether intentional or not to obtain a presentation of a particular financial position, financial performance or cash flow, therefore it is necessary to correct the company's errors in the previous period by carry out financial restatements retrospectively.

Company it is mandatory to carry out a financial restatement if there is a change in accounting policy required by PSAK, this means that management is not suspected of committing fraud or manipulation in the company's financial statements, whereas if the change in accounting policy is carried out voluntarily or there is an error made by the company then a financial restatements is required. It is indicated that the company carried out this because of manipulation carried out by the company management. This research will use voluntary financial restatements or errors made by the company, while companies that are indicated not to have committed fraud because they are mandatory are not used in this research.

Financial restatements carried out by the company because it occurs voluntarily has several categories according to General Accounting Office (GAO) (2002): (a) Acquisitions and Mergers. According to the acquisition activity, this financial restatement category can be justified or not, so it can be interpreted as a form of misuse of accounting methods, the addition of profits or subtraction of losses related to the acquisition, (b) Cost or Expense.This type of financial restatement is caused by unnecessary costs or expenses, this occurs because the costs or expenses paid are not appropriate, irresponsible expenditure, or there are errors that result in errors in financial reports along with inappropriate taxes, (c) In-process R&D. The application of an accounting methodology that produces incorrect financial statements so R&D that is in process can be assessed when an acquisition occurs, (d) Reclassification. Restatement occurs because there are discrepancies in accounting items, because financial report items are not grouped properly, namely debts paid are categorized as investments, this is considered dishonesty, (e) Related party transactions. Financial Restatements occur due to inappropriate disclosures and inaccurate accounting work results, costs, debts or assets that involve transactions or relationships with related parties, (f) Restructuring, Assets, and Inventory. This restatement category occurs due to a decrease in asset value, errors related to investment accounting treatment, timing of impairment, goodwill, restructuring activities, valuation and inventory quality problems, (g) Revenue Recognition. This type of financial restatement occurs because work results are not properly recognized, so that unclear work results can be the cause of errors in income recording, (h) Securities Related. This restatement category is due to inaccurate accounting for derivatives, warrants, stock options as well as unreasonable conversions of securities or securities, (i) Other Issues. Financial restatementoccurs due to insufficient loss reserves, loan fraud, loan write-offs, bad credit, and accounting fraud or irregularities.

Financial restatement is not only done to improve the integrity of financial information, but can provide an opportunity for managers to misuse accounting data to use the complexity of restatement of financial reports carried out by managers to eliminate traces of earnings management and seek profits for themselves. *Financial restatement* is a restatement of financial statements that have been reported due to changes in accounting principles or errors in accounting recording(Pertami, 2016). If a company announces a financial restatement because there are indications of error or fraud, it will be a negative signal for the market. This is because financial restatements give a bad view of the company and the company is considered to be providing wrong information to investors. On the other hand, when the market assesses that the company has a big responsibility to admit its mistakes and will comply with regulations, then carrying out a financial restatement will make the company viewed positively (Dewi, 2017). The existence of this signal will make the market react and be able to respond to new information due to the announcement of a financial restatement(Sari & Harto, 2019),this is in accordance with the efficiency market hypothesis theory(Sinaga, 2014). This market reaction will cause differences in returns before and after the financial restatement is announced. According toDewi (2017)the company's condition became uncertain when the restatement was announced. This is because the financial restatements carried out by the company causes investors to lose their trust in the company(Sahputra & Diantimala, 2018). WhenGeneral Accounting Office (GAO) (2002)reported that the first day before and after the company announced its financial restatement, the average experienced a negative abnormal return, namely 9.5%. The average abnormal return doubled 60 days before and after the financial restatement, namely 18.2%. Investors will estimate the financial restatement before the announcement and begin to identify share prices that experienced a decline in the months before the announcement of the restatement of financial statements, thereby giving an increased impact on the company when announcing the financial restatement.

H1: There is a difference in stock returns before the financial restatement and after the financial restatement.

2. RESEARCH METHOD

The quantitative research design in the form of an event study aims to test differences in stock returns before and after financial restatement in manufacturing companies listed on the IDX in 2016-2019. The research used an observation period of 3 days before the restatement event and 3 days after the restatement event.

