

## The Mandatory Adoption of IFRS and Timely Loss of Recognition

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### ABSTRACT

The purpose of this article is to study the effect of the mandatory adoption of IFRS on accounting conservatism in the French context. The problem raised by this research is therefore to study the impact of the mandatory adoption of IFRS on the degree of accounting conservatism. Our problem is articulated as follows: What is the impact of the mandatory adoption of IFRS on accounting conservatism? in order to respond to our problem, we have chosen to refer to French companies belonging to the SBF 120 index. these companies have therefore been monitored over the period from 2003 to 2012.

In order to analyze the effect of the mandatory adoption of IFRS on accounting conservatism following an in-depth review of the accounting literature, we used two econometric models: Basu's (1997) and Khan and Watts' (2009)... Following Basu's (1997) model, we concluded that the adoption of IFRS had a positive impact on the level of accounting conservatism. In other words, the transition from local accounting standards to IFRS has led to an increase in the level of prudence for these French companies, these companies anticipate losses better than before. Since Basu's (1997) model has been strongly criticized in the accounting literature, we have used a more recent model, Khan and Watts' (2009) model, to test the impact of IFRS adoption on the level of accounting conservatism. Based on Khan and Watts' (2009) model, we concluded that during the overall study period these companies did not incorporate bad news into the accounting result, but more specifically the existence of accounting conservatism was noted only for the years 2007, 2008.

Thus, in the light of the results we have achieved, we are able to affirm that the transition to IFRS has had an impact on accounting conservatism; a positive impact according to Basu's (1997) model over the so-called post-IFRS adoption period and an overall negative effect according to Khan and Watts' (2009) model.

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## 1. INTRODUCTION

Following the various financial scandals that shook the international economic sphere as well as the bankruptcy of large internationally renowned companies such as Enron and Vivendi which represented the epitome of transparency, a climate of endless doubt has emerged. Indeed, Culpan and Trussel (2005) and Chih and *et al.* (2008) have stated that the financial crisis is the combined result of two factors: failing governance mechanisms, as well as a lack of transparency in accounting information.

From now on, the privileged users of accounting information who are investors following an Anglo-Saxon accounting orientation have become increasingly sceptical about accounting information disclosed through financial statements. Those investors who in the past decades considered accounting information quality information because it emanates from official documents that are the financial statements are now asking the ultimate question: is the disclosed accounting output a quality output when is this information voluntarily manipulated by management to produce accounting information that most closely matches investors' expectations.

Thus, among the regulations put in place at the international level, the IFRS international accounting standards put in place by the IASB, the body responsible for drawing up these financial reporting standards, constitute an interesting regulation in the sense that this regulation aims to ensure that all companies refer to the same accounting language.

IFRS are therefore international accounting standards that have been put in place by the international accounting standard-setter to ensure the transparency of accounting information through the reduction of the unavoidable informational asymmetries that exist between producers of accounting information and capital providers who are investors. 2005 was a pivotal year in the history of international accounting standards because the international accounting standard-setter has legally imposed the adoption of IFRS for listed companies that are members of the European Union.

It should be noted that IFRS are standards that have been judged by a large number of countries as being of "high quality" (Daske et al. 2006), even if in some contexts the adoption of IFRS has not had the expected effect (Khan and Baig, 2016).

Most research has therefore recognized the salutary contribution of IFRS, as an example in the international context Houque and *al.* (2015) analysed the effect of the transition to IFRS on one aspect of the quality of accounting information, namely the earnings management... After analysis,

these researchers confirmed that IFRS are high-quality standards since, following empirical analysis, a significant decrease in abnormal accruals has been observed...

Defending the idea of high-quality accounting information, the international accounting standard-setter has resumed the qualitative characteristics that the accounting output must have within its conceptual framework, which is a sort of a constitution. In order to meet investors' informational needs as much as possible, accounting information must therefore have the following qualitative characteristics: value relevance, loyalty, comparability, verifiability, speed and finally understandability or intelligibility. Indeed, as part of our research, we have decided after a careful review of the accounting literature to focus on the concept of accounting conservatism, which is the equivalent of the precautionary principle. Indeed, our choice to focus on this concept is based on two reasons: first, a review of the literature, rich in the diversity of results that have dealt with the association between the adoption of IFRS and accounting conservatism; second, the reevaluation of the principle of prudence in the new conceptual framework.

Thus, the issue underlying this article is as follows: what is the impact of the mandatory adoption of IFRS on accounting conservatism?

It should be stressed that the attribute of accounting conservatism has not given rise to an abundant literature, particularly in the French context, and it is, therefore, one of the reasons why we will try to enrich accounting literature through our study. We will therefore see whether the mandatory transition to IFRS of companies included in the SBF 120 index has led to an increase or decrease in the level of accounting conservatism.

It should be noted that we have chosen to refer to the French context because it is more interesting to test the impact of accounting standards with an Anglo-Saxon orientation in a non-Anglo-Saxon environment than in an Anglo-Saxon environment... Indeed, in accordance with the French vision of accounting, information is a fundamental basis for the presentation of accounts, whereas according to the Anglo-Saxon conception of accounting, accounting information constitutes a privileged strategic source when investors make their decisions.

Thus the main motivation for this research is to prove that the mandatory transition to IFRS for French companies has been beneficial, because due to IFRS accounting information is a prudent information allowing the investor to be informed in time of any useful information relating to the mobilisation of his funds. In other words, IFRS are

international accounting standards with an international focus that promote transparency, which work in favour of the interests of investors who are inevitably victims of information asymmetry. Thanks to IFRS, investors will be able to obtain information at the first signs of potential losses. Indeed, by following a chain approach, investors will obtain financial gains over the long term.

The interest of our research is in particular to prove to companies that still refer to local accounting standards that the rigorous application of IFRS upstream makes it possible to meet the information needs of investors downstream, who, following the various financial scandals, are increasingly demanding in terms of the quality of accounting information... Thus, compliance with IFRS for these companies will enable them to gain the confidence of investors, on the one hand, and to disclose prudent accounting information, on the other hand, guarantees the company's long-term sustainability.

Our article will therefore be composed of two main sections: in a first section we will analyze the principle of timely loss of recognition by first using the vision of the different accounting standard setters and then we will refer to the conception of timely loss of recognition according to the different researchers. Through a more or less exhaustive review of the accounting literature, we will examine the relationships between timely recognition of loss and the mandatory adoption of IFRS. In a second section we will proceed to the empirical analysis that underlies our research work. Finally we will conclude.

