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# The Changing Value Relevance of Accounting Information: An Overview

Hilda Octavana Siregar[1], Nashirotun Nisa Nurharjanti[2]
[1]Public Sector Accounting, Vocational College, Gadjah Mada University
[2]Accounting, Faculty of Economics and Business, Muhammadiyah Surakarta University
hilda.octavana.s@mail.ugm.ac.id

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**ABSTRACT**
This article aims to provide an overview of the value relevance of accounting information development for investors and creditors who are the primary users of financial statements. The traditional approach views stock prices as value relevance of the focal accounting information that can reflect the company's condition. However, during the last 2 (two) decades, the value relevance of accounting information has varied more, such as cash flow, operating profit, and tangible assets. Furthermore, value relevance for creditors is bankruptcy prediction, bond rating, loss frequency, fair value measurement, and changes in the company's accounting method. The change in the value relevance of accounting information is essential in increasing its usefulness and can contribute to research on the usefulness of accounting information in the future.

## INTRODUCTION

Based on the Statement of Financial Accounting Concepts (SFAC) No. 1, the purpose of financial reporting of business entities is to provide valuable information in making business and economic decisions. Although before the issuance of SFAC No. 1, it showed that external users were diverse but had the same characteristics, namely the need to predict future cash flows. Thus, SFAC No. 1 defended that financial statements should be general-purpose even though they are specific to investors and creditors (FASB, 1978).

Changes in the purpose of financial reporting transformed from the main focus on being accountable for company resources (custodianship/ stewardship/ accountability) to providing information for decision-making, such as cash flow information and providing financial reports (balance sheet, profit, and loss) (The Trueblood Committee, 1972).

Then in 2010, SFAC No. 1 was replaced with SFAC No. 8 Chapter 1 on the Conceptual Framework for Financial Reporting, which provides financial information about valuable entities to exist and potential investors, lenders, and creditors in decision-making regarding providing resources to the entity. It shows a disparity because in SFAC No. 1, the primary users are investors and creditors, while SFAC No. 8 is grouped into resource providers.

The objectives of this study are first, to describe the usefulness of accounting information; second, to review research articles on the usefulness of accounting information for investors; third, to review research articles on the usefulness of accounting information for investors; fourth, to review the value relevance of accounting information in the perspective of various countries.

## BACKGROUND

It is indispensable to prepare financial statements that are valuable for both primary users, investors and creditors, to fulfill the purpose of financial statements because they have different interests in accounting information. Investors are shareholders in the company who obtain the final residual rights from the company's assets. Meanwhile, creditors are users who acquire initial rights from the company's assets when the company is liquidated. Most investors provide resources longer than creditors, although there will be investors who only own aimed at reselling for a profit.

Investors obtain results in the form of dividends and arbitrage between the nominal price and the market price of the shares. Meanwhile, creditors receive interest and profit from the price difference between the transaction price and the nominal value of the debt if it is a bond). The need for accounting information for investors is the relationship between the profits presented in the financial statements that can describe the level of dividends received or reflect the market price of the company's shares. Investors attempt to analyze the financial statements presented by the company so that investors can avoid losses. It means that this difference is due to the various choices of accounting methods, which can generate different profits. Meanwhile, creditors need accounting information on the adequacy of the company's cash to pay debts that are due, which are presented in the balance sheet and cash flows.

Accounting information in the income statement contains accruals. It means that the amount of accounting profit is different from the amount of cash owned by the company. This difference illustrates the interests between the two primary users. When companies need to generate accounting profits that can affect stock prices on the stock exchange, companies can use accounting methods to increase profits, although the quality of the profits generated is poor. Meanwhile, creditors prioritize cash inflows or company cash income and override accrued income.

Accounting information for investors is contained in the company's financial statements, which result from financial statement analysis or fundamental analysis in making investment decisions. This analysis produces market values linked to accounting information. Hence, it can benefit investors to estimate the expected level of return and risk of investment (Puspitaningtyas, 2012). How investors react to accounting information is called the concept of value relevance that is closely related to the theory of decision usefulness of accounting information, which emphasizes increasing the usefulness of accounting information.