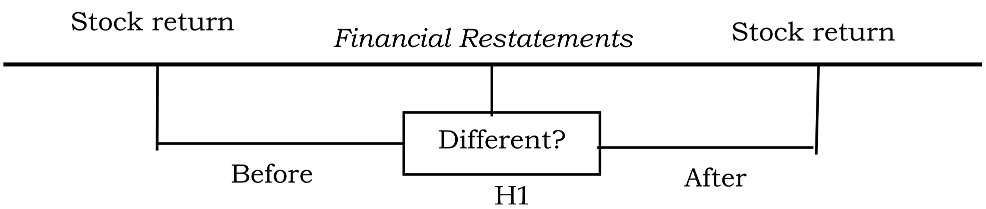

Figure 1. Analysis Model

The variable used is stock returns, namely the returns received by investors for the investments they make(Legiman et al., 2015). Measuring stock returns uses average abnormal returns, with the following steps:

a. Calculating Actual return is the return that occurs at time t which is the difference in the current price relative to the previous price (Hartono, 2010).

$$Ri,t = \frac{P_t - P_{t-1}}{P_{t-1}}$$

Information:
Ri,t = Actual return securities i in period t
Pt = Stock price in period t
P_{t-1} = Stock price in period t-1

b. Calculating IHSG stock returns or market returns on portfolio (Hartono, 2010).

$$Rmt = \frac{IHSGt - IHSGt\text{-}1}{IHSGt\text{-}1}$$

Information:
Rmt = Return daily market period t
IHSGt = Composite stock price index for period t
IHSGt-1 = Composite stock price index for period t-1

c. Calculating expected return or normal return is the return that should be obtained if no event occurs, so the normal return needs to be estimated (Hartono, 2010).

$$E(Ri,t) = Rm,t$$

Information:
E(Ri,t) = Expected return securities i period t
Rm,t = Return daily market period t

d. Calculating abnormal returns is the excess of returns that actually occur over normal returns (Hartono, 2010).

$$ARi,t = Ri,t – E(Ri,t)$$

Information:

ARi,t = Abnormal return securities i period t
Ri,t =Actual returns securities i period t
E(Ri,t) =Expected return securities i period t

e. Calculating the average abnormal return, the test is not carried out for each security, but is carried out in aggregate by testing the average abnormal return cross-sectionally for each event period (Hartono, 2010).

$$AARi,t = \frac{\Sigma^{N}_{i-t} ARi,t}{N}$$

Information:
AARi,t = Average Abnormal Return securities i period t
Σ^{N}_{i-t} ARi,t = Abnormal return on securities i period t
N = Number of securities affected by the event announcement

The data used is quantitative in the form of financial statements, publication dates of financial statements, and data to calculate abnormal returns such as stock prices and the composite stock price index (IHSG). The research object is a manufacturing company listed on IDX, with sample selection criteria: (1) The company is registered on the IDX during the 2016-2020 period consecutively, (2) The annual report is available on IDX website, and (3) The company carries out a financial restatements.

Data analysis was carried out using a difference test with SPSS version 23 software with the following steps: (1) Descriptive Statistics Test, (2) Normality Test, and (3) Hypothesis Test, using a different t-test with samples related to Mann-Whitney test (Ghozali, 2016).

3. RESULTS AND DISCUSSIONS

The research object was a manufacturing company registered on the IDX, where according to predetermined criteria, a sample of 44 companies was obtained. The results of descriptive statistical tests can be seen below.

Table 1 Descriptive Statistical Test Results

Day	N	Minimum	Maximum	Mean	Std. Deviation.
D-3	44	-.240692	.105265	-.00504698	.045020536
H-2	44	-.219256	.047839	-.00604969	.038587947
H-1	44	-.252151	.091361	.00327088	.048739622
H-0	44	-.327513	.070684	-.01038858	.060280179
H+1	44	-.035161	.061661	.00723853	.022664301
H+2	44	-.086091	.214598	-.00082032	.039966982
H+3	44	-.133344	.539515	.01011663	.089499675

From Table 1 shows that on days 3 and 2 before the financial restatement event the average value of stock returns was negative as well as on day 2 after the financial restatement event, while the positive average value occurred on day 1 before the event and day 1 and 3 after the event. The lowest average value was two days after the financial restatement announcement of -0.00082 (-0.082%), while the highest average value occurred three days after the financial restatement announcement of 0.010 (1%).