## **2. TIMELY LOSS OF RECOGNITION OR THE PRINCIPLE OF PRUDENCE**

### **2.1. Timely Loss of Recognition as Perceived by the Various Accounting Standard Setters**

As any discipline accounting has evolved in response to social and economic changes, so while accounting was originally only a means of accountability in the event of disputes, nowadays accounting has evolved and has become a privileged means of enabling investors to make strategic decisions.

Nowadays, as investors are increasingly suspicious of disclosed accounting information, they accept to mobilize their funds on the condition that the information conveyed through the financial statements is accounting information that displays high levels of transparency. Indeed, Capiez (1998) defined the notion of transparency as the ability of accounting and financial information to provide the most optimal information to any

interested party on the company's situation at a given time as well as on its profitability. Given that it has been proven in numerous previous studies that even if investors aspire to fully transparent information, the reality is quite different, since, according to the agency theory initiated by Watts and Zimmerman (1978), the delegation of power from the principal, who holds the capital to the agent, leads to an unavoidable asymmetry of information. Thus, the manager, being naturally opportunistic, will take advantage of his informational advantage to deprive the principal, who will have to bear so-called agency costs in order to try to minimize this informational asymmetry.

In a context of informational asymmetry, timely recognition of loss is an effective alternative to combat this informational asymmetry... It should be stressed that the concept of timely recognition of loss is an important one and occupies a special status among the various accounting standard setters.

The American accounting standard-setter was a pioneer in defining timely recognition of loss. Thus, with reference to SFAC n°2, the principle of timely recognition of loss has been defined as follows: "A prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered". Through the definition of the American accounting standard-setter, timely loss recognition of loss is a prudent attitude of the accountant in order to verify that, on the one hand, the risks specific to companies have been measured at their fair value and, on the other hand, uncertainty has been taken into account. It should be noted that according to Givoly and Hayn (2000), the most official definition of the concept of timely recognition of loss is that put forward by the FASB, the American accounting standard-setter.

Later in 1989, the international accounting standard-setter defined the timely recognition of loss as an attitude to be adopted under conditions where the environment is characterized by continuous instability, and this prudent attitude prevents accountants from overstating gains and understating losses.

As it is always concerned that international accounting standards should be standards that are in line with the real needs of the market, the IASB made certain amendments to its conceptual framework in 2010 that did not concern the principle of prudence. In 2015 in his exposure draft, the international accounting standard-setter stated that accounting information must be neutral information, neutral information is information based on the principle of prudence. Finally, in 2018, on 29 March 2018, the IASB published its new conceptual framework, which specifies that high-quality accounting information is information that has

both essential and auxiliary qualitative characteristics. Indeed, among the essential qualitative characteristics are fidelity, according to this new “constitution of the international accounting standard-setter”, the accounting output is said to be faithful when it fully reflects an economic reality, without any bias and taking care not to make so-called significant errors, etc.. It should be noted that the accounting standard-setter has specified in particular that information that does not take any bias constitutes neutral information. This neutral information is based on the principle of prudence.

In short, what we can learn is that the general trend of the international accounting standard-setter is in favour of prudent accounting, averse to risk even though according to Mora and Walker (2015) at present there is no research-based on empirical validation that has recognized the supremacy of prudent or conservative accounting over dynamic accounting and vice versa. These researchers have particularly stated that there is no standard accounting system adapted to all economic entities, and that timely recognition of loss is not applied in a standard way, in particular, it depends on factors other than those relating to accounting.

Therefore, the accountant must take a certain degree of precaution to disclose to investors via the financial statements accounting information similar to a market fluctuations resonance fund. The aim is to enable investors to pursue the most optimal investment policy, i.e. a policy that moves away from both over- and under-investment.

Thus, after having presented the concept of accounting conservatism from the perspective of the various accounting standard setters, we will present in the following a more or less exhaustive reviewing literature on accounting conservatism.

## **2.2. Review of The Literature on Timely Loss of Recognition**

Before moving to the various definitions of timely recognition of loss it is relevant to note that the very term accounting conservatism is an Anglo-Saxon term, the notion of prudence represents an equivocal notion, following a continental accounting orientation, since the term accounting conservatism was first mentioned by Bliss (1924).

Indeed, according to Bliss (1924), timely recognition of loss is the result of “anticipate no profit, but anticipate all losses”, in other words, it is more beneficial to anticipate potential losses than to anticipate gains that may not be realized... Thus what we can affirm is that already in 1924 the need to opt for prudent accounting was felt.

Later in 1985 Belkaoui argued that timely recognition of loss is based on the fact that it makes more sense to record assets but especially income at their lowest value and expenses as well as debts at their highest value.

Watts and Zimmerman, who initiated agency theory in 1978, proposed a definition of accounting conservatism in 1986. Indeed, according to these researchers, timely recognition of loss is the fact that the accountant chooses the lowest valuation to record assets and the highest valuation to record liabilities from among all the options at his/her disposal.

In 1997 Basu stated that timely recognition of loss is the fact that accounting practitioners impose a higher degree of conservatism to recognize so-called favourable news when the same requirement is not required to recognize unfavourable news... Thus, following this definition we retain that accounting conservatism militates in favour of prudent disclosure, thus warning against risk.

According to Penman and Zhang (2001), timely recognition of loss is the accounting option that links assets to their smallest book values.

### **2.3. The Two Types of Accounting Conservatism: Conditional Conservatism/Unconditional Conservatism**

Indeed, in 1997 Basu pointed out that “pervasive conservatism” refers to an accounting conservatism that is not dependent on information, while “news-driven asymmetric recognition” is modulated according to the news updates.

It should be noted that many researchers have defined these two types of accounting conservatism. In this respect, we refer to Beaver and Ryan (2006) who pointed out that conditional conservatism is the fact that the accountant records assets in the accounts under so-called unfavourable conditions, which therefore implies an undervaluation of assets.

According to Watts and Holthausen (2001), conditional conservatism is based on a set of precautions that the accountant must take to record losses as soon as the first indicators are available, since, according to these researchers, the purpose of this so-called conditional conservatism is on the one hand not to trigger investors and on the other hand to prevent companies that opt for accounting characterised by excessive overvaluation from being subject to justice.

