The impact of IFRS adoption on the accuracy and dispersion of analysts' forecasts in the Brazilian stock market

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Abstract

This study aims to analyze the impact of adopting international accounting standards on the accuracy and dispersion of analysts' forecasts in the Brazilian stock market. Data were extracted from the Institutional Brokers Estimate System (IBES) database and reference forms of companies published on the Brazilian Securities and Exchange Commission's website for the period 2000–2015. The difference-in-differences methodology was used to compare the results of companies that voluntarily adopted the IFRS with those of companies that adopted the IFRS after the mandatory adoption period. The results suggest that mandatory IFRS adoption contributed to an increase in the accuracy of analysts' earnings forecasts for non-financial companies, while it did not significantly impact the dispersion of analysts' forecasts. These findings suggest that IFRS adoption contributed to an increase in the quality of analysts' earnings forecasts, providing investors with more security when utilizing this information for decision-making.

1. Introduction

This study aims to evaluate the impact of adopting the international financial reporting standards (IFRS) on the quality of analysts' earnings forecasts for companies listed in the Brazilian stock exchange.

Analysts play a key role in the stock market, since they evaluate companies using information from the current period to predict future results. Kothari (2001) and Ramnath *et al.* (2008) indicate the relevance of research in this area. Thus, it is evident that the analyst's role as an information disseminator to the market is central, enabling the market to be more efficient (Dechow and Schrand 2004, Gu and Wu 2003).

Within the informational content provided by market analysts, the financial information of companies deserves special attention. Previous research has indicated that IFRS adoption leads to a decrease in analyst forecast errors and therefore a decrease in information asymmetry in the stock market (Lang and Lundholm 1996, Ashbaugh and Pincus 2001, Jiao *et al.* 2011, Cotter *et al.* 2012).

However, the impact of IFRS adoption on the quality of accounting information depends on the institutional aspects of the acceding countries, such as the development of the stock market, *legal enforcement* for the implementation of standards, as well as incentives of the acceding companies to divulge information (Markov and Tamayo 2006, Soderstrom and Sun 2007, Daske *et al.* 2013).

Consequently, the results for Brazil may differ from those found in the international literature, owing to the smaller size of companies, lower number of analysts providing business coverage, limited coverage of companies, highly concentrated ownership in the stock market, and low degree of institutional development in Brazil (Djankov *et al.* 2006, La Porta *et al.* 1998, La Porta and Shleifer 2008).

Research on IFRS adoption and the accuracy of analysts' forecasts are still recent, and the results are yet to be consolidated (Martinez and Dumer 2014, Gatsios *et al.* 2016, Domingues and Nakao 2017, Oliveira and Coelho 2018). Nonetheless, the divergence of results may be justified by the two stages of IFRS adoption in Brazil—the period of partial adoption and that of compulsory adoption—the latter being combined with the 2008 financial crisis. Moreover, some Brazilian companies having stocks in other countries may have already disclosed information in accordance with international standards even before their compulsory adoption in Brazil.

This study aims to evaluate the quality of analysts' forecasts in Brazil after IFRS adoption by answering the following research question: Has the adoption of IFRS in Brazil increased the accuracy and reduced the dispersion of analysts' forecasts for joint stock companies in Brazil?

To address this question, this study analyzes data from 2000 to 2015, with an annual frequency of analysts' forecasts. Data were extracted from the I/B/E/S baseline and reference forms of companies published on the CVM website. The *Difference-in-Differences* methodology was used for the analysis. This study differs from previous studies with regard to the choice of methodology, providing a more precise evaluation of the analysis. Moreover, to validate the results, this study assessed firm characteristics and the economic scenario in order to isolate the effect of IFRS adoption on the quality of analysts' forecasts in Brazil. The economic scenario analysis is relevant because it captures the simultaneous impact of the financial crisis of 2008 and the adoption of IFRS in Brazil. Finally, the study also examines the dispersion of analysts' forecasts, a topic that has not been discussed in previous studies in the Brazilian context.

