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Contribution to the Study of the Impact of IFRS on the Quality of Information and Financial Markets: Which Theories are Used?

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Abstract

The aim of this article is to examine the extent to which theories of financial market effi-ciency, agency and signaling can be used to study and understand financial phenomena, in particular conflicts of interest between managers and shareholders, and investor behavior in financial markets following the transition to International Financial Reporting Standards (IFRS).

Keywords: *IFRS, Informational Efficiency Theory, Agency Theory, Signal Theory*

INTRODUCTION

Since the advent of accounting around the world, the quality of information has constantly attracted the attention of all corporate players, because of the role it plays in the business world. Indeed, decision-making requires that the information communicated be useful, reliable and error-free. However, the problem of reliable information has become increasingly acute since the emergence of modern forms of enterprise, characterized by the separation of ownership and management, leading to the emergence of information asymmetries and agency problems, as well as earnings management based on the accounting choices offered to preparers by local accounting systems, with damaging consequences including the financial scandals of the 2000s and the deterioration of investor confidence in international financial markets.

In order to restore the normal functioning of financial markets, meet investors' expectations in terms of quantitative and qualitative information, and ensure comparability on a global scale, the IASB developed new standards, known as "International Financial Reporting Standards" (IFRS), which came into force in Europe in January 2005. This decision prompted finance researchers to demonstrate the effect of adopting these standards on the quality of financial information, using a variety of methodologies.

Furthermore, the study of a phenomenon, whatever its field, requires reference to the theory or theories that frame it. Thus, a theory serves to define, describe, understand, explain, represent and predict a particular phenomenon and a set of relationships specific to this phenomenon, after having verified a certain number of hypotheses. A theory is also used to ask new questions, to structure certain observations, to provide assessments of reality and even, in some cases, to make decisions that affect the course of everyday events.

In the literature, the study of financial phenomena often refers to a number of financial theories, such as the theory of the efficiency of financial markets, agency theory and signal theory. Our work consists in examining the theories that more specifically frame phenomena relating to the quality of financial information, and how they can be mobilized in the context of IFRS adoption, which leads us to pose the following problem: To what extent do the theories of informational efficiency, agency and signal constitute basic theoretical frameworks for describing, understanding and explaining the phenomenon of the quality of accounting figures in the IFRS era?

To answer this question, the first section is devoted to the development of the theory of efficient financial markets. The second and third sections are devoted respectively to a treatment of the foundations of agency

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and signal theories, and how these theories are exploited in the context of international accounting harmonization, followed by a conclusion.

The Theory of Efficient Financial Markets

Definition and Purpose

The theory of efficient financial markets has its origins in the work of French mathematician Louis Bachelier (1900), who observed "abnormal" upward movements followed by similar downward ones, which he called martingales. This concept would later give rise, in modern financial theory, to the notion of a random market in stock prices. It wasn't until the 1950s, however, that this theory developed and attracted particular interest from researchers. It was revived in the work of Cootner (1964), and formalized in Eugene Fama's famous thesis, defended in 1965. This theory is based on the assumption that financial market players act intelligently when the market provides them with all the information they need to react correctly within a reasonable timeframe, in order to maximize their profits. In other words, a financial market is said to be efficient if, and only if, all available information concerning each financial asset listed on the market is immediately incorporated into the price of that asset. However, to question the idea of efficient markets is to question the assumption that economic agents are rational.

In reviewing the literature, a number of studies have shown that the validity of this theory remains controversial, due to the absence of unanimous conclusions. In this context, and following the 1987 stock market crash, Bourguinat (1992) points out that for some authors, this crash constitutes an event that should consider this theory dead. On the contrary, for others, the crash acted as a restorative force, bringing stock prices back into line with economic fundamentals, and making the market efficient. Jacquillat and Solnik (2002, P.47) emphasize the importance of this theory, widely accepted by practitioners and academics alike.

Dimensions of Informational Efficiency

Referring to the work of Jacquillat and Solnik (2002), we emphasize that the concept of informational efficiency encompasses two main dimensions: the economic efficiency of financial markets and the rationality of investors.

Economic Efficiency of Financial Markets And Informational Efficiency

Basic Principles

The economic efficiency of financial markets refers to the purely economic functions of the financial industry. According to Fama (1965), "a financial market is said to be efficient if and only if all available information concerning each financial asset quoted on that market is immediately incorporated into the price of that asset", he adds, "In an efficient market, competition between many intelligent investors leads to a situation where, at any instant, the effective prices already reflect the effects of information on past events and on events likely to take place in the future, in other words, in an efficient market at any instant the effective price of the security will be a good estimate of its intrinsic value". Jensen (1978) adds that a market cannot be considered efficient if it is impossible to make above-average profits without incurring above-average risks.