Givoly and *al.* (2007) have argued that conditional conservatism is only a reflection of accounting that focuses on changes in value.

As for the so-called unconditional conservatism, this concept was defined by Beaver and Ryan (2005) as “the book value of net assets is understated due to predetermined aspects of the accounting process”. Thus, from this definition, we can confirm that this type of conservatism is based on an undervaluation of the book value of the so-called net assets through specific aspects of the accounting process. In 2003 Watts argued that unconditional conservatism has a strong presence in socio-economic contexts where tax burdens are high.

In short, to conclude on these two types of accounting conservatism, we will present in the table below the foundations of these two types of accounting conservatism

**Table 1**  
**The foundations of the two types of accounting conservatism**

<i>Conditional conservatism, conservatism imposed on leaders</i>	<i>Unconditional conservatism</i>
Asset accounting is based on economic values	Asset accounting is based on historical cost
It is the result of environmental changes in market value	Unconditional conservatism is the result of the leader’s decision-making choice
Different econometric models can evaluate this type of accounting conservatism	Unconditional conservatism is difficult to quantify because it depends on the manager’s decision-making choices and therefore econometric models have proven to be inadequate to measure this type of accounting conservatism

#### 2.4. Accounting Conservatism and the Adoption of IFRS

After a careful review of the accounting literature, we noticed that a significant number of studies have established a relationship between IFRS and the quality of accounting information. Since the concept of quality is a multidimensional concept (Gaio, 2010), researchers have conducted studies in which they have chosen to study the effect of IFRS on a particular attribute of accounting information. Dayanadan and al (2017) investigated the association between the quality of accounting information and earnings management over two periods: the first period 2002 - 2004 was used of pre-adoption of IFRS, the second period 2005 - 2008 was used of post-adoption, it extends from 2005 to 2008. In order to test this association, these researchers chose as a sample companies from Western Europe (Denmark, Belgium, Greece, Switzerland, Finland...), companies from Eastern Europe (Hungary, Romania, Croatia, Russia...)



and ultimately economic entities from other countries such as South Africa, Singapore, Israel, Australia. Thus, after analysis, these researchers produced the following results: a decline in earnings management in France and the Scandinavian countries was observed during the so-called post-adoption phase, while the “life-saving” contribution of IFRS was not observed in Germany or in law countries. These researchers, therefore, backed up their results with the fact that common law countries characteristics are line with the Anglo-Saxon conception of accounting: a rigorous legal framework, an institutional system that ensures the protection of investors’ interests. Thus, at the end of their research Dayanadan and al (2017) noted an improvement in the quality of accounting information through a decrease in earnings management for companies from countries where the vision of accounting is an Anglo-Saxon conception.

In the international context, Elbakry and *al.* (2017) carried out a comparative analysis between British and German standards in order to determine whether the value relevance of accounting figures is more important under IFRS or, on the contrary, it is German standards that have a greater value relevance, so these researchers chose a mixed sample composed of both German companies, which are 136 economic entities and 96 British companies, to carry out their empirical analysis. These researchers concluded that the value relevance of the accounting figures was higher under IFRS than under German standards.

So what we can, therefore, confirm in light of the results obtained is that the transition to IFRS has led to an improvement in the quality of accounting information.

As another attribute for judging the quality of accounting information, accounting conservatism has been the subject of much research, in particular, the various studies have analysed the existing association between accounting conservatism and the adoption of IFRS.

Apart from the attributes mentioned in the various studies mentioned above, there is another attribute that is equally important for judging the quality of accounting information, namely accounting conservatism, which is important because it is an effective means of countering the unavoidable information asymmetry that exists between information holders and capital holders such as investors.

Since we are interested in the consequences of the adoption of IFRS, we will, therefore, present various studies that have analysed the existing association between accounting conservatism and the adoption of IFRS.

In the European context, Piot and *al.* (2011) referred to a sample of 5000 economic entities from 22 EU Member States monitored over the period from 2001 to 2008, in order to analyse the relationship between the adoption of IFRS and the level of accounting conservatism. After the analysis performed by Piot and *al.* (2011), noted a decrease in the level of accounting conservatism for companies that did not voluntarily adopt IFRS either before the regulatory date. In particular, these researchers added that the existence of highly negative correlations is all the more marked when there are significant divergences between international and local accounting standards and when the company is audited by a big four.

In the international context, Garcia and Pop (2011) used country institutional factors to assess the quality of accounting information following the adoption of IFRS. Thus, the chosen sample was composed of economic entities from 12 countries monitored over the period from 1999 to 2008. After careful analysis, these researchers noted that companies opted for aggressive, non-conservative accounting after the transition to IFRS, but that this non-conservative accounting has declined as a result of effective enforcement systems.

Affes et Labelle (2013) studied the place of the legal framework in the quality of accounting information and following the mandatory transition to IFRS. It should be noted that the quality of accounting information was assessed by the following attributes: earnings management and the level of accounting conservatism. Thus Affes et Labelle (2013) referred to 4.807 listed companies from 30 countries monitored over the period from 2005 to 2008. At the end of their studies, Affes et Labelle (2013) found an increase in aggressive accounting, i.e. non-conservative accounting, where the practitioner works to quickly cherry-pick the first signs of favourable news. This researcher has stressed that to mitigate this aggressive accounting, monitoring by financial analysts is an effective means.

In the international context, Barth and *al.* (2008) examined a sample of 327 economic entities from 21 countries to test the effect of the transition from local standards to IAS (until 2001 international accounting standards were called IAS) over the period from 1994 to 2003 on the various attributes of accounting information quality. After analysis, Barth and *al.* (2008) noted that for companies that chose to refer to IAS, the quality of accounting information had improved due to a decrease in earnings management, an increase in value relevance of accounting information and finally an increase in the level of accounting conservatism compared to companies that did not adopt IAS.

Also in the same context, Chan and *al.* (2015) analyzed the impact of the mandatory adoption of IFRS on the level of accounting conservatism of 23,225 entities/year over the period from 2002 to 2007. Following an empirical analysis, these researchers noted that there has been an increase in the level of prudence, particularly for companies with a high level of debt. Indeed, the more a company is financially not autonomous, the more it will have to prove its good faith by disclosing the most prudent accounting information possible.