Table 2. Normality Test Results

One-Sample Kolmogorov-Smirnov Test								
		D-3	H-2	H-1	H-0	H+1	H+2	H+3
N		44	44	44	44	44	44	44
Normal Parameters, b	Mean	- .005046 98	- .006049 69	.003270 88	- .010388 58	.00723853	- .00082 032	.01011 663
	Std. Deviation	.045020 536	.038587 947	.048739 622	.060280 179	.02266430 1	.03996 6982	.08949 9675
Most Extreme Differences	Absolute	,229	,266	,247	,298	.125	,208	,287
	Positive	,183	,187	,168	,188	.125	,208	,287
	Negative	-.229	-.266	-.247	-.298	-.073	-.203	-.280
Statistical Tests		,229	,266	,247	,298	.125	,208	,287
Asymp. Sig. (2-tailed)		,000c	,000c	,000c	,000c	.008c	,000c	,000c

a. Test distribution is Normal.
b. Calculated from data.
c. Lilliefors Significance Correction.

Based on the normality test, it produces a statistical probability of the Kolmogorov Smirnov test of 0.00 < 0.05 respectively starting from H-3, H-2, H-1, H-0, H+2, H+3 so it is concluded that the data is not normally distributed which assumptions are not met. Meanwhile, H+1 shows 0.008 > 0.05 where the assumptions are met.

Table 3. Mann-Whitney Test Results

Test Statistics	
	AAR
Mann-Whitney U	1,000
Wilcoxon W	7,000
Z	-1,528
Sig. (2-tailed)	0.127
Exact Sig. [2*(1-tailed Sig.)]	0.200

Based on the Mann-Whitney difference test, it produces a sig value. of 0.200 is greater than 0.05, so it shows that the hypothesis is rejected, where there is no difference in stock returns before and after the financial restatements announcement. The results of this study are in line with researchSahputra & Diantimala (2018)where there is no difference in stock returns before and after the financial restatements event because financial restatements events are rare or rare so that few investors in Indonesia are aware of this event. This also shows that there is no increase in information asymmetry before and after the financial restatements in the stock market. Other similar research is also in line with the results of this research are Sinaga (2014) which shows that there is no significant difference between EPS and CFPS before and after the financial restatements occurred. Sinaga (2014) emphasized that the Indonesian capital market is in a semi-strong form where investors are less able to absorb and process the available information, or investors need a longer time to be able to evaluate information, especially information about financial statements. Investors look more at information that contains economic value which can increase or decrease the value of the company which will make the market react and can influence investment decisions which will have an impact on company returns. Atasoge et al. (2021)also supports that financial restatement has no effect on market reactions.

Financial restatements activities carried out by companies often give negative signals to investors because restatements carried out by companies tend to give investors a sense of distrust, but the results of this research show that financial restatements information does not influence investors' decisions to invest, which is thought to be because investors consider financial restatements do not contain information that can be used to determine company stock returns. Siregar & Rahayu (2018) supports the results of this research where in presenting company financial statements, sometimes accountants find things that require changes, so the financial statements need to be restated, therefore this is considered normal for investors so it does not influence investors' decisions.

4. CONCLUSION

Investors do not consider companies that carry out financial restatements as information that contains important value and this is considered a normal activity where in presenting financial statements sometimes accountants find things that require changes, so that investors do not react to the occurrence of financial restatements. As a result of the absence of this reaction, it will not influence investment decisions from investors or the market so it will not have an impact on company stock returns when a financial restatements occurs. Therefore, this research provides results that there is no difference in stock returns before and after the financial restatements announcement. The limitation of this research is the small sample because financial restatement events still rarely occur in Indonesia so it is less able to capture the impact of financial restatement events, therefore future research should increase the number of event windows and research periods.

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