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Impact of the mandatory IFRS adoption on the information content of earnings: Information Asymmetry and Analysts' Forecast

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Abstract— This paper aims to determine whether the application of IFRS / IAS (International Financial Reporting Standards/International Accounting Standards) for listed companies in the European Union since 2005 is beneficial in terms of the information content of earnings.
The relevance of earnings was reflected by the level of information asymmetry which is unobservable. That's why, we apprehend it in this study by financial analysts' forecasts (error and dispersion). So, the article purpose is to study the impact of IFRS adoption on the financial analysts' forecasts.
The years 2002-2012 are used as analysis period and we focus on the French context. Using all the companies that belong to the CAC All Tradable index for the entire study period, our results show a significant effect of this international standards on financial analysts' forecasts.

Keywords— IFRS, Information content, Information asymmetry and financial analysts' forecasts

I. INTRODUCTION

International openness is a source of proliferation of existing relationships between the different stakeholders of the company where each relationship can be characterized by an information asymmetry.

Solving problems of information asymmetry require the establishment of means of control. One of these means is the obligation of production and disclosure of the accounting and financial information that reflect the true financial position of the company. This is why, financial reporting can represent a source of reducing of information asymmetry. Reliability and relevance of financial information are based to the accounting principles applied in their preparation. Therefore, the main objective of accounting harmonization is to improve the relevance and comparability of earnings in order to properly assist to decision making. This improvement generates a reduction of information asymmetry.

Even if more and more countries adopt the International Financial Reporting Standards, there is a continue debate around the impact of their application on the information content of earnings.

According to Philippe Danjou, Chief of Accountant business in the AMF (Financial Markets Authority), the adoption of new accounting standards IFRS introduced a new estimation philosophy and upgrading business performance. They have a considerable impact on the financial reporting of companies and they change the meaning and the significance of several indicators used by investors. This impact is in terms of quality and quantity of information disclosed. But, even if the superiority of IFRS relating to the amount of information disclosed was undeniable, previous work showed two divergent reflections concerning the information disclosed quality. So, some researchers consider that IFRS improve the information content of accounting numbers because they lead companies to disclose more and better information and limit discretionary accounting choices. However, others consider that IFRS adoption is likely to reduce the information content of accounting numbers because it limits the number of authorized accounting policies.

Our study aims to analyze the impact of IFRS on the information content of earnings after the mandatory adoption on 2005 in the French context. Then, we examine the impact of the international standard on the information asymmetry. In this study, we focus on forecasts of financial analysts (error and dispersion) to apprehend the level of information asymmetry. Indeed, the analysts use the financial information to calculate forecasted earnings, that's why the accuracy and the dispersion of earnings forecast reflect the quality of earning information and the level of information asymmetry.

This research is one of the few to analyze the impact of mandatory IFRS on the information content of earnings through their impact on analysts' forecast properties. The majority previous studies have researched the effect of IFRS on the quality of the earnings by interesting on earnings management or on investor responsiveness to earnings announcement.

This paper is organized as follow. The first part discusses the relevant literature and develops hypotheses. The second part describes the research methodology adopted. The last part is devoted to the presentation and analysis of results obtained.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

A. IFRS and Earning information quality:

European Union imposed the application of IFRS in all listed companies from January 2005 as a result of unsuccessful attempts of harmonization. This decision is argued by the improvement of the financial information quality for better decision making.

The results found by researchers studying the impact of IFRS on the financial information quality are not similar. Several authors have confirmed the improvement of the explanatory power of the accounting numbers following the adoption of IFRS [15] [5]. By conducting a comparative study between companies that have mandatory adopted the IFRS and those that maintain local standards, [17] shows that the information content of annual earnings increases after the mandatory adoption of IFRS. This result was attributed to the existence of additional information under IFRS. Furthermore, the authors of [10] study the impact of additional informational relevance due to the adoption of IFRS in 2005 in several contexts. They test the relationship between stock returns and accounting numbers (earnings and equity). The results indicate that the impact of adopting IFRS on the informational relevance of accounting numbers is different from one country to another. The informational quality of earnings and equity was improved in the French, Spanish and Italian markets after the transition to IFRS but it has deteriorated in the UK and German markets. These authors concluded that the effect of adopting IFRS on the quality of accounting numbers depends on institutional factors in each country, which is confirmed by [29].