Forms Of Financial Market Efficiency

The theory of the informational efficiency of financial markets assumes that shares are fairly priced, which implies that all players are immediately aware of the information available. Fama (1970) distinguishes three forms of informational efficiency: weak, semi-strong and strong.

> Weak hypothesis: This form of efficiency is based on the idea that historical prices are now the only component of available information. In other words, at any given time, prices contain only past price trends and returns. Consequently, market players cannot use knowledge of past prices to make abnormal gains. Most tests based on this form of efficiency are based on random walk theory, which aims to determine whether future returns can be predicted on the basis of past returns.

Semi-strong hypothesis: under this form of efficiency, prices fully incorporate all the information of the weak form, as well as all public information on the health of the company, such as annual reports, earnings announcements, dividend or bonus share payouts, acquisitions of other companies, rumours, etc. The aim is to determine at what point the company will be able to predict future returns on the basis of past returns. The aim is to determine how quickly prices integrate this diversity of public information.

Strong hypothesis: A market is said to be efficient in the strong sense if the possession of private information by a particular player has no influence on observed prices, and therefore does not allow arbitrage between the different options on offer.

Investor Rationality

Basic Foundations

The second dimension of the concept of financial market efficiency is based on the rationality of economic agents in carrying out market transactions. Given certain relevant information, known as "fundamentals", investors are able to optimize their supply and demand choices on the financial market and maximize their utility function. Lucas (1978); Grossman and Shiller (1981) specify that investors are considered rational if they master not only the fundamentals, but also the exact relationship between these fundamentals and the value of the goods traded, so that there is an analogy between the "true" economic value of a good and its equilibrium price on a market of perfect competition.

Forms Of Investor Rationality

Rationality is a vague concept that needs to be explored in greater detail, particularly when it comes to the behavior of economic agents on financial markets. Every decision depends on the cognitive capacities of each agent to receive and process information. We can therefore distinguish three forms of rationality:

Strong form of rationality: this form is described as total or perfect, where the investor is assumed to be omniscient, calculating and endowed with unlimited cognitive capacities. It consists of a form of adequacy between the means and the objectives pursued, and the constraints with which the agent is confronted are of an external nature, such as income or the state of technology. Stiglitz and Walsh (2004) emphasize that such a model does not claim to describe how the economy really works, but serves as a reference to a state of perfect efficiency. This conception of rationality has been widely criticized, giving rise to other conceptions that seek to better understand the determinants that can influence agents' decisions on financial markets.

Semi-strong form of rationality or substantive rationality: Like the strong form of rationality, the agent has unlimited cognitive capacities, and although he is informed in probabilities, he always remains self-interested, heroic and calculating. He thrives in a risky environment, where information is costly, so that only second-order optimization is possible.

The weak form of rationality or bounded rationality: the term 'bounded' doesn't mean that the agent still doesn't behave rationally, but he won't have the benefit of all the information to make his decisions, either because of scarcity in the face of a need, or because of abundance which requires a draw. In other words, the agent's cognitive capacities for gathering and processing information are very limited, but he is always interested. Thus, the decision-maker can never be certain that his choice will lead to the objectives he has set himself, due to the unpredictable risks of his environment. Ultimately, the agent's processing of information remains a key element of procedural rationality, insofar as his margin of satisfaction will derive from the degree of control he exercises over this information.

Conditions For Efficient Financial Markets

In the literature, a considerable number of tests have been carried out to determine how close financial markets are to the perfect market. Indeed, the closer we get to the desired level, the more it is possible to produce models based on this hypothesis. With this in mind, E. Fama (1970) put forward three hypotheses to justify market efficiency:

The rapid and inexpensive dissemination of information: in other words, a market can only be considered efficient if it ensures the free flow of information.

The immediate reaction of investors to perceived information: economic agents are assumed to be rational, and react by making rational decisions.

The price of a financial asset follows a random trajectory.

These assumptions imply the verification of 4 conditions:

Rationality of investors**:** all economic agents must act rationally and consistently in relation to the information they receive, given that investors always seek to maximize their utility through the buying and selling operations they carry out.

Free flow of information and imminent reaction by investors**:** this is based on the principle that information must be disseminated simultaneously to all economic agents, so that they can react in real time.