In the international context, Andre and *al.* (2015) have opted to analyse the relationship between mandatory adoption of IFRS and accounting conservatism. In order to explore this relationship, these researchers chose a sample of 16 European countries monitored over the period from 2000 to 2010. Following a rigorous empirical analysis, these academics noted a decrease in the level of accounting conservatism, which was not matched by the conclusion reached by Lara and *al.* (2008), as the transition to IFRS led to higher levels of accounting conservatism for common law countries.

In 2012, however, Zeghal, referring to a sample of 15 European countries, claimed that the transition to IFRS standards had no effect on the level of accounting conservatism.

In the Malaysian context, Marzuki and Abdul Wahab (2016) examined the effect of the mandatory adoption of IFRS on the degree of accounting conservatism of Malaysian companies. Indeed the sample consists of 1760 firms/years analyzed between the years:2004-2008. In order to fully understand the effect of IFRS, these researchers first referred to the institutional factors in the Malaysian context that have an impact on the level of accounting conservatism

Indeed, the institutional factors are:

- Political relations in Malaysia - companies in Malaysia highly depend on the country's policies
- Family relationships: in Malaysia, economic entities are in a large majority of family businesses, many studies have shown that there is a negative correlation between accounting conservatism and family businesses.
- The origin: it has been proven that when the probability of people sitting on the board of directors is of Malay nationality this has an effect on the level of accounting conservatism.

Influence of the country's rich people: Companies that are mainly financed by rich people, in other words, people who have enough financial means opt for more cautious compatibility after the adoption of IFRS

After analysis, these researchers noted that the transition to IFRS standards had improved in the level of accounting conservatism, taking into account institutional factors.

In the Turkish context, Suadiye (2017) examined the impact of the mandatory adoption of IFRS on various attributes of the quality of accounting information, namely: earnings management, accounting conservatism and the value relevance. Referring to a sample of 2041 observations (firms/years) from 157 Turkish listed companies monitored over the period (1999 - 2015), this researcher stated that following the transition to IFRS, a decrease in the level of accounting conservatism was observed.

In the Asian context, Salah and Abdel-Salam (2019) analysed the impact of the adoption of IFRS on the quality of accounting information, using a sample of 426 manufacturing companies from 8 industries listed on the Taiwanese stock exchange, monitored over the period from 2008 to 2014. The quality of the accounting information was assessed through the following measures: earnings management, accounting conservatism and informational relevance. After empirical validation, these researchers noted that the transition to IFRS did not lead to a change in the level of accounting conservatism for these companies.

Finally, in the Romanian context, Carpa and Toma (2018) analyzed the impact of IFRS on the accounting conservatism of Romanian listed companies (BVB), i.e. 62 firms monitored over the period (2010-2015), the year 2012 has been voluntarily eliminated by the researchers because during this year, many works related to the preparation of accounts in accordance with IFRS have been carried out. They concluded that there is a high degree of accounting conservatism for Romanian companies that apply IFRS and are over-indebted. It should be noted that this research is in line with that of Dobre et al (2015) who noted that in the Romanian context, the transition to IFRS has improved the quality of accounting information since a better recognition of gains as well as losses has been noticed.

Following a careful review of the accounting literature on the association between the mandatory adoption of IFRS and accounting conservatism which found that the meaning of this relationship is sometimes positive and sometimes negative, given the heterogeneity of the results, it seemed more relevant to formulate a non-directional assumption. Indeed, regarding the note that following a review of the literature we found that the relationship between the adoption of IFRS and accounting conservatism is sometimes positive and sometimes negative. We have, therefore, decided to formulate a non-directional

hypothesis in the sense that there is a relationship between the adoption of IFRS and accounting conservatism but we do not refer to a specific meaning of the positive or negative relationship, so our hypothesis is a non-directional hypothesis

H1: There is a relationship between the mandatory adoption of IFRS and the timely recognition of loss.

### 3. METHODOLOGY

#### 3.1. Description of our sample

In order to test the impact of the mandatory adoption of IFRS on accounting conservatism or timely recognition of loss, we have elected to refer to french companies in the SBF 120 index. Our choice to test our hypothesis in the French context is justified by the fact that France represents the only member country of the European Union where local accounting standards, i. e. French standards, are fundamentally different from IFRS standards as well as financial reporting standards following an Anglo-Saxon orientation... We have chosen to refer to the French context because the French accounting system is totally different from the Anglo-Saxon accounting system. Indeed, as an example according to the Anglo-Saxon conception of accounting, accounting is a strategic decision-making tool, whereas according to the French conception, accounting is a means of accountability. Thus, we enrich the accounting literature by choosing our sample.

In addition, many studies have identified numerous shortcomings in the application of IFRS in the French context.

Always following deductive reasoning after having justified the choice of our study context, we will justify our choice to study the French companies belonging to the SBF 120 index.

The companies of the SBF 120 have a significant advantage, this sample includes a considerable number of companies which allows us to better understand the economic reality of the French financial market. Our sample has the advantage of presenting French companies belonging to different sectors of activity. In accordance with Chavent and *al.* (2006), the companies included in the SBF 120 index meet the criterion of diversification and give an overall picture of the different sectors of the French market.

It is noteworthy that we eliminated from our sample companies that met different accounting rules and therefore in order not to distort our results. Our sample is therefore composed of 102 companies that we

followed for two periods: the first period 2002 - 2004 was used as the pre adoption of IFRS and 2005-2012 as the post-adoption of IFRS. Due to the unavailability of data, we collected our data abroad at the University of Paris Dauphine. Indeed, we have used the following databases: DIANE; ORBIS,

Following the observation of the unavailability of data as well as the existence of missing data, our final sample is composed of 87 economic entities.

It should be noted that since these are the same companies that we have followed for several years, our data are therefore panel data

So in the following table we will show how we constructed our sample?

**Table 2**  
**Sample constitution**

Number of listed French companies	120
Banking Institutions	5
Insurance companies	5
Leasing companies	3
Companies that have early adopted IFRS before 2005.	18
= Number of available companies	94
(-) Comments not available	7
= Final sample	87

In order to test our hypothesis, we will use two models: the Basu's (1997) model (1997) and the Khan and Watts model (2009). It should be noted that we have chosen to test our hypothesis according two models because by consulting the accounting literature on this subject we noticed that Basu's model (1997) is certainly a pioneering model in the evaluation of accounting conservatism, but other models were subsequently developed to correct the deficiencies noted in Basu's model (1997). Khan and Watts' (2009) model is an example of a model that, based on the failures of Basu's (1997) model, proposed an econometric model in which they look at accounting conservatism through factors specific to economic entities such as: size, debt level and ratio market to book.