The results indicate that compulsory IFRS adoption in Brazil increased the accuracy of analysts' forecasts, but it did not alter the dispersion pattern of such forecasts. Furthermore, this study found evidence that the macroeconomic conditions are an important determinant of

the quality of analysts' forecasts. These results suggest that greater accuracy in analyst forecasts enables lower risk of investor decision-making in portfolio allocation.

This paper is organized as follows. Section 2 presents a theoretical reference of IFRS adoption in Brazil and analysts' forecasts, as well as discusses the research hypotheses. Section 3 presents the methodology, data, and models used in the study. Section 4 discusses the study results. Finally, Section 5 concludes the study.

2. Theoretical Background

The IFRS is a set of international accounting standards (Deloitte, 2012) aimed at the improvement of information quality, among others. According to Ball (2006), IFRS adoption leads to greater reliability of financial information for investors, since IFRS facilitates easy understanding among international analysts and investors. Daske *et al.* (2008) state that the introduction of IFRS represents the most significant regulatory change in the history of accounting.

In Brazil, IFRS adoption was conducted in two stages: (i) the approval of Law 11.638/07, enabling partial adoption from 2008 onward; and (ii) compulsory adoption by all public listed companies in the Brazilian stock market from 2010 onward.

Previous studies investigating the impact of IFRS adoption on the quality of accounting information employ the cost of equity, the level of earnings management, and timely recognition of losses as proxies for quality. The results mostly indicate an improvement in the information content made available (Daske *et al.* 2013, Li 2010). Nonetheless, this impact is linked to institutional aspects of the acceding countries, such as the development of the stock market, and *legal enforcement* for implementing standards, and incentives of the acceding companies to divulge information (Markov and Tamayo 2006, Sun 2007). Daske *et al.* (2013). Thus, the impact of IFRS adoption may be different in emerging countries (Zhou *et al.* 2009).

Brazil is characterized by a low level of development of the stock market, high ownership concentration in listed companies, and low degree of institutional development (Djankov *et al.* 2006, La Porta *et al.* 1998, La Porta and Shleifer 2008). Studies conducted on IFRS adoption in the Brazilian context indicate a low impact of the adoption on financial statement quality (Santos and Calixto 2010, Nardi and Silva 2014).

Regarding analysts' forecasts, studies were conducted to evaluate the impact of IFRS adoption on the quality of market analysts' forecasts. With the increase in accounting information quality and the resulting decrease in information asymmetry, a decrease in the market analysts' forecast error is expected. The non-standard results indicate an increase in accuracy and a decrease in dispersion of profit estimates made by market analysts (Lang and Lundholm 1996, Ashbaugh and Pincus 2001, Bae *et al.* 2008, Tan *et al.* 2011, Jiao *et al.* 2011, Glaum *et al.* 2011, Cotter *et al.* 2012, Aubert and Grudnitski 2012, and Preiato *et al.* 2015)"

Research on IFRS adoption and the quality of market analysts' forecasts in Brazil are still recent, and they present results that are yet to be consolidated (Martinez and Dumer 2014, Gatsios *et al.* 2016, Domingues and Nakao 2017, Oliveira and Coelho 2018). National research primarily evaluates the impact of IFRS adoption on analysts' forecast accuracy. However, accuracy is not the only dimension of forecast quality found in the market analysis literature. Martinez (2007) states that analysts' forecast quality must be evaluated on the basis of accuracy, dispersion, and bias.

Regarding the national research in the subject, the divergence of results may be explained by IFRS adoption in Brazil. There were periods of voluntary and compulsory adoption, an effect combined with the 2008 financial crisis, and the fact that some Brazilian companies already chose to disclose information according to international standards before compulsory adoption in Brazil because they negotiated stocks in other countries.

Through the use of difference-in-differences methodology, the analysis of forecast accuracy and dispersion, and the inclusion of a variable representing the economic scenario in the models, this study aims to contribute to the existing literature.

Two hypotheses were analyzed according to the models presented in the study.

H1: The accuracy of analysts' forecasts increased after IFRS adoption in Brazil.
H2: The dispersion of analysts' forecasts decreased after IFRS adoption in Brazil.

3. Data and Methodology

The data used in this study were obtained from the *Thomson Reuters® platform, the I/B/E/S/ and Thomson Financial databases, and the Securities* and Exchange Commission (CVM) website, which provides information from the reference forms of the companies analyzed.