Recently, the authors of [2] conduct a meta-analysis of studies that verify the impact of adopting IFRS on informational relevance and reported revenues transparency. Their result shows that the informational relevance of equity did not increase after the adoption, while the informational relevance of earnings generally increased when they valued using pricing models. They also suggest that discretionary accruals have not decreased after the adoption of IFRS. The authors controlled for factors such as legal origin, accounting system and auditing and the difference between domestic GAAP and IFRS on the impact of IFRS and have not found any significant effect.

In addition, many studies have shown a similarity in the informational relevance of accounting data under IFRS and U.S. GAAP [25] [19]. This result can be explained by the fact that IFRS are inspired mainly from American accounting standards. By conducting a comparative study between companies from 20 countries that have adopted IFRS in 2005 and companies from countries that have not adopted IFRS, [1] shows the inexistence of significant differences between these two sets of firms in the informational quality of accounting data.

We contribute to this literature with a different approach that attempts to verify the impact of IFRS on the informational content of earnings through their impact on the properties of financial analysts' forecasts as a measure of asymmetric information.

B. IFRS and analysts' forecast properties

IFRS, the accounting language adopted by listed companies since 2005, gives more transparent, more rigorous and more detailed information. Therefore, it certainly had an impact on the financial analysis of companies.

The authors of [3] study the impact of differences between local standards and international standards in terms of disclosure requirements and evaluation effects on the accuracy of analysts' forecasts. By taking a sample of non American companies from 13 countries, they show that a high level of difference between the local accounting system and IFRS is positively associated with the absolute value of the error of the financial analysts' forecasts. This indicates that the more local standards are converged with IFRS, the more analysts' forecasts are accurate. So, they stipulate that the use of international standards informs analysts about the company economic and financial situation better than the local standards. This study is based on a sample of firms that have adopted the international standards between 1990 and 1993. During this period, firms could state that they adopt IFRS without applying them entirety, which is problem for the relevance of the results found. To resolve this problem, [8] focus only on the year 1999 from which firms are obliged under IAS 1, to comply with all IFRS, to declare that they use these standards. They find that the voluntary adoption of these standards leads to higher level of dispersion of financial analysts' forecasts and consequently to an increased uncertainty among analysts. [12] studies the relationship between the forecasts' error of financial analysts and company compliance with IFRS. The results suggest that compliance with the disclosure requirements of IFRS reduces the information asymmetry and strengthens the ability of analysts to provide more accurate forecasts.

The impact of the mandatory adoption of IFRS on analysts' forecasts has been also studied by [16] in the European context. The results show that the forecasts become more accurate and less dispersed after the adoption of the new accounting standards. These authors found that the adoption of IFRS improves the published results quality. In the same context, [14], with a sample of five countries (Sweden, Netherlands, France, Germany and the UK), shows that the mandatory adoption of IFRS has no significant effect on the accuracy of global forecasts of financial analysts. However, by comparing the IFRS impact between countries, they show an improvement in forecast accuracy in the UK, a country with local accounting standards more similar to IFRS, and no decrease in error forecasting in countries with previous accounting standards that differ from IFRS. They also show that, after adopting IFRS, the forecasts' dispersion seems to decrease in most countries. [27], by studying the impact of IFRS in 25 countries, shows that the quality of the forecasts of financial analysts is improved only for foreign analysts attracted by the adoption of these standards.

The heterogeneity of the results found by previous research shows that the question of the impact of IFRS on financial analysts' forecasts requires more exploration. That is why; we analyze in this study this relationship in the French context over a period ranging from 2002 to 2012.

C. Hypotheses development

Financial analysts collect and analyze companies' financial information to form an opinion on them. These opinions are expressed in research notes, earnings forecasts and recommendations to purchase, sell or retention of shares. Indeed, these outputs are informative to investors because their publication led to a market reaction that result in the observation of abnormal returns on the publication day or on the following day [11]. Moreover, the financial analyst is considered as a responsible of partial reduction of the asymmetry through his publication. According to [4], data from the financial statements are an important source of information for financial analysts. Furthermore and given the important role of financial analysts' forecasts in decision-making, these new standards are expected to improve forecasts of financial analysts. We predict that the mandatory adoption of IFRS in Europe is positively associated with analysts' earnings forecast accuracy. Therefore our first hypothesis is:

H_1: The forecasts analysts' accuracy will increase after the mandatory adoption of IFRS.

Through the earnings published after adoption of IFRS, companies should provide to different users of financial statements; especially the participants in the financial markets, information that enable them to assess the value of the firm.

According to [18], the adoption of IFRS will reduce the weight of private information as the result of the improvement of the quality and quantity of public information. That's why, the standards would lead to increased consensus among analysts. We, therefore, suppose that the mandatory adoption of IFRS in Europe is negatively associated with the degree of disagreement among analysts. So, our second hypothesis is:

H_2: The dispersion of the analysts' forecasts will decrease after the mandatory adoption of IFRS.

III. THE METHODOLOGICAL OPTIONS RESEARCH.

A. Model and variables of Research

To check the impact of IFRS on information asymmetry using the properties of analysts' forecasts (error and dispersion), we propose the following two models:

$$\text{Error}_{t,i}(EPS) = \beta_0 + \beta_1 IFRS_t + \beta_2 \text{Ln MktCap}_{t-1,i} + \beta_3 LnN_{t-1,i} + \beta_4 \Delta EPS_{t-1,i} + \beta_5 Decline_{t-1,i} + \beta_6 Loss_{t-1,i} + \beta_7 SDeps_{t-1,i} + \beta_8 FP_{t-1,i} + \beta_9 CS_{t,i} + \varepsilon \quad (1)$$

$$\text{Dispersion}_{t,i}(EPS) = \beta_0 + \beta_1 IFRS_t + \beta_2 \text{Ln MktCap}_{t-1,i} + \beta_3 LnN_{t-1,i} + \beta_4 \Delta EPS_{t-1,i} + \beta_5 Decline_{t-1,i} + \beta_6 Loss_{t-1,i} + \beta_7 SDeps_{t-1,i} + \beta_8 FP_{t-1,i} + \beta_9 CS_{t,i} + \varepsilon \quad (2)$$

The forecasting error is the difference between the expected profit and profit released. So it is expressed:

$$E(EPS)_t = EPS_{it} - \pi(EPS_{it})$$

With EPS_{it} = The earnings per share of firm i on year t

and $\pi(EPS_{it})$ = The average forecast of EPS for firm i in year t

The dispersion is determined for the absolute value of the difference between the highest forecasting and the lowest forecasting.

$$D(EPS)_t = | \text{forecast}_{h,i,t} - \text{forecast}_{l,i,t} |$$

To make comparability across firms, dispersion and error are normalized by the stock price of the company at t-1.

To calculate these variables, we use earnings forecasts submitted in 180 days starting 15 days after the beginning of the year. The choice of this period derives from the study's aim which is assessment of the informational content of earnings published by forecast EPS of year t. This procedure ensures that when the analyst makes his prediction, he takes into account the accounting information published.

The variable of interest is the IFRS adoption which refers to the change in the accounting framework following the mandatory adoption of IFRS in Europe since 2005. It is equal to 1 for years after 2005 and 0 otherwise.

It has been shown that the quality of forecasts varies with firm size. More accurately, the size of the company is negatively associated with the error and dispersion of financial analysts' forecasts [16]. Indeed, large companies may have access to more information more easily than small. Moreover, they are expected to have a high level of disclosure which leads to greater precision and less dispersion in financial analysts' forecasts. Similarly to prior studies [3] [16], we define firm size (LnMktCap) as the natural log of a firm's market capitalization at the end of year t-1.

The number of analysts is another variable that may have an impact on the forecasts quality [18] [22] [16]. It is determined by the natural logarithm of the number of analysts following the company and providing earnings forecast in the final consensus forecast for year t [18]. This variable is positively associated with forecast accuracy and negatively associated with the dispersion of financial analysts' forecasts. [22] argues that there is more competition among analysts when the number of analysts increases. These will be more incentive to forecast accurately. So, the firms followed by a high number of financial analysts will have more accurate forecasts and a higher level of forecasts' dispersion.