Absence of transaction costs and taxes on stock markets**:** Investors may be reluctant to invest or divest in the presence of transaction costs or stock market taxes that erode or cancel out potential gains.

Atomicity and investor liquidity: economic agents will not trade in securities if, for reasons of liquidity, the transactions they carry out themselves risk causing the price of these securities to fluctuate.

The Adoption of IFRS As Part Of The Theory Of Efficient Financial Markets

The emergence of IFRS is due to the inability of national standards to provide relevant information reflecting the economic reality of the company, thus enabling investors, through their rational behavior, to make the best choices and maximize their utility function by intervening in the financial markets. A review of the empirical literature shows that the study of the link between IFRS adoption and efficiency theory refers to informational relevance to explain the impact of these standards on financial reporting and financial markets. Indeed, numerous studies have been carried out, and although the results are not unanimous and differ according to the context targeted and the methodology adopted, the majority of authors arrive at results confirming the superiority of IFRS over local standards in terms of informational relevance.

In this context, Oubahou and El ouafa (2024), find that IFRS accounting figures better explain stock market performance in the Moroccan context. In addition, Salameh (2013) reached a similar conclusion, confirming the deterioration in informational relevance of accounting figures drawn up under local French standards compared with IFRS, which provide relevant information. Kwon et al (2017) argued that a higher level of accounting disclosures, combined with strong mandatory application of IFRS, would lead to improved informational relevance. Escaffre and Sefsaf (2008) find that accounting profits and equity under IFRS have significant explanatory power compared with US standards. In addition, Hung and Subramanyan (2007) confirmed the divergent orientations of IFRS (investors/fair value) and German standards (stakeholders/prudence), highlighting the greater market sensitivity of IFRS earnings and equity compared with national standards. In addition, Tsalavoutas and Dionysiou (2014) pointed out that disclosures following mandatory IFRS adoption have helped to increase the relevance of corporate reporting in the European Union, with the level of relevance of disclosures positively correlated with the level of IFRS compliance. Lenormand *et al* (2007) add that the improvement in the quality of financial information following the mandatory transition to IFRS depends on the legal and institutional rules governing disclosure and transparency that accompany the change in accounting standards.

On the other hand, Cormier *et al* (2009) point out that adjustments to the amount of equity under IFRS resulting from consideration of optional exemptions at the time of transition can be a positive sign of improved accounting quality. Ibrahimi and El Baghdadi (2023) in turn found that book value of equity and net income has a positive and significant relationship with stock market value in the post-IFRS period. Similarly, Cormier *et al.*(2012) found that, under IFRS, materiality is a tool for forecasting future cash flows, enabling book values to be reconciled with market values. In this respect, an analysis of stock market returns shows that the predictive nature of accounting results is more important under IFRS than under French GAAP.

Ultimately, the IFRS conceptual framework underlines the importance of effective and relevant information, insofar as financial markets are the true source of corporate financing and a place where investors can maximize their utility through the optimal choices they make. Considering that international accounting standards are based on the principle of fair value measurement, which often reflects a high degree of transparency and aligns accounting information with stock market prices and returns, we can conclude that the adoption of IFRS is helping to restore investor confidence by providing high-quality information, as well as encouraging companies to disclose more information, thereby achieving a very high level of effectiveness and efficiency within financial markets.

AGENCY THEORY

Agency theory originated with Berle and Means (1932), following the emergence of the modern corporation characterized by the separation of ownership and management. Later, Jensen and Meckling (1976) published an article detailing the main thrusts of this theory. We first present its main foundations, and then apply its contribution to the adoption of IFRS.

basic fundamentals

The study of agency relationships goes back to Adam Smith's reflections on the inefficiency of joint-stock companies, whose management was entrusted to non-owning agents who had no interest in managing the business entrusted to them. After the advent of joint-stock companies, Berle and Means (1932) revisited the question of the separation of ownership and control. Agency problems were first addressed by Ross (1973), then studied and analyzed theoretically by Jensen and Meckling (1976), who define agency theory as "a contract by which one or more persons (the principal) engages another person (agent) to perform a task on his behalf, implying a delegation of decision-making power to that agent".

This theory highlights the problem of divergent interests between the owners of the means of production, on the one hand, and the managers who use these means at the principal's request, on the other. This is a good reason to believe that agents will not always act in the principal's interest. Moreover, this divergence of interests can lead to additional operating costs for the company, known as agency costs.