The analysis period was from 2000 to 2015: (i) voluntary adoption period (2000-2007); and (ii) compulsory adoption period (2008-2015). According to Markov and Tamayo (2006), a longer period of data after the adoption of IFRS is necessary to facilitate learning among companies and accounting information users.

Finally, financial companies were excluded from the study sample due to the difference in the adoption of IFRS in the Brazilian case.

This study used data from the EPS annual forecast of companies, which was carried out by analysts in December of each year. The choice of December was justified by the aim of collecting analysts' forecasts with the largest amount of information available and using forecast during a period when the analyst already has less uncertain information on companies and the economic scenario (Cotter *et al.* 2012).

The sample comprised all the companies that presented at least one forecast value for the earnings per share (EPS) in the years analyzed. A total of 227 companies were included for the analysis of forecast accuracy and dispersion. the sample comprised 958 and 908 observations for forecast accuracy and forecast dispersion, respectively. The sample was reduced to study the dispersion of the analysts' forecast estimates because it was impossible to calculate the standard deviation of analysts' estimates for companies with only one estimate recorded.

To analyze *the accuracy of analysts' forecasts before and after IFRS adoption in Brazil, the Absolute Forecast Error (AFE) variable was constructed.*

AFE was defined as the absolute difference (module) between the annual EPS of company j during disclosure $(A_{j,r})$, and the median of the forecast made by analysts for the annual EPS in December $(F_{j,t})$, divided by the stock price on the last working day of December $(P_{j,t})$, represented in (1):

$$AFE_{j,t} = \left| \frac{A_{j,r} - F_{j,t}}{P_{j,t}} \right| \tag{1}$$

The *EPS* of company j represents the earnings per share for the previous year before the stock issue.

To test whether the dispersion of analysts' estimates decreased after IFRS adoption in Brazil, the dependent variable Dispersion of Projections *(DP)* was used.

The *DP* variable was defined as the standard deviation of company j's analysts' estimates in period *t,* in December, divided by the price of stock on date *t*, represented in (2):

$$DP_{j,t} = \frac{Desvio\ Padrão\ das\ Estimativas\ dos\ Analistas_{j,t}}{P_{j,t}} \tag{2}$$

The variables AFE and *DP* were created following Cotter *et al.* (2012) and Lang and Lundholm (1996).

To evaluate the impact of IFRS adoption on the accuracy and dispersion of analysts' forecasts, the following independent variable was proposed:

IFRSOBR – A dummy variable used to analyze AFE and DP in periods before and after the mandatory adoption of IFRS in Brazil, which takes the value of 1 for periods after the mandatory convergence to IFRS, and 0 for other periods.

To segregate the effect of IFRS adoption on analyst forecast accuracy and dispersion, control variables were used to control for the effect of company size, number of analysts, earnings or losses, volatility of the results and macroeconomic conditions, in accordance with previous studies (Lang and Lundholm 1996, Ashbaugh and Pincus 2001, Lang and Lundholm 1996, Martinez 2007, Lys and Soo 1995, Ernstberger *et al.* 2008, Lang and Lundholm 1996, Tan *et al.* 2011).

To verify whether the forecast error and dispersion of analysts' estimates decreased for the Brazilian joint stock companies after their compliance with IFRS, two regression models were used along with the D*ifference-in-Differences* technique.

The study sample was divided into two groups: (i) the control group, composed of the companies that adopted the IFRS voluntarily; and (ii) the treatment group, comprising companies that adopted the IFRS in a compulsory way, after mandatory IFRS adoption in Brazil. The companies that disclosed accounting information in a pattern different than the BRGAAP before 2010, or chose to be accepted by the IFRS before the compulsory adoption period were considered as companies that voluntarily adopted the IFRS.

To adapt the data to the proposed model, the control variable **OBR** was added to the models. The **OBR** variable takes the value of 1 in case a company has adopted IFRS in a compulsory way, and 0 otherwise.