### 3.2. Presentation of the empirical analysis

#### 3.2.1. Description of Basu's model (1997)

In order to test our hypothesis, we will first use Basu's (1997), model . Indeed Basu's (1997) model comes from research conducted in the American context

over a period from 1963 to 1990, Basu (1997) stated that the return per share is an indicator of the news, while returns per share with a positive sign refer to the news with a negative sign. Thus Basu (1997) assessed accounting conservatism through the inverse regression presented below :

$$EPS_{it} / P_{it-1} = \alpha_0 + \alpha_1 D_{it} + \alpha_2 R_{it} + \alpha_3 R_{it} + \varepsilon_{it}$$

According to the model of Basu (1997), we notice that the variable to be explained, which is the relationship between the accounting result and the share price, depends on two co-dependent variables: the stock market return  $D_{it}$  as well as the product ( $R_{it} * D_{it}$ ). It should be noted that according to Basu's (1997) model, the  $\alpha_3$  coefficient reflects the speed with which so-called unfavourable news is disclosed, while the  $\alpha_1$  coefficient refers to the timing of disclosure of so-called favourable news. It is noteworthy that to measure the level of accounting conservatism, Basu (1997) focused in particular on the determination coefficient  $R^2$  for bad news and the determination coefficient for good news. In the case where the determination coefficient for bad news is higher than the  $R^2$  for good news, so the accounting will be qualified as conservative. Otherwise, the accounting will be qualified as so-called aggressive accounting, is not prudent

By referring to the different coefficients if the coefficient  $\alpha_3$  increases between the so-called pre- and post-adoption phase of IFRS, in this case, we can affirm that the accounting is a conservative accounting. Thus, the increase in this coefficient justifies the fact that companies are able to anticipate probable losses more quickly.

In the event that the good news coefficient is the  $\alpha_2$  coefficient increases between the period of pre-adoption of IFRS and the period of post-adoption of IFRS, in this case, we will be able to affirm that the accounting is not conservative accounting, the company is unable to anticipate its losses

In the following, we will, therefore, present the variables related to Basu's (1997) model

After having presented the variables relating to the Basu's (1997) model we will first present the descriptive statistics relating to the model of Basu (1997) and then we will present the results of the two estimates of the Basu model (1997): the first estimate has to do with the so-called pre-adoption phase of IFRS and the second estimate relates to the so-called post-adoption phase of IFRS.

**Table 3**  
**Variables related to Basu's model (1997)**

Type of variables	Measured Effect	Acronym	Measure
Dependant	Association between accounting income and stock return.	$EPS_{it}/P_{it-1}$	Accounting income / Stock return
Dependant	Market share price of the company	$P_{it-1}$ share price at the beginning of the fiscal year	Share price in year t-1
Dependant	Earning per share	$EPS_{it}$	Net income / Number of shares
Dependant	Stock return	$R_{it}$ $R_{it}$ is the return on firm i from 9 months before fiscal year-end t to three months after fiscal year-end	$P_t - P_{t-1} / P_{t-1}$ $P_t$ : share price, 3 months after the end of the fiscal year $P_{t-1}$ : share price 9 months before the end of the fiscal year (April)
Independent	Fluctuations in stock return	$D_{it}$ Dichotomous variable	which is equal to 1 in the case where $R_{it}$ is less than 0, 0 otherwise

**Table 4**  
**Descriptive statistics on Basu's model (1997)**

Variable	Observation	Mean	Standard deviation	Minimum	Maximum
$P_{it}$	959	57.5485	111.5517	1.12	1399.027
$R_{it}$	959	-0.9473182	0.0878277	-0.9992852	-0.1071429
$EPS_{it}$	871	-2.94102	2562.726	-66281.25	15365.63
$D_{it}$	959	1	0	1	1
$RD_{it}$	1.077	-0.8435266	0.3074087	-0.9992852	0

Reading the table above we notice that the highest average is the one relating to the  $P_{it}$  variable, in fact, the average is equal to 57.5485.

The lowest average is the one referring to the variable  $EPS_{it}$ , which is -2.94102.

As for the dispersion indicator, which is the standard deviation, we note that the highest standard deviation is that relating to the variable relating to the share price, i.e. the  $P_{it}$  variable, this standard deviation is 111.5517.

The smallest standard deviation is the one related to the variable  $D_{it}$



Thus, to conclude, we can affirm that the  $D_{it}$  variable is the variable that most closely approximates its mean.

The  $P_{it}$  variable is the variable that is very different from its average, so we can say that it is a heterogeneous series. It should be stressed that this result is entirely justifiable because the share price depends on two types of factors: the so-called endogenous factors, on which they depend on the company, and the exogenous factors which are inevitably imposed on the company.

**Table 5**  
Estimation of the Basu model (1997) for the pre-IFRS adoption period

$EPS_{it}$	Coeff	Std Err	T	$P >  t $	[95% Conf. Interval]	
$R_{it}$	-0.0032022	0.0429608	-0.07	0.941	-0.0883153	0.0819109
$D_{it}$	-3.867584	4.097584	-0.94	0.347	-11.98564	4.25047
$R_{it} * D_{it}$	-5.711288	5.764145	-0.99	0.0324	-17.1311	5.708521

Reading the table above, we note that during the period known as the period of pre-adoption of IFRS, the coefficient relating to unfavourable news, i.e. the coefficient  $\alpha_y$ , is -5.711288. This coefficient is therefore negative and significant because  $P > |t|$  is equal to 0.0324, i.e. less than 0.05. At this stage of the research, therefore, we can only affirm that during the so-called pre-adoption phase of IFRS there is a negative correlation between  $EPS_{it} / P_{it-1}$  and the coefficient relating to bad news. During the pre-adoption phase of IFRS, these companies opted for aggressive and therefore non-conservative accounting.

In order to be able to assess the impact of IFRS on accounting conservatism, we must therefore, compare the above estimate, which refers to the so-called pre-IFRS adoption phase, to that relating to the post-IFRS adoption phase.