Jensen and Meckling (1976) distinguish between three types of agency costs:

supervisory costs, incurred by the principal in controlling the agent's work

Liability costs, which are borne by the agent and ensure that the principal is not harmed;

Residual (opportunity) costs, which represent the difference between the result of the agent's behavior for the principal and what would result from behavior that would effectively maximize the principal's well-being.

IFRS adoption in the context of agency theory

It is interesting to note that agency theory provides a comprehensive theoretical framework for analyzing and explaining the problems associated with information asymmetry, which exist mainly between shareholder-managers and creditor-managers, especially as owners do not play an active role in the management of the company. This division of roles between owners and managers is at the root of agency problems, with the latter tending to pursue their own interests to the detriment of the former, since they have more information about the company (Fama, 1980; Fama and Jensen, 1983). Consequently, mechanisms enabling investors to control these problems and align the interests of investors and managers include the use of optimal contracts, boards of directors and information transmission intermediaries such as financial analysts and rating agencies (Healy and Palepu, 2001).

In examining the relationship between disclosure and the reduction of information asymmetry, we argue that the adoption of IFRS will encourage companies to provide more mandatory disclosures than the local accounting system, or even optional disclosures. In addition to annual and half-yearly reports, these companies will be able to publish interim management reports and quarterly financial statements.

The study of the relationship between IFRS disclosure and the reduction of the problem of information asymmetry has been the subject of several research studies worldwide. Using share liquidity as a proxy for information asymmetry, (Diamond and Verrecchia, 1991; Kim and Verrecchia, 1994) argue that, when the level of disclosure is high, investors can be relatively confident that each stock market transaction is taking place at a fair price, thereby increasing the liquidity of the company's shares. In the same vein, Welker (1995) and Sengupta (1998) report a negative and significant relationship between analysts' assessment of the level of disclosure and the dispersion of supply and demand for securities. Leuz and Verrecchia (2000) show that German companies adopting foreign standards have a lower bid-ask spread than companies using domestic accounting standards. Furthermore, they found a positive and significant correlation between IAS/IFRS adoption and trading volume, but not with regard to share price volatility.

In analyzing the impact of voluntary and mandatory IFRS adoption on the cost of capital as a second indicator of information asymmetry. Botosan (1997) found a negative relationship between the cost of capital and the level of voluntary disclosure only for companies with low analyst coverage. Within this framework, Piotroski (1999) shows that companies making extra-industry disclosures experience an increase in the market capitalization of their earnings, which reduces the cost of capital. Other studies, Botosan and Plumlee (2002) also found a negative relationship between the cost of capital and the classification of disclosure in analyst reports.

Other authors, notably Lang and Lundholm (1993), use analyst monitoring as a proxy for understanding information asymmetry. They find that companies that publish more information have high analyst tracking, low forecast dispersion and low forecast revision volatility. Francis and Shipper (1999) also find that companies which organize conference calls have a higher analyst following. Similarly, Botosan and Harris (2000) show that companies that undertake voluntary sector disclosure experience a reduction in their information asymmetry.

Ashbugh and Pincus (2001), in a study carried out on a sample of non-US companies from 13 countries, examined the impact of differences between local standards and IFRS on the accuracy of analysts' forecasts. The results show that, prior to the adoption of IFRS, the greater the difference between IFRS and local standards, the greater the analysts' error. After the adoption of IAS/IFRS, the authors find a reduction in analyst forecast errors. This indicates that the use of international standards provides analysts with better information on company performance and reduces information asymmetry.

On the basis of the advanced literature, we can confirm that disclosure according to international IFRS financial reporting standards contributes to the reduction of information asymmetry and encourages investors to invest and make optimal decisions compared with those made under domestic standards.

Signal Theory

Originating in the work of S. Ross (1977), signal theory was developed to compensate for the shortcomings of equilibrium market theory. It is based on the observation that information is not transmitted to everyone at the same time, and that information asymmetry is the rule.

Basic principles

The theory of signaling is placed in the context of asymmetric information in the market. The goods or services offered by suppliers are heterogeneous. Unlike buyers, suppliers know the quality of what they offer. This is well illustrated by the famous example of used cars, where buyers would have great difficulty distinguishing a good used car from a "lemon" (Akerlof, 1970). In this context, competition encourages suppliers offering quality products to inform buyers about them. By signaling, they hope to obtain prices that match the quality of their offerings**.**

The concept of signal is not precisely defined in this theory. Drawing on Kelly (1991, p. 190), we define a brand as an action (or manipulable attribute) that a company can undertake to honestly convey private information about itself to others in order to distinguish itself. Through signaling, those with information transmit it to those with less (Spence, 2002). Based on the work of Spence (1973), the hypothesis is that a signal must be

more costly (not necessarily in monetary terms) or more difficult to issue for a "bad" company than for a "good" company.