The models used are presented in (3) and (4):

$$EPA_{j,t} = \beta_0 + \beta_1\,IFRSOBR_{j,t} + \boldsymbol{\beta_2 IFRSOBR_{j,t} X\ OBR_{j,t}} + \beta_3 LNASSET_{j,t}$$
$$+ \beta_4 ANALIST_{j,t} + \beta_5 LOSS_{j,t} + \beta_6 DPROE_{j,t} + \beta_7 EMBI_{j,t} + \beta_8 OBR_{j,t}$$
$$+ \beta_9 DUMMY\ SETOR_{j,t}$$
$$+ e_{j,t} \tag{3}$$

$$DP_{j,t} = \beta_0 + \beta_1\,IIFRSOBR_{j,t} + \boldsymbol{\beta_2 IFRSOBR_{j,t} X\ OBR_{j,t}} + \beta_3 LNASSET_{j,t}$$
$$+ \beta_4 ANALIST_{j,t} + \beta_5 LOSS_{j,t} + \beta_6 DPROE_{j,t} + \beta_7 EMBI_{j,t} + \beta_8 OBR_{j,t}$$
$$+ \beta_9 DUMMY\ SETOR_{j,t}$$
$$+ e_{j,t} \tag{4}$$

in which,

LNASSET – represents the natural logarithm of total assets of company j in period t.
ANALIST – represents the number *of* analysts who made forecasts for company *j* in period t.
LOSS – A *dummy* variable that takes the value of 1 in case of loss, and 0 in case of earnings in the financial year were disclosed for company j.
PROE - Standard deviation of the last three returns on (annual) net equity for company j.
EMBI - Natural logarithm of the *EMBI+BR* index in period *t*.

The coefficient β_1 reflects the relationships between the dependent variables and the period of compulsory IFRS adoption in Brazil. β_2 represents the impact of IFRS adoption on <u>analyst forecast accuracy and dispersion</u> for companies that adopted IFRS compulsorily, compared to those of companies that adopted the standards voluntarily way, and $e_{j,t}$ represents the random error of company j in period t. The sectoral dummies were used according to the methodology of the Global Industry Classification Standard (GICS).

Finally, *Chow* and *Hausman* tests were carried out to determine the suitable models and relationships between the variables, as well as tests of self-correlation and heteroscedasticity to confirm the validity of the results.

4. Results

Table 1 shows the descriptive statistics of variables. The results suggest changes in the variables' behavior during the period analyzed, demonstrating the variability of the sample; more precisely, they indicate that the variable in question, IFRS adoption, has a varied impact during the period of analysis. The average of *the* variables AFE and *DP* changed during the compulsory adoption period of IFRS in Brazil, indicating that the forecast accuracy increased while the dispersion of estimates decreased after compulsory adoption of IFRS in Brazil.

These results are in line with hypotheses 1 and 2, which imply an increase in forecast accuracy and a decrease in forecast dispersion, respectively, after IFRS adoption in Brazil. However, as presented in Table 1, it is important to highlight that the control variables also underwent changes during the analysis period.

Table 1 - Descriptive Statistics - Accuracy and Dispersion of Analysts' Forecasts

Variables	No. of observations	Mean	Standard deviation	Minimum	Maximum
Period Before IFRS Adoption – Accuracy					
AFE	430	1.2111	2.8668	0.0028	21.6850
ANALIST	430	7.1000	4.4978	1.0000	23.0000
DPROE	430	3.2758	18.8941	0.0048	185.7649
LNASSET	430	21.3575	1.5497	16.4644	25.2905
EMBI	430	6.0597	0.5974	5.1960	7.2243
Period of Mandatory Adoption - Accuracy					
AFE	548	1.0121	3.0237	0.0028	22.9751
ANALIST	548	8.8668	4.1466	1.0000	18.0000
DPROE	548	3.8397	18.9235	0.0048	185.7649
LNASSET	548	21.7825	1.3849	17.9583	26.5753
EMBI	548	5.4075	0.2158	5.2146	5.8446
Period Before IFRS Adoption – Dispersion					
SD	395	0.6890	1.8030	0.0000	13.6249
ANALIST	395	7.6152	4.3207	1.0000	23.0000
DPROE	395	3.3347	19.6179	0.0048	185.7649
LNASSET	395	21.5202	1.4863	16.4644	25.2905
EMBI	395	6.0358	0.5947	5.1960	7.2243
Period of Mandatory Adoption – Dispersion					
SD	510	0.6147	1.7688	0.0000	13.6249
ANALIST	510	9.3137	3.8067	2.0000	18.0000
DPROE	510	3.2287	15.8863	0.0048	185.7649
LNASSET	510	21.8399	1.3527	17.9583	26.5753
EMBI	510	5.4043	0.2144	5.2146	5.8446