**Table 6**  
Basu's (1997) model estimate for the post-IFRS adoption period

$EPS_{it}$	Coeff	Std Err	T	$P >  t $	[95% Conf. Interval]	
$R_{it}$	-0.0216839	0.750383	-0.03	0.977	-1.496181	1.452813
$D_{it}$	35.66616	43.20588	0.83	0.410	-49.23304	120.5654
$R_{it} * D_{it}$	0.1080318	62.6361	1.72	0.0085	-15.04763	231.1112

Thus, by carrying out a comparative analysis between these two estimates of Basu's model (1997), we note that the speed through which the so-called unfavourable news is taken into account in the accounting

result increases considerably. The very sign of the coefficient relating to bad news has changed. During the pre-adoption phase, this coefficient was -5.711288 while during the so-called post-adoption phase of IFRS this coefficient is positive and is 0.1080318.

Thus, in the light of the results we have achieved, we maintain that the mandatory adoption of IFRS has led to a considerable increase in the coefficient relating to the disclosure of unsatisfactory news in the accounting result, which therefore supports the existence of a positive relationship between the mandatory adoption of IFRS and accounting conservatism in the French context.

In short, our assumption that there is a relationship between accounting conservatism and the mandatory adoption of IFRS is confirmed. There is a relationship between the mandatory adoption of IFRS and accounting conservatism, which is a positive sign. Our result is therefore in line with the expectations of the international accounting standard-setter, who advocates that quality accounting information is information that is necessarily based on the notion of prudence.

Our result is therefore in line with the results of the work of Barth and *al.* (2008), Elshandidy and Hassanein (2014) but is in contradiction with those of André and *al.* (2015) and Piot and *al.* (2011)

As we have previously stated, Basu's model (1997) is a pioneering model in the, been developed to measure accounting conservatism, we will focus in the following on one of these models, which is the model of Khan and Watts (2009)

### 3.2.2. Description of Khan and Watts' model (2009)

The model proposed by Khan and Watts in 2009 is based in part on Basu's (1997) model in which they incorporated the characteristics of economic entities to assess accounting conservatism. and it should be noted that the characteristics of economic entities are the size of the economic entity, its degree of debt, and the ratio market to book.

Thus, in the following, we will present the model by Khan and Watts (2009)

Indeed, Khan and Watts' (2009) model is based on the fact that the parameters that refer to good news, as well as bad news, are replaced by the formulas below.

The model proposed by Khan and Watts in 2009 is based in part on Basu's (1997) model in which they incorporated the characteristics of economic entities to assess accounting conservatism, and it should be noted that the characteristics of economic entities are the size of the economic entity, its degree of debt, and the ratio market to book.

Indeed, Khan and Watts' (2009) model is based on the fact that the parameters that refer to good news, as well as bad news, are replaced by the characteristics specific to economic entities, such as size, market-to-book ratio, debt level.

$$\alpha_3 = \lambda_0 + \lambda_1 SIZE_{it} + \lambda_2 MB_{it} + \lambda_3 LEV_{it}$$

$$\alpha_4 = \mu_0 + \mu_1 SIZE_{it} + \mu_2 MB_{it} + \mu_3 LEV_{it}$$

The model of Khan e Watts (2009) thus becomes

$$NI_{it} = \alpha_1 + \alpha_2 D_{it} + R_{it}(\lambda_0 + \lambda_1 SIZE_{it} + \lambda_2 MB_{it} + \lambda_3 LEV_{it}) + R_{it} D_{it} \\ (\mu_0 + \mu_1 SIZE_{it} + \mu_2 MB_{it} + \mu_3 LEV_{it}) + (\delta_0 SIZE_{it} + \delta_1 MB_{it} + \delta_2 LEV_{it} + \\ \delta_3 D_{it} \times SIZE_{it} + \delta_4 DR_{it} \times MB_{it} + \delta_5 D_{it} \times LEV_{it}) + \varepsilon_i$$

In order to fully understand the Khan and Watts model (2009), we will, therefore, present the variables related to the Khan and Watts model (2009).

**Table 7**  
**Variables related to the Khan and Watts model (2009)**

<i>Type of variables</i>	<i>Measured Effect</i>	<i>Acronym</i>	<i>Measure</i>
Dependant	Association between accounting income and stock return.	$NI_{it}$	Accounting income / Share price
Dependant	Stock return	$R_{it}$	$\frac{P_t - P_{t-1}}{P_{t-1}}$ $P_t$ : share price, 3 months after the end of the fiscal year $P_{t-1}$ : share price 9 months before the end of the fiscal year (April)
Independent capital)	Size	$SIZE_{it}$	Ln (market value of equity
Independent	level of indebtedness	$LEV_{it}$	Total liabilities / Market capitalization
Independent	Ratio market to book	$MB_{it}$	Market Capitalization/ Total equity
Dependant	Fluctuations in stock return	$D_{it}$	A dichotomous variable which is equal to 1 in the case where $R_{it}$ is less than 0, 0 otherwise

Thus, after having presented the variables related to the Khan and Watts model (2009), we will first present the descriptive statistics related to the Khan and Watts model (2009) and then, as a second link, we will focus on the results related to this model.

**Table 8**  
**Descriptive statistics on Khan and Watts' model (2009)**

<i>Variable</i>	<i>Observation</i>	<i>Mean</i>	<i>Standard Deviation</i>
$NI_{it}$	947	0.7314412	0.618403
$SIZE_{it}$	1036	0.1481278	0.01368655
$MB_{it}$	1039	0.0069977	0.0506523
$LEV_{it}$	922	0.1985861	0.3080672
$R_{it}$	959	0.483162	0.3613853
$DR_{it}$	959	0.6642336	0.4725041

Reading the table above, it is clear that the highest average is that relating to the variable indeed its average is 0.7314412. As for the lowest average, it is that relating to the variable relating to the ratio market to book, its average is 0.0069977.

Concerning the indicator relating to the measurement of dispersion, we note that the highest standard deviation is that relating to the variable  $NI_{i,t}$ , it is 0.618403. Thus this variable is very different from its mean, so we can affirm that it is a heterogeneous series.

$NI_{i,t}$  is a variable that relates the accounting result to the stock price, the stock price being in perpetual fluctuation it is therefore quite expected that the variable, displays the highest standard deviation.