Spence (1974) distinguishes between two types of signal:

> Non-costly signals: in this case, the signal is not costly for the agent issuing it, but it is costly for the agent seeking to imitate it by mistake.

This is why they set a critical debt threshold. Any company whose debt level exceeds the critical threshold is perceived by the market as being of high quality, and its managers therefore receive appropriate remuneration. If the debt level is below the critical threshold, the company is perceived as being of low value, the managers drive the company into bankruptcy and their remuneration is called into question.

> Costly signaling, in which informed players incur costs to signal their true value: In this case, signaling costs are linked to the fact that the entrepreneur forgoes further diversification of his asset portfolio. These costs are negatively linked to the actual profitability of the planned investments.

IFRS adoption in the context of signaling theory

Based on the assumption that managers have additional informational power than creditors and owners. Some authors use the level of debt as leverage to demonstrate the company's sound financial position, and thus as an effective means of reducing information asymmetry on the financial markets. Ross (1977) points out that a company's debt level is a signal given by management about the company's current and future cash flows. Indeed, managers who take on debt need to know the company's future cash flows and be confident in its ability to repay them (principal and interest). According to these authors, only successful companies can bear relatively large debts, as they are able to meet their commitments without problems. At the same time, Levis (1990) found that companies in a poor financial situation cannot bear the consequences of a high level of debt, and will face a high risk of bankruptcy.

Following the same logic, (Koh and Walter, 1989; Kim and Ritter, 1999), show that the value of a company depends on the level of leverage: by increasing leverage, the company signals its greater efficiency, which leads to a reduction in information asymmetries on financial markets. Corporate indebtedness can be seen as an effective means of reducing agency costs, as this will lead to a convergence of shareholder and management interests (Poincelot, 1999). In the same vein, Hodgson and Stevenson-Clarke (2000) show that cash flow has a relevant information content for highly leveraged companies, compared with companies with lower leverage ratios.

Examining the effect of company leverage on the impact of IFRS, Salameh (2013) finds that accounting data is more informative after IFRS implementation for companies with low leverage. This finding highlights the moderating effect of debt on the information content of accounting data resulting from mandatory IFRS adoption. Debt is seen as a performance signal for a company. When a company is performing well, it can easily meet the obligations associated with a high level of debt. Moreover, it can be seen as a means of reducing agency costs, because in the case of a highly indebted company, the manager is obliged to act not only in his own interests, but also in those of other stakeholders. For example, bank-type debts increase the bank's control over the manager's management activities, reduce the manager's ability to make optimal investments by reducing free cash flow due to fixed interest payments, and increase the manager's risk of insolvency and job loss due to the possibility of liquidation by the bank.

Based on the literature, we argue that the adoption of International Financial Reporting Standards (IFRS) by preparers of corporate financial statements sends a signal to the market about the quality of financial information and the elimination of information asymmetries.

CONCLUSION

Developing a theoretical framework is a crucial and highly stimulating stage in the humanities and social sciences research process. It allows us to explore the abundant literature and make enriching discoveries. However, this dimension of the research process can also be a source of anxiety, as the quantity of potentially interesting

theoretical references in a research project often seems overwhelming. Moreover, it is difficult to define its beginning and end, although it is often presented as lying on a thread between problem and methodology. Thus, the theoretical framework, including the choice of relevant theories, provides a better understanding of the phenomenon under study by contributing to the formulation of the research question and objectives, as well as to methodological choices.

The aim of this study is to demonstrate the extent to which the theories of informational efficiency, agency and signaling serve as basic theoretical references for studying the phenomenon of the quality of financial information disclosed to different key users following the transition to IFRS. We have divided this work into three main sections, the first of which is devoted to developing the theory of efficient financial markets, focusing on its basic foundations, dimensions, forms and conditions for achieving a perfect market, and so on. The second section is devoted to the development of agency theory, which emerged as a result of the moral hazard existing between owners and managers. The final section is devoted to the foundations of signal theory and its contribution to the analysis of the quality of financial reporting under IFRS.

Empirical analysis shows that the publication of IFRS-type information helps to restore confidence in financial markets, by guaranteeing the reliability and relevance of information. Furthermore, these standards reduce managerial discretion and agency costs, confirming that these theories are at the heart of any study dealing with the impact of IFRS on the quality of financial information and investor behavior on financial markets.

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