For instance, a comparative analysis demonstrated that the number of analysts increased and investor risk decreased during the mandatory adoption period, compared to the voluntary adoption period.

Table 2 shows the coefficients, standard deviation, and the p-value for each variable in the models. The methodology used is panel data analysis with random effects. The use of this methodology is justified by the data characteristics and the Hausman specification test.

To interpret the results of the accuracy and dispersion models of analyst forecasts, the coefficient obtained by the variables, IFRSOBR and OBR, stands out. They represent the isolated effect of IFRS adoption on companies that adopted them mandatorily after 2010. Consequently, other effects that may have an impact on the dependent variables other than IFRS adoption are mitigated.

The accuracy model indicates a negative and statistically significant relationship between the *AFE* variable and the *IFRSOBR X OBR* variable, indicating that analysts' forecast accuracy increased during the mandatory adoption period, compared to the period before the adoption in Brazil.

Table 2 - Models - Accuracy and Dispersion of Analysts' Forecasts

Variables	Data	Accuracy Model	Dispersion Model
IFRSOBR	*Coefficient*	0.6275	0.0477
	Standard Deviation	0.4096	0.2312
	P-Value	0.1260	0.8370
IFRSOBR X OBR	*Coefficient*	**-0.8714**	-0.1559
	Standard Deviation	0.4945	0.2960
	P-Value	0.0780	0.5980
OBR	*Coefficient*	**0.7113**	0.3477
	Standard Deviation	0.3985	0.3334
	P-Value	0.0740	0.2970
ANALIST	*Coefficient*	-0.0359	**-0.0255**
	Standard Deviation	0.0255	0.0153
	P-Value	0.1600	0.0950
DPROE	*Coefficient*	**-0.0136**	-0.0135
	Standard Deviation	0.0073	0.0091
	P-Value	0.0620	0.1400
LNASSET	*Coefficient*	-0.0069	0.0983
	Standard Deviation	0.1631	0.0987
	P-Value	0.9660	0.3200
EMBI	*Coefficient*	**0.6259**	**0.2724**
	Standard Deviation	0.2954	0.1215
	P-Value	0.0340	0.0250
LOSS	*Coefficient*	**-0.8692**	-0.2695
	Standard Deviation	0.3987	0.4079
	P-Value	0.0180	0.2720
CONSTANT	*Coefficient*	-1.8884	-2.7120
	Standard Deviation	3.3062	2.4163
	P-Value	0.5680	0.2620
Dummy **Sector**		Yes	Yes
Adjusted R^2		0.0395	0.0279

This interpretation considers the relative effect of IFRS adoption between the group of companies that already adopted IFRS before the mandatory period and the group that adopted IFRS only during the mandatory period. Since the coefficient is negative, a smaller forecast error standard was found for mandatory adopters compared to voluntary adopters. Apparently, this effect can be attributed to the mandatory adoption of IFRS in Brazil. Furthermore, the isolated variable of the effect of the IFRS period, IFRSOBR, is not significant. However, when this variable is analyzed in conjunction with the compulsory or voluntary adoption, using the difference-in-differences methodology, the result is significant, showing the effect of IFRS adoption on analysts' forecast accuracy.

The result presented confirms hypothesis 1 that states an increase in analysts' forecast accuracy after mandatory IFRS adoption in Brazil. This is in line with the evidence found in the international literature (Ashbaugh and Pincus 2001, Bae *et al.* 2008, Jiao *et al.* 2011).