The smallest standard deviation is the one related to the size variable, i.e. the variable  $SIZE_{i,t}$  indeed the standard deviation 0.01368655 we can, therefore, deduce that the variable  $SIZE_{i,t}$  is the variable that is the closest to its average, we can, therefore, affirm that it is a homogeneous series.

**Table 9**  
**Estimation according to the Khan and Watts model (2009)**

<i>Independent Variable</i>	<i>Expected Sign</i>	<i>Coefficient</i>	<i>P&gt; t </i>	<i>significance at the 5% threshold significance</i>
Ret	+			
Ret*Size	+	-0.0000196	0.0077	Yes
Ret*M/B	-	0.0002723	0.993	No
Ret*Lev	-	$5.42 \cdot 10^{-9}$	0.044	Yes
D*Ret	+	-0.1418321	0.035	Yes
D*Ret*Size	-	0.09156995	0.040	Yes
D*Ret*M/B	+	0.1033003	0.944	No
D*Ret*Lev	+	-0.067782	0.746	No

According to the table, we can see that the parameter relating to unfavourable news, the parameter relating to the product D\*Ret, is

negatively significant, it is -0.1418321, this coefficient is significant because  $P > |t|$  is 0.035 and is therefore below the 5% threshold. So during the period studied these companies are not conservative and therefore opt for aggressive and non-conservative accounting as recommended by the international accounting standard-setter.

In the same vein, we notice that the coefficient relative to the product. We can, therefore, affirm that the larger the company, the less it discloses good news and the more it is intended to avoid paying too much tax. Our result is not in line with the result of Khan and Watts (2009) who pointed out that the larger the size of a company, the more the company will be encouraged to disclose the so-called favourable news.

The coefficient relating to the  $Ret * M/B$  product is positive but not significant, at the 5% threshold, and is 0.0002723. Thus, the more growth opportunities a company has, the more it will be encouraged to disclose the favourable news, and the more growth opportunities a company has, the more it will disclose the good news.

As for the coefficient relating to  $Ret * Lev$ , it is a positive and significant sign at the 5% threshold, since it is  $5.42 * 10^{-9}$ . Thus, the more indebted a company is, the more it will have to disclose to the market the so-called favourable news in order to reassure lenders and particularly to prove its transparency towards other stakeholders.

It is noteworthy the coefficient for the product  $D * Ret * SIZE$  is positive and significant at the 5% threshold, i.e. 0.09156995. Thus, the larger the company, the more adverse news it incorporates into its accounting result. Our results, therefore, do not match the results of Khan and Watts (2009). Our results, therefore, contradict the idea that the larger a company, the higher the level of information asymmetry, making it difficult to recognize losses in a timely manner.

Concerning the coefficient relating to the product  $D * Ret * MB$ , it is positive, it is 0.1033003 but not significant at the 5% threshold, so there is a positive relationship between the incorporation of the so-called unfavourable news in the accounting result and the market to book ratio.

This result, therefore, reflects the fact that the more a company has strong growth opportunities, the more it will disclose bad news to the stock market.

Finally, concerning the coefficient relating to the product  $D * Ret * LEV$ , this coefficient is of negative sign, it is -0.067782. This result, therefore, means that the more a company is not financially autonomous, the less it

will disclose unfavourable news. This result goes against accounting literature because, according to Khan and Watts (2009), the fact that a company is financially dependent should indirectly force it to disclose unfavourable news to the market in order to enable investors to act in full knowledge of the facts.

Thus, through the results we have obtained, we can affirm that, in general, the French companies belonging to the SBF 120 index have opted for rather aggressive and non-conservative accounting, referring to Khan and Watts' (2009) model, which does not meet the expectations of the international accounting standard-setter, who advocates prudent accounting information.

Always after understanding accounting conservatism, we will focus on the following on accounting conservatism for the different years to see if for some years accounting conservatism has been shown for these companies.

**Table 10**  
Results of coefficients related to bad news by year (Khan and Watts, 2009)

<i>Year</i>	<i>Coefficient for product D*R</i>	<i>T stat</i>	<i>P&gt; t </i>	<i>Significance</i>
2002	data unavailability			
2003	-0.13076	-1.93	0.06	No
2004	-0.2210293	0.74	0.001	No
2005	-0.718918	-0.55	0.586	No
2006	-0.4280736	-0.040	0.970	No
2007	0.8379063	0.02	0.00486	Yes
2008	0.2151657	0.24	0.00456	Yes
2009	-0.1829185	-0.49	0.0427	Yes
2010	-0.1910464	-1.28	0.206	No
2011	-0.3631556	-0.99	0.327	No
2012	-0.6570717	-0.05	0.961	No

Reading the table above, we can see that these companies are not conservative overall because during the years 2003, 2004, 2005, 2006, 2009, 2010, 2011 and 2012 the coefficient relating to the product D\*R is negative.

On the other hand, we note that during 2007 and 2008 and 2009 the coefficient relating to unfavourable news is positive since for 2007 it is 0.8379063 and is significant because  $P>|t|$  is 0.00486, which is, therefore, less than 5% and for 2008 this coefficient is 0.2151657 and is significant at the 5% threshold. Finally, for the year 2009 the coefficient relating to the

product,  $D^*R$  is positively significant, indeed this coefficient is 0.1829185 it is significant because  $P > |t|$  is 0.0427 which is less than 5%.

What we can say, then, is that during these three years the accounting conservatism has been noticed for these companies. Thus, we will be able to explain our result by the fact that even if the international accounting standard-setter recommends prudence in accounting information disclosed via the financial statements, the fact remains that IFRS are complex standards that require a certain degree of preparation: the company must have funds at its disposal to reorganize departments according to the Anglo-Saxon accounting concept, the company must possess sufficient funds to ensure quality training for its staff, who will then be able to apply IFRS in a correct manner. It should be noted that conservatism is not only dependent on the accounting standards chosen but that other factors can explain accounting conservatism in this respect, such as the effect of the crisis or the institutional environment in which companies carry out their transactions.

Thus, to answer our hypothesis that there is a relationship between accounting conservatism and the mandatory adoption of IFRS, referring to Khan and Watts' (2009) model, we can first affirm that there is a relationship between accounting conservatism and the mandatory adoption of IFRS... Overall, this relationship is negative in the sense that according to Khan and Watts (2009) French companies opt for non-risk averse accounting which is just a form of aggressive accounting. In a more specific way, when we focus on accounting conservatism year by year, we notice that accounting conservatism is really noticeable during 3 years, namely 2007, 2008 and 2009.