It is widely discussed in the literature that the change in the firm's result have an effect on financial analysts' forecasts [18] [24]. So, forecasts for firms with more variable results are less accurate and the dispersion is higher. Furthermore, [13] shows that the results variability makes the forecasting more problematic. So, more the change in result of two successive years is great, more difficult will be forecasting profits. Δ EPS is measured by the absolute value of the change in EPS of firm i between t-1 and t

Because financial analysts are subject to conflicting interests and firms in difficulty tend to disclose little information to point out its difficulties, analysts anticipate imperfectly losses [23]. Forecast error and dispersion tend to be higher when the announced EPS is negative or significantly fall. Financial distress is approached through Decline and Loss.

Decline is a binary variable which designed whether the result of the year t has been increased or decreased compared

to result of the year t-1. In addition Loss is a binary variable which designed whether the result of the year t is solvent or insolvent. These two variables are expected to be positively associated with the error and forecast dispersion. In fact, financial analysts are optimistic agents that tend to underestimate profit falls and losses. Indeed, [6] confirms that it is easier for analysts to forecast profits as losses and increases profits rather than decreases. The obtained results suggest that the "type and variation of profit expected" is by far the effect that best explains the accuracy and dispersion of forecasts.

Decline takes the value 1 if the result of year t is less than that of the year t-1, 0 otherwise and Loss takes the value 1 if the result for the year t is negative, 0 otherwise.

SDeps represents the standard deviation of EPS for firm i calculated over the four years preceding the year relative to estimated EPS [23]. It is standardized by the stock price of the company concerned in t and it aims to assess the difficulty of forecasting. The dispersion and the error increase with the increasing of this value [18]. In fact more the benefits of the firm are fluctuating less forecasting profits is easy.

The financial performance of the company, as measured by the standard deviation of ROE based on the five years before year t, is positively associated with forecast error and forecast dispersion [16]. According to these authors, it is difficult to have accurate forecasts and less dispersed forecasts where the financial performance varies widely.

The last control variable is the financial crisis. Financial capitalism has entered a deep crisis in 2007. This crisis, at first banking and located in the American mortgage market, quickly became global and financial. It led to a heightened uncertainty in financial markets, which creates problems of asymmetric information and makes the collect of the necessary information more difficult which increases the difficulty of the work of the financial analysts. That's why, it is expected that crisis is positively associated with the error and dispersion of analysts' forecasts.

The effects of this crisis persist until now but the main effects can be limited to the three years 2008, 2009 and 2010. So this variable takes 1 for the years 2008, 2009 and 2010 and 0 otherwise

The impact of IFRS on financial analysts' forecasts is tested using a panel data model and the regression is performed using STATA.

B. 2.2. Sample and data

To conduct our empirical study, we have taking as a sample all listed French companies in the CAC All Tradable Index. According to [7], this index reflects the diversity of the implementation of IFRS and it is the best type of sample that can draw conclusions on the application of international standards.

[9] shows that France is one of the European countries where the accounting standards are most different from IFRS and subsequently the mandatory adoption of IFRS in 2005 has led to a profound change in the Financial reporting. Furthermore, the study of French context enables us to determine the effect of the adoption of IFRS and generalize the results to all companies of Europe because the adoption of IFRS is mandatory for all companies listed in Europe from January 2005.

The exam of the impact of IFRS taking as sample one country aims to eliminate any biases associated with the use of international samples and to avoid the effect of differences in institutional environments before adopting IFRS.

Firms in financial sectors identified by Global Industry Classification Standard, such as insurance companies, credit agencies and banks are excluded. This treatment is justified by the specific accounting and financial characteristics of these organisms. According to [28], these companies have special characteristics that might bias the results.

This study spreads over 11 years from 2002 to 2012, while eliminating the transition year. There are three lines of research: [16] considers that the transition year is the first year of mandatory adoption of IFRS 2005, [26] considers that the year of transition is the year prior to the year of the mandatory adoption of IFRS 2004 and [21] considers that the two years 2004 and 2005 represent transition years.

According to [26], managers are more likely to manage their results during the year preceding the year of the mandatory adoption of IFRS to avoid large fluctuations in results and to keep them within a certain range at the time of mandatory adoption. The year 2004 was a year of comparative financial statements where many companies had practiced a double set of books. Indeed, the presence of two repositories on the same financial markets during the same period may bias the results. Based on this postulate, the year 2004 considered as a transition year is excluded.

For the dispersion, the observation characterized by a single financial analyst is eliminated. To test the dispersion of financial analysts' forecasts, the firm must be necessarily followed by at least two analysts. In both sample (forecast error and dispersion) analyst coverage ranges from 1 (2 for dispersion) to 16.

The observations which data are missing or extreme are eliminated. Subsequently, our final sample for the first model consists of 620 observations and for the second model consists of 470 observations.

To collect data, we have taken the market data from the database Datastream, data from financial analysts' forecasts from I / B / E / S data and annual reports from Worldscope data.

IV. RESULTS

This study is based on a sample of panel data. Given that, it is necessary to verify the specification of a homogeneous or heterogeneous of data. The Hausman specification test is used to discriminate between fixed and random effects.

The results of this test shows for the first model a chi 2 = 66.28 with prob> chi2 = 0.0000 and for the second model a chi 2 = 35.24 with prob> chi2 = 0.0001, which leads us to retain the fixed-effect model to estimate our models.

For the first model, the empirical results show that 13.87% of the variation of forecasts' error is explained by the

mandatory adoption of IFRS and the control variables. Fisher which is equal to (9.39) confirms the good quality of the model to a level of less than 1% significance. Thus, we reject the null hypothesis and states that the regression is significant as a whole. We can conclude that the first model is statistically significant and is explanatory of the phenomenon.

For the second model, the empirical results show that 29.96% of the variation of forecasts' dispersion is explained by the mandatory adoption of IFRS and the control variables. Fisher which is equal to (18.16) confirms the good quality of the model to a level of less than 1% significance. Thus, we reject the null hypothesis and states that the regression is significant as a whole. We can conclude that the second model is statistically significant and is explanatory of the phenomenon also.

Table 1 and 2 present the result regression.

TABLE I
Regression results of the forecast error

Variables	Coef	Std Err	Z	P>|z|
IFRS	-0.3058435	0.1383457	-2.21	0.027**
LnMktCap	2.050188	0.2557701	8.02	0.000***
LnN	-0.5515764	0.227091	-2.43	0.015**
Δ EPS	1.534083	1.123732	1.37	0.173
Decline	0.00334	0.1016097	0.03	0.974
Loss	0.1219101	0.1810679	0.67	0.501
SDeps	3.073188	0.8231506	3.73	0.000***
FP	-0.0012904	0.0078931	-0.16	0.870
CS	0.1325218	0.1126179	1.17	0.243
Cons	-7.42695	0.9025087	-8.23	0.000***

R-sq = 0.1387
F(9)=9.39, Prob>F=0.0000

*Significant at 10%; **significant at 5%; ***significant at 1%.

TABLE III
Regression results of the forecast dispersion

Variables	Coef	Std Err	Z	P>|z|
IFRS	-0.1629718	0.0746438	-2.18	0.030**
LnMktCap	-1.46756	0.1442288	-10.18	0.000***
LnN	0.6912199	0.1660021	4.16	0.000***
Δ EPS	0.5779029	0.6218222	0.93	0.353
Decline	0.0279066	0.0575631	0.48	0.628
Loss	0.1904854	0.1116574	1.71	0.089*
SDeps	-1.211483	0.5406442	-2.24	0.026**
FP	0.0885813	0.004133	2.08	0.039**
CS	0.0575778	0.067012	0.86	0.391
Cons	5.654989	0.5362386	10.55	0.000***

R-sq = 0.2996
F(9)=18.16, Prob>F=0.0000

*Significant at 10%; **significant at 5%; ***significant at 1%.

Our research question is to analyze the impact of the mandatory adoption of IFRS on the financial analysts' forecasts. Statistical tests show that IFRS adoption is negatively associated with the properties of analysts' forecasts namely error and dispersion.

Indeed, an examination of causal relations shows that the coefficient associated with the link between the adoption of IFRS and the error of analysts' forecasts is negative (-0,305) and statistically significant (0.027). Therefore, the first hypothesis is confirmed. In addition, the results show that the coefficient associated with the link between the adoption of IFRS and the dispersion of analysts' forecasts is negative (-0,162) and statistically significant (0.30), which also confirms our second hypothesis research.

These results show that the mandatory adoption of IFRS in 2005 produces an improvement in the quality of financial analysts' forecasts. Indeed, the forecasts are more accurate and less dispersed after the adoption of IFRS which corroborates the results found by [16].

The financial analysts' forecasts were used in our study as a measure of information asymmetry level of a given company. Furthermore, the reduction in error and forecast dispersion reflects a reduction in information asymmetry. This result highlights the informational contribution of the adoption of this new international standard which allows to conclude that the mandatory adoption of IFRS represents a source of improving the information content of accounting earnings.

The results of the regression of the two models highlight the existence of several significant relationships between the dependent variables (error and dispersion) and the control variables.

The forecast error is significantly and positively associated with firm size, the standard deviation of EPS and negatively associated with the number of financial analysts. In addition, the forecast dispersion is significantly and positively associated with the number of financial analysts who follow the company, the loss and the financial performance and negatively associated with the size of the company and the standard deviation of EPS.

The positive association found between the error and the size of the company is opposite to that found by [16] and to our expectations and similar the result of [23]. According to these last authors, this result can be explained by the complex assets and activities of large companies. In these companies, the traditional communication tools such as accounting numbers are unable to give a clear idea about their real situation. There are companies whose economic reality is hard to grasp. On the contrary, the size is negatively associated to the forecast dispersion which can be explained by the higher possibility of large companies to access to further information.

The standard deviation of EPS is a measure of the results instability which represents a source of forecast difficulties. So, the increase of instability generates a higher level of error and a low forecast accuracy. The negative effect of this variable on forecast dispersion may be explained by the analysis period. In fact, in times of crisis, financial markets are characterized by a high instability which led analysts to reconcile their forecasts to previous results.

The negative relationship between the forecast error and the number of financial analysts is explained by the competition among the analysts. When the number of analysts following the company is higher, each analyst aims to forecast more accurately than other and consequently the forecast error decreases and the forecast dispersion increases.

It is confirmed by the results obtained that the losses which captures the financial distress and the variation of the financial performance increase the forecast dispersion.

The non-significant effect of the crisis on error and dispersion of financial analysts' forecasts can be explained by the analyst's reaction to this critical period. Faced with the risk of committing significant forecast errors, the analysts are forced to intensify their research. According to [20], financial analysts, in times of crisis, most follow market movements to eliminate any estimates errors.

V. CONCLUSION

Our study focuses on a major objective of the mandatory adoption of IFRS in Europe dice 2005, which is the improving of the relevance of earnings. To answer our research question, we tried in this study to determine the impact of these standards on the information content reflected by their impact on information asymmetry. To do this, we have used the financial analysts' forecasts as a proxy of information asymmetry. We took as sample all of the CAC all tradable for the period 2002-2012.

The results show that the information content of earnings is improved after the mandatory adoption of IFRS and this improvement is reflected by a reduction of error and dispersion of financial analysts' forecasts. The financial analysts' forecasts are more accurate and less dispersed after the mandatory adoption of IFRS.

The originality of this study lies in analyzing the impact of mandatory IFRS on the information content of earnings through their impact on analysts' forecast properties and in taking a 10 year period from 2002 to 2012 as a period of study. This eliminates all bias due to the learning of these standards.

The results provide evidence relevant to the continue debate about the benefits of international accounting harmonization. Even if the adoption of IFRS is mandatory diced 2005 for all listed European companies, the impact of these standards may be dependent on the specific institutional factors in each country. This study can be enriched by the inclusion of several European countries to clearly identify the impact of institutional environments.

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