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Research showed that there was a change in value relevance to investors and creditors that the relationship between accounting information and valuation and bond returns has improved over the past 39 years (Givoly et al., 2017). It is different from the research results (Collins et al., 1997), (Marshall, 2000) and confirmed further in research (Givoly et al., 2017), which indicated a decrease in the relationship between accounting information and valuation and stock returns. However, several studies confirmed changes in different directions when there were differences in the usefulness of accounting information (Francis & Schipper, 1999).

Research stated that the value relevance of accounting information for investors has increased over the last 2 (two) decades. The level of income and changes in income were positively related to the stock pricing process while the balance sheet relationship did not behave, assets were positively associated with firm value, and liabilities were negatively correlated (Lam et al., 2013). Changes in accounting regulations (IFRS convergence) increase value relevance for accounting information (Outa et al., 2017) and (Rahayu & Setiawan, 2019).

Various studies that have been conducted for more than 20 years indicated different results. There were a decrease and also an increase in the relevance of the value of accounting information that could have an impact on decisions made by investors and creditors. It means that the usefulness of accounting information decisions must continue to be improved. Hence, it is valuable for both primary users.

## USEFULNESS OF ACCOUNTING INFORMATION

For accounting information to be useful and acceptable to users, it must be relevant (Olugbenga & Atanda, 2014). Relevance is only measured if it is significantly relevant to the market value of the company. However, if there is no significant relationship, it can be concluded that the accounting information is irrelevant (Bhatia & Mulenga, 2019).

The American Accounting Association's A Statement of Basic Accounting Theory (ASOBAT) in 1966, in developing the theory, began to consider objectives from the compiler's point of view enabling user-informed judgments and decisions. One of the goals issued by ASOBAT is to make decisions that focus on the use of limited resources. It is a prelude to accepting the goal of decision-usefulness in developing accounting theory.

Then, ASOBAT is valuable in searching for objectives compiled in the APB Statement 4 document on Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises issued in 1970, Trueblood Report and SATTA (1977). It groups theories into three, namely Classical, Decision-Usefulness, and economic information. These documents are the result of a goal-seeking project from each institution that becomes a meta-theory. These documents focus on the decision-usefulness of accounting information as it relates to value relevance.

## SPECIAL REQUIREMENTS FOR ACCOUNTING INFORMATION USERS

According to SFAC No. 8, valuable financial accounting information must meet two fundamental qualitative characteristics: relevance and appropriate representation. Relevance is the ability of accounting information to make a difference in decisions by assisting users to form predictions about the outcome of past, present, and future events or to confirm and correct estimates (predictive value and confirmatory value) within materiality limits.

Relevant accounting information for investors indicates that there is a significant relationship between accounting information in the financial statements and the company's market value, with the profit indicator being able to describe the predictive value of dividends or cash flows that investors will receive. Meanwhile, accounting information to confirm and correct this estimate can be shown by financial statements that are presented can be confirmed by previous transactions.

According to SFAC No. 8, the correct representation is the agreement between the measurement or explanation of the phenomenon to be presented. To be an accurate representation of accounting information must be complete, neutral, and free from error. It is done with 3 (three) stages, namely identifying economic phenomena, determining the most relevant information, and deciding the ability of the information.

Entities in presenting accounting information precisely always require a high cost. Something that

can be accurately represented in a measurement is always the opposite of verifiability. For accounting information for investors whose detailed presentation level is high, the comparability will be low. The measurement using the fair value of assets in SFAS No. 157 stated that level 1 presentation utilizes a market approach. The company's stock has a well-defined offering price, the market is active, and the assets are identical. Thus, the comparability with other stocks is low. For measurements with a precise level of presentation at level 2 using the income approach, active market, similar assets, and the offer price are not always the same. It is called a replacement cost measurement. Measurements with presentation accuracy at level 3 using a cost approach whose measurements utilize estimates, unobservable inputs, and high costs.

## VALUE RELEVANCE OF ACCOUNTING INFORMATION FOR INVESTORS

Accounting information in the form of earnings is beneficial for investors who can predict future cash flows through dividends received by them. Furthermore, earnings also can indicate a significant relationship between accounting information and the company's market value that is proxied by stock prices in the market without going through dividends.

### Another Profit Concept

Accounting profit is the result of the matching concepts between revenues and costs presented in the income statement. However, analysts stated that the accounting profit calculation is not yet complete. It is because other costs must be taken into account in making decisions due to determining a decision. Costs are not historical and have not yet been incurred, but the information can lead to different decisions. Thus, it impacts value relevance for users. This concept is called the Residual Income Model (RIM).