In short, what we come out with from this research is that by referring to the pioneering model of accounting conservatism, Basu's (1997) model, there is a positive correlation between the mandatory adoption of IFRS and accounting conservatism, following a comparative analysis between two periods: the period known as the period of pre-adoption of IFRS and the period known as the period of post-adoption of IFRS.

Referring to the model of Khan and Watts (2009) we notice that the general tendency of French companies is to follow an aggressive accounting system that is not risk-proof. Accounting conservatism was only noticeable during three years, the years 2007, 2008 and 2009. The estimation of accounting conservatism according to Khan and Watts' (2009) model allowed us to see which factors work in favor of more prudent accounting and which factors do not work in favour of such accounting. the size factor has a positive impact on the incorporation of bad news into the accounting

result, while factors relating to the following variables: MTB and LEV are not explanatory variables of accounting conservatism.

#### 4. CONCLUSION

In our conclusion, we used the following methodological path: first, we stated that following the empirical validation of Basu's model (1997), the transition to IFRS has had an impact on the level of accounting conservatism of French companies. This impact has been positive. In other words, the transition to international accounting standards has led French companies to disclose bad news more quickly than good news.

For the sake of relevance, we have subsequently assessed the accounting conservatism by referring to a more recent model than Basu (1997) and it is, in this case, the model of Khan and Watts (2009) after empirical validation we noted that the relationship between accounting conservatism and the adoption of IFRS is negative. We then affirmed that the heterogeneity of the results comes from the fact that in Basu's model (1997) the accounting conservatism is explained by accounting variables, stock market order while for Khan and Watts' model (2009) the researchers base themselves on the variables presented by Basu (1997) by adding the characteristics of the companies such as the size of the companies.

It should be noted that the divergence in the results obtained may be due to the fact that IFRS are one of the determinants of accounting conservatism but not the only determinant.

It, therefore, emerges that this model appeared after Basu's (1997) model, i.e. Khan and Watts' (2009) model, is a more relevant and precise model, the meaning of which we were able to see for which years accounting conservatism was noticed, we were able to detect the characteristics of entities in favour of prudent accounting as well as the characteristics in favour of aggressive accounting.

Thus, this research enriches the accounting literature in the sense that it proves that the Basu' (1997) model and the Khan and Watts model (2009) constitute two models that are not complementary but antagonistic. We, therefore, justify our results by the fact that accounting conservatism is apprehended differently. According to Basu's (1997) model, accounting conservatism is explained by stock market variables, while according to Khan and Watts' (2009) model, accounting conservatism is explained by two types of variables: accounting variables and stock market variables.

Indeed according to the Basu model (1997), there is a relationship between the mandatory adoption of IFRS and accounting conservatism



and this relationship is positive; this positive relationship has not been proven by the Khan and Watts model (2009); since, according to this model, French companies chose a rather aggressive or non-cautious accounting.

In fact, our research can be a reference for various parties.

**For the privileged user of accounting information**, i.e. the investor, this research proves that compliance with IFRS constitutes proof that accounting information disclosed via the financial statements is information that is totally transparent... Thanks to IFRS, more particularly to an attribute of IFRS which is accounting conservatism, the investor will be duly and timely informed of predictable losses, which will enable him to act in full knowledge of the facts. In particular, this research will encourage investors to invest preferentially in companies that refer to IFRS rather than to their local standards

**For banks**, this study proves that companies that have adopted IFRS are reliable companies in the sense that any information that can influence the decision-making choices of different stakeholders is disclosed in a timely manner. by opting for prudent or risk-averse accounting, companies create a climate of trust and transparency that will act in favour of a possible agreement when applying for a loan.

**For leaders**, this research substantiates the positive impact of IFRS on the quality of accounting information. Indeed, managers must make every effort to ensure the rigorous application of IFRS. Proper application of IFRS means that investors are timely informed of bad news, which will allow them to act quickly since in the event that an executive opts for aggressive and non-conservative accounting, investors will have access to information when it is no longer relevant and they will even be able to sell the shares, which may in the long term call into question the executive's employability.

**Concerning the international accounting standard-setter**, our research is useful in the sense that it constitutes proof that companies that had to adopt IFRS in a legal way either in 2005 now opt for prudent or risk-averse accounting.

Despite the significant contributions of our research, however, some limitations have been noted, such as :

- The small sample size
- the unavailability of certain data (our data were collected abroad at the University of Paris Dauphine)
- the study of the concept of accounting conservatism was difficult because, by consulting the various documents drawn up by the

IASB, we have noted that the vision of the international accounting standard-setter is not clear enough: in 1989 the international accounting standard-setter advocates neutral accounting information, in 2010 the notion of prudence is not mentioned and finally in 2018 the IASB stated in its new version of the conceptual framework that accounting information must be neutral and this neutrality is based on prudence.

- As IFRS are “young” accounting standards, which are constantly modified through amendments

Thus, in the light of the limitations have mentioned above, future researchers will be able to address the following themes

- Extend the study period to better understand the effect of IFRS on the level of accounting conservatism, IFRS are complex standards in order to properly assess their effects on the quality of accounting information it is necessary to choose a more or less long study period.
- Since the concept of information quality is a multidimensional concept (Gaio,2010), future researchers will be able to analyze the effect of the mandatory adoption of IFRS on one of the aspects of accounting information quality, namely the earnings management or the cost of equity capital.
- Many developing countries have opted for IFRS in order not to be on the sidelines of the financialization of the global economy, so it would be appropriate for future researchers to analyse the impact of “high quality” IFRS standards in the context of developing countries
- It should not be forgotten that during the 2008 crisis many parties accused IFRS and in particular the use of fair value as the main cause of the financial crisis, as IFRS are constantly changing standards to better meet the informational expectations of investors, but particularly other stakeholders concerned with accounting information, future researchers will, therefore, be able to conduct an international study to analyse the effect of the adoption of IFRS on the quality of accounting information in a context of financial crisis.
- Study the impact of the mandatory adoption of IFRS on an attribute of accounting information, such as earnings management and governance mechanisms, etc. Since IFRS represents one aspect of accounting information quality and not the only one, the purpose

of this study is to see if the combination of effective governance mechanisms and IFRS quality standards leads to an improvement in the quality of accounting information, which will be reflected in a decline in earnings management.

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