The dispersion model suggests that the decrease in dispersion in analysts' forecasts found in the descriptive statistics does not present a statistically significant relationship with the *IFRSOBR X OBR* variable. Thus, the decrease in the dispersion of analysts' forecasts cannot be attributed to IFRS adoption. This result is contrary to the evidence provided by international studies (Ashbaugh & Pincus, 2001; Bae, Tan, & Welker, 2008; Jiao, Koning, Mertens , & Roosenboom , 2011); nevertheless, the result is in line with that of Cotter *et al.* (2012), which considered the case of Australia. In addition, because analyst forecast dispersion is more sensitive to the extreme points of the sample, it may be concluded that not all market analysts make accurate forecasts after IFRS adoption.

With respect to control variables, the importance of the macroeconomic analysis, inserted in the model through the variable measuring the Brazil risk deserves attention. The effect was significant for both forecast accuracy and forecast dispersion. Moreover, it is worth mentioning that the variable measuring the dispersion of results, DPROE, has a negative sign.

The results suggest that IFRS adoption had an impact on the quality of market analysts' forecasts, owing to the impact on forecast accuracy. Having access to forecasts with reduced forecast error may allow Brazilian stock market users to tap better information content for decision-making in portfolio allocation, since market analysts' forecasts help investors in stock evaluation (Dechow and Schrand 2004).

Compared to the results of previous research (Martinez and Dumer 2014, Gatsios 2016, Domingues and Nakao 2017, Oliveira and Coelho 2018), this study aids in evaluating IFRS adoption in Brazil and effectively demonstrates the importance of the difference-in-differences methodology, since solely analyzing the period of IFRS adoption in Brazil may not help in capturing the changes in the quality of analysts' forecasts. Furthermore, the study demonstrates the importance of using the economic scenario as a control variable for analyzing the accuracy and dispersion of analysts' forecasts.

The results of this study are relevant to the international literature, since they provide evidence regarding the effect of IFRS adoption in countries with a lower degree of institutional development and low development of the stock market (Daske et al. 2013). Finally, the results make headway for future IFRS convergence and expected results in various economic and financial conditions.

5. Conclusion

This study examined the effects of IFRS adoption on analysts' profit estimates for joint stock companies in Brazil. For this purpose, two models were developed and analyzed using the *Difference-in-Differences* methodology: (i) the accuracy model; and (ii) the dispersion model. Data were obtained from the *Thomson Reuters*® platform, the I/B/E/S and *Thomson Financial* databases, and the reference forms of companies published on the CVM website.

Moreover, the descriptive statistics of the variables analyzed and average difference tests were presented to evaluate the behavior of the dependent variables in the IFRS adoption period.

The study period was divided into two categories: the period before the mandatory adoption of IFRS; and the period of mandatory compliance with IFRS. Accordingly, differences between companies that adopted IFRS voluntarily and those that chose to adopt IFRS only after the compulsory adoption period were analyzed.

The model results indicated that analyst forecast accuracy increased during the compulsory adoption period in Brazil. This result is in line with the findings of Ashbaugh and Pincus (2001), Bae *et al.* (2008), Jiao *et al.* (2011), and Cotter *et al.* (2012), who indicated a decrease in analyst forecast error after IFRS adoption.

Compared to the period before compliance with IFRS, there was no statistically significant change in the dispersion of analyst estimates during the compulsory adoption period. This result differs from the studies presented by Ashbaugh and Pincus (2001), Bae *et al.* (2008), and Jiao *et al.* (2011); however, it is similar to the findings by Cotter *et al.* (2012).

The results of this study confirm an increase in analyst forecast accuracy after IFRS adoption in Brazil, although there is no decrease in analyst forecast dispersion for Brazilian joint stock companies.

Greater accuracy of analyst forecasts may positively impact the Brazilian stock market, since it enables an improvement in the information content for investor decision-making, thus allowing greater efficiency in portfolio allocation decisions. This result enables the evaluation of IFRS in Brazil.

The results of this study indicate the need for further research in the area, with greater emphasis on the effect of the economic scenario on market analyst forecasts. Furthermore, this study presents initial evidence on this topic. Nevertheless, this study has limitations with regard to data sources, since the amount of data available for the Brazilian case is still very low compared to the international scenario.

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