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The Role and Impact of International Financial Reporting Standards on Cross-Border Financing for a Systemically Important Bank from Macroeconomic Perspectives—Technical Review Research Study

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Abstract

The author of the study note that the extensiveness of a country's international accounting disclosure requirements is a good for the overall disclosure extensiveness of the exchange in that foreign country, which, in turn, is bigly correlated with the cost of listing such as United States, Canada, United Kingdom, The Netherlands, France, Japan, and Germany. The United States and the national over-the-counter market have enjoyed significant growth in foreign listing. In absolute terms, the U.S. numbers are even more impressive. As of December 2019, the 1,420 foreign companies whose shares are traded in the United States reparent the largest amount of foreign listings of any major stock exchange in the world., which reflects, at least in part, recognition by multinational entities that the U.S. securities market represents the most efficient market in the world, thus translating into a lower cost of capital for issuer of securities. This technical research review article may support both the public trade companies and policymakers around the World.

Keywords

IFRS, IAS, Cross-Border Financing, SEC, SIB, SIFI

1. Introduction

Under present rules, foreign companies that offer securities to do U.S. public or that seek a listing on a U.S. stock exchange must either present their financial statements in conformity with U.S. GAAP or present their financial statements in accordance with their home standards accompanied by quantified reconciliations of earnings and equity that would have been reported if U.S. GAAP were applied, together with a narrative discussion of the differences. Practically speaking, the latter choice has the effect of forcing a foreign company to comply with U.S. GAAP even though the formal basis or preparation for its financial statements is its home country standards. Finally, under certain circumstances, accounting information in addition to that required by U.S. GAAP must be disclosed to comply with the separate requirements of the SEC. For many foreign companies, compliance with U.S. GAAP and with additional SEC disclosure requirements is prohibitively costly, in terms of both time and money. Even for a world-class company in a country with a highly sophisticated set of accounting and disclosure standards, the cost of conversion to U.S. GAAP can run into millions of hours. For companies in countries with lesser developed accounting systems can be even higher. Direct costs aside, some foreign companies choose to avoid public financial or stock listing in the United States because of the negative impact that U.S. GAAP would have on its reported profits and equity. Indeed, it was not until 1993 that the first German company the Benz Group had its shares listed on the New York Stock Exchange and equity under German accounting principle to corresponding amounts in accordance with U.S. GAAP (Dick & Missonier-Piera, 2019).

Among many important differences from U.S. GAAP, German accounting rules permit the use of provisions for future losses and expenses. Such provisions, which extend far beyond what is permitted under U.S. GAAP, are often used for the purpose of smoothing reported earnings from period to period. Thus, in years in which profits are high, arbitrary provisions are created to reduce reported income. In years of low profits or even losses, the buildup of past provisions is released to bolster reported income. This specific mechanism, of course, masks the true operating performance of a Germany corporation from year to year. Benz was no exception, but the magnitude to which it manipulated earnings through the use of provisions is truly staggering (Nurunnabi, 2019).

2. Technical Research Review Synthesis

Under present rules, foreign companies that offer securities to do U.S. public or that seek a listing on a U.S. stock exchange must either present their financial statements in conformity with U.S. GAAP or present their financial statements in accordance with their home standards accompanied by quantified reconciliations of earnings and equity that would have been reported if U.S. GAAP were applied, together with a narrative discussion of the differences. Practically speaking, the latter choice has the effect of forcing a foreign company to comply with U.S. GAAP even though the formal basis or preparation for its financial statements is its home country standards. Finally, under certain circumstances, accounting information in addition to that required by U.S. GAAP must be disclosed to comply with the separate