RIM provides a concise framework that relates accounting information to firm value and is widely used for estimating the value and cost of equity. RIM stated that company value is the sum of the book value and present value of expected future residual income. Thus, estimating future residual income is essential for RIM implementation (Cheng, 2005)"ISSN":"00014826","abstract":"This paper investigates the determinants of residual income scaled by book value of equity, i.e., abnormal return on equity (ROE. RIM is also known as Economic Profit (EP) or Economic Value Added (EVA). EP is the cost of investment at the beginning of the period or can also be defined by net operating profit after tax minus the capital invested multiplied by the average cost of capital.

EVA is only a measuring tool (if used correctly, it can be an effective tool), indicating whether or not the value created by the company is present. It can be assumed that EVA does not create but only measure value. EVA can be maximized by optimizing the company's share price and shareholder ownership. Corporate finances can improve after adopting EVA due to the measurement effect and productivity increases by eliminating valueless links (DiFonzo & Bordia, 1998).

Other profit concepts such as RIM, EP, or EVA attempt to present relevant accounting information. With the analysis of other profit concepts in the company, investors use accounting information in decision-making. However, research results do not support the claim of Stern Stewart & Co (2003) that EVA is superior to other measures in explaining stock returns (Ismail, 2006).

### Efficient-Market Hypothesis (EMH)

Based on modern financial theory, a decent theory is an efficient capital market theory. The term "efficiency" refers to the fact that investors do not have the opportunity to gain abnormal profits from capital market transactions compared to other investors. They cannot beat the market. So, the only way investors can earn more significant returns is by investing in higher-risk assets (Ţiţan, 2015).

An efficient capital market occurs when there are numerous sellers, buyers, and choices are available, and there are no limits. This efficient capital market is always associated with stocks on the exchange, active stocks, and no "inactive" stocks. Three categories of efficient capital markets are weak, semi-strong, and strong. Weak form efficient market conditions are seen from the stock price, which is determined from its history. Hence, no investor gains a profit above normal.

The semi-strong form of an efficient market is that stock prices on the exchange come from previous prices and contain all published information. Even though, it is not all information.

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Announced information is reflected in the stock price and absorbed instantly, without lag time, and unbiased. Meanwhile, the strong form of the efficient market indicates that the stock prices on the stock exchange contain published and unpublished information. Thus, almost no stocks operate strongly. Because in strong form efficient market conditions, there is no scientific theory for investors to analyze unpublished information.

As research in capital markets progresses towards more refined predictions and not only on the signs but also the magnitude of the value relevance coefficient, there is a belief that weak efficiency markets will have an essential role in value relevance (Aboody et al., 2017).

**Capital Asset Pricing Model (CAPM)**

The usefulness of accounting information for investors is proven empirically on the relationship between published accounting data and changes in stock prices. If there is a significant relationship, then there is evidence that accounting information is useful in the company's valuation. CAPM is a theory that describes the relationship between risk and returns on investment, both individual assets called the Security Market Line (SML) and portfolio assets called the Capital Market Line (CML) (Wolk et al., 2017).

Investors always expect high returns from every investment. However, if the expected return is high, it is continuously followed by an increased risk. The risk must be reduced to obtain optimal investment returns. One of the methods used to reduce the level of risk is to diversify investments called portfolios. CML showed that a certain weight of some assets could reduce the total risk of the portfolio.

Although by creating an investment portfolio, unsystematic risks can be eliminated. Meanwhile, systematic risks that can disrupt capital market conditions cannot be eliminated. So, when investors invest in individual assets, systematic risk must be a concern. Systematic risk is a measure of the volatility of an asset's return on the market portfolio. The higher the systematic risk compared to the market portfolio, the investment in the asset is riskier than the market portfolio.

Capital market research is mainly done to explore the relationship of accounting information reflected in stock prices. It is essential because it can observe the ability of the market to allocate resources efficiently depending on accounting information for analysis, assessment, and performance measurement. For standard-setters, capital market research is to examine the standards that can meet the objectives of efficiency and value relevance in accounting information for investors.

**Measurement of Value Relevance for Investors**

Some capital market research confirmed that value relevance is changing. Value relevance is not only seen from the financial statements published by the company, but investors also need to analyze to comprehend the condition of the company or use other profit concepts such as RIM, EP, and EVA.

Value relevance can be seen from the stock price, or the results of the interest accounting variables (Aboody et al., 2017), or earnings and book value that are frequently used. Thus, under semi-strong market conditions, stock prices can be used to measure value relevance because stock prices contain information that is published quickly and unbiasedly. In contrast to the weak form of efficient market conditions, it cannot provide information on the company's current condition because the stock price only includes previous values.

Several studies have shown that the cash flow variable can describe value relevance better because it has a significant relationship with stock prices compared to earnings and book value and RIM estimates (Pfeiffer & Elgers, 1999), (Aboody et al., 2017).

The increase in value relevance occurs in the IFRS convergence process using a market price research model and market investment returns. It is because the IFRS standard uses a fair value that can reflect the company's economic condition more and increase transparency in financial statements to intensify investor confidence in the company (Rahayu & Setiawan, 2019). Earnings levels and changes, book value, and RIM can change the relevance of accounting information for investors (Lam et al., 2013).

Research that compared between countries on the value relevance of accounting information gave different results. In Korea, book value and operating profit were the primary value relevance, while in China and its two special administrative regions

(China Mainland), earnings and cash flow were accounting information that had value relevance (Kwon, 2018).

A study resulted in a decrease in the quality of accounting information after adopting IFRS in Greece. The results of research in Asia showed that Chinese GAAP had more relevant value. In Australia, Ahmed and Goodwin (2006) concluded that local AGAAP increased the value relevance of accounting information than AIFRS. Few studies believed that IFRS adoption did not improve the quality of accounting information (Callao et al., 2007; Chalmers et al., 2008; Clarkson et al., 2010; Goodwin et al., 2008; Klimczak, 2011; Tsalavoutas). et al., 2012). The inconsistent results may be due to methodological differences between the studies, the background and situation of the country where the research was completed, differences in political, legal, and economic systems between countries, and existed socio-cultural factors between countries (Bhatia & Mulenga, 2019).

Based on the studies' opinion, the value relevance for investors can be indicated from earnings, cash flows, and changes in accounting rules. Concerning the objective of financial statements to provide information used in decision-making, standard setters must continue to update so that the resulting accounting information remains relevant to investors. Apart from accounting profit, other concepts that can provide information on the company's condition are also essential. However, financial statement preparers, standard setters, and external users must also approve these concepts. Hence, the same value relevance measure becomes precise.

According to Holthansen and Watts, most value relevance research assumed market efficiency. Although most value relevance research adopts the current measurement view, EMH has implications for any value relevance research that embraces the event approach, which is the standard method of information content research. According to Nilsson, market efficiency is significant for information content research, which assumes that investors actually use accounting information to make decisions. Nilson argued that an inefficient market would lead to less reliability because it relies on the assumption that investors immediately react to new information and use it to revise stock prices (Rebecca UI, 2015).

EMH is one of the conditions that can produce different value relevance. The semi-strong form of an efficient market is considered the best because it can absorb information optimally. Furthermore, the country's economic conditions also significantly affect the value relevance of accounting information. The more sophisticated an accounting standard that can perform transparency through financial reports, the more sophisticated it can affect the value relevance for investors. The accrual and cash-based accounting methods have differences in presenting financial statements, profit, and loss. The balance sheet contains accrual transactions and sometimes becomes less useful. Thus, the cash flow statement provides cash information so that investors can assess the company's performance in real terms.

## VALUE RELEVANCE OF ACCOUNTING INFORMATION FOR CREDITORS

One of the primary users of financial statements is creditors. Creditors are parties who provide resources to the entity but are not involved in activities. The right to gain a return is prioritized over investors. The investor is the last party to obtain the right of return. It can be seen from the financial statements presented, from the income statement presented firstly before other reports. Managers as agents receive employee benefits in the company's operational costs, including interest costs that are the results (returns) to creditors.

Meanwhile, investors can only own the final results in the income statement if there is a profit, and it is accepted at the General Meeting of Shareholders (GMS) to gain the result in the form of dividends. From the systematic preparation of the income statement, which can show the rights first, the value relevance of the two users is different. Although accounting information produced by managers is sometimes a rescue from the inability to fulfill obligations to creditors, it will impact accounting information that is biased for investors.

The Debt Covenant hypothesis stated that managers determine accounting choices to avoid defaulting debt contracts because they are expensive (Watts and Zimmerman, 1986). Chava and Roberts (2008) revealed that the violation of the Debt Covenant resulted in a significant

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decrease in the company's investment in the future because creditors took action to protect the pledged collateral (Dewi & Wirama, 2019).

These management activities can be detrimental to users of financial statements because those who comprehend the complete accounting information are the managers as preparers of financial statements, which can then reduce or create bias to the published information. Therefore, creditors must analyze the company's financial statements and not only observe what is published. Debt covenant violations can be seen by analyzing the debt-to-equity ratio (DER).

Empirical evidence on the effect of debt covenant slack on the value relevance of accounting information has not been found. However, other similar studies have found that the earnings response coefficient (ERC) of companies with lower DER tends to be smaller than the ERC of companies with higher DER (Dhaliwal et al., 1990; Moradi et al., 2010) (Dewi & Wirama, 2019).

One explanation is that in companies that tend to improve performance with higher debt than equity, information about company earnings will be more valuable to creditors because investors believe that companies will prioritize paying their debts over dividends. The lower the debt covenant slack, the lower the value of accounting information, i.e., profit and book value, is also low. The small value of debt covenant slack indicates that the company's actual DER tends to be high and close to the maximum DER limit or even has exceeded the maximum DER required in the debt covenant. It is in line with the empirical evidence put forward by Dhaliwal et al. (1990) and Moradi et al. (2010) (Dewi & Wirama, 2019).

***Bankruptcy***

Ratio-based accounting is beneficial in distinguishing between companies that go bankrupt and those that do not. Bankruptcy companies tend to have different financial ratios before bankruptcy than non-bankrupt companies. Predictability of up to five years before bankruptcy has been demonstrated. This finding does not mean that companies with "poor" ratios must go bankrupt in the future, but rather that bankruptcy may happen (Wolk et al., 2017).

A company may go bankrupt if it has lower income before interest and taxes to total assets, a more significant decline in net income, relatively low working capital to total assets, or high market-based leverage (total liabilities to the market value of assets). A more comprehensive model that concludes accounting information, market data, and company characteristics provides an estimate of future bankruptcy. This model is the most reliable model for predicting bankruptcy. It is consistent with different types of data considering various aspects of a company's financial difficulties.

The value relevance of accounting information through ratios is the method most often used by users of financial statements. Furthermore, the ratios can present the company's performance in one period, compared with previous periods, and also compare with similar industries or companies. The method used is the accounting-based method (ratio) and the market-based method.

Several research results ensured that accounting-based methods (ratio) are more significant in economic benefits than market-based methods. Two market-based models, one is based on Hillegeist et al. (2004), and the naive market-based model is according to Bharath and Shumway (2004). Both models are based on the contingency claims model by Black and Scholes (1973) and Merton (1974) and view equity as a call option on company assets with a strike price equal to the face value of the liability. The probability of bankruptcy is the probability that the call option will expire worthlessly or, in other words, the asset's value is less than the nominal value of the liability at the end of the holding period (Agarwal, V., & Taffler, 2008),

Through the bankruptcy prediction model, creditors can determine the expected return by combining the guarantees submitted by the company. When the possibility of a company going bankrupt is high, the cost of debt determined will also be increased, and the term will be short and vice versa. If the company is not predicted to go bankrupt, creditors will provide cheaper debt costs. However, the bankruptcy prediction model does not always indicate that the company will go bankrupt but present the possibility of going bankrupt. Bankruptcy prediction models assist creditors in decision-making. This model results can change decisions. Hence, the value relevance of the accounting information for creditors in the bankruptcy model is the higher the probability of going bankrupt.

***Credit Rating***

Accounting data is also related to bond ratings and default risk premiums. Among the essential ratios are profitability, earnings variability, and leverage. Research is also utilized to evaluate alternative accounting data sets related to bankruptcy predictions, bond ratings, and risk premiums. The issues examined were historical cost versus price level-adjusted income, the effect of lease capitalization versus non-capitalization, and recognition of pension liabilities versus footnote disclosures (Wolk et al., 2017).

*Credit scoring, bankruptcy prediction, and rating models must be robust on discriminatory to minimize the costs of providing credit to poor debtors or lost profits when suitable debtors are rejected. Discriminatory power can be interpreted that the model used can separate the credibility of the debtor.*

The usefulness of accounting information for creditors is categorized under the following conditions:

1. Creditors who buy long-term bonds
   When deciding to buy long-term bonds, the prediction of the company's bankruptcy comes first. It can be done with an accounting-based method (ratio) to predict the company's condition in the future, whether it is likely to go bankrupt or sustain. Accounting information for the previous 5 (five) years can predict conditions in the future.
2. Bonds that are not yet rated
   Accounting information can be used in decision-making when you want to purchase bonds that have not yet been rated. Accounting data is highly correlated with bond ratings. In companies with good financial performance, in general, the bond ratings are also good.
3. Low bond rating
   When a bond's rating is low, it should cost a high-interest rate. When the bond rating is low, interest may not be high. Accounting information can calculate the additional amount of costs that creditors must receive for a low bond rating.
4. Creditor approval
   When a debtor makes a loan application to creditors (banks and other financial institutions), the analyst will not convey a strategy for the application to be approved. However, the debtor can experiment from the accounting information submitted at the bank, what accounting information applications can be approved.

**Value Relevance Measurement for Creditors**

The results indicated that trends in accounting standard-setting orientation (such as a change towards fair value, reflecting an increasing emphasis on balance sheets) and standard adoption (in the form of increased conservatism) affect the value relevance of accounting information to creditors, which is supported by changes in economic factors (such as changes in the probability of default and rate of change in GDP). Changes in the content of accounting information to creditors from time to time are also affected by reporting factors. These factors are a change towards fair value measurement, an increase in conservatism, and an increase in the frequency of losses (which is also partly due to economic factors). The effect of these factors is partially mitigated by the increased intensity of intangible investment. The unique information needs of creditors, who are the primary group of financial statement users, can form and evaluate the merits of accounting standards. (Givoly et al., 2017).

In addition to bankruptcy predictions, bond ratings, the intensity of intangible assets, fair valuation, conservatism, and increased losses are the value relevance of accounting information for creditors. This information is not all explicitly presented in the financial statements, but there are also those that require an analysis process. This change in the value relevance of accounting information for creditors can be used as material for standard setters so that accounting information is relevant for creditors in making decisions.

## VALUE RELEVANCE OF THE ACCOUNTING INFORMATION IN THE PERSPECTIVE OF VARIOUS COUNTRIES

A study comparing accounting information's value relevance in Japan, China, and Korea through accounting profit, book value, net cash flow, operating profit, and net operating cash flow shows that accounting profit is the most relevant value in accounting information (Kwon, 2018). It can be concluded that accounting profit can be used from both investors and creditor perspectives because

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it is the most accessible indicator for companies to produce and is easy to interpret.

Research result (Bhatia & Mulenga, 2019) indicated that the value relevance of accounting information increases after the adoption of IFRS in Romania, Australia, Asia, Germany, and Africa (Pavithran et al., 2018).

On the other hand, some studies revealed that after IFRS adoption, there is a decrease in the value relevance of accounting information in Greece and China (Callao et al., 2007)"ISSN":"10619518","abstract":"EU Regulation 1606/2002 requires application of International Financial Reporting Standards (IFRS.

Research conducted by (Outa et al., 2017) stated that IFRS convergence results in higher value relevance in East Africa. The researchers argued that the benefits of revised/converged IFRS are captured by the increased relationship between stock prices, book value, and earnings and revealed that value relevance in East Africa was lower than in developed countries.

## CONCLUSION

The primary users of financial statements are investors and creditors, who are the primary providers of resources in the company. Financial reporting objectives must meet the needs of both users. In contrast, both users have different rights to the company's assets. Hence, the value relevance of accounting information is also different. Investors in making relevant accounting information must reflect the company's condition in the stock price. However, the need for accounting information for investors is currently broadening to other information, such as cash flows, changes in accounting methods that can demonstrate transparency and fair value measurement.

Meanwhile, creditor users need value relevance of accounting information on bankruptcy prediction, bond rating, conservatism, loss frequency, and fair value measurement. Although it looks different in the analysis, several value relevancies of accounting information for investors and creditors use the same accounting data.

This article concludes that accounting information can be used in making decisions by investors, as has been discussed by many previous studies, but nowadays sometimes other information becomes more useful in making decisions by investors, and in certain cases it can even be inversely related to accounting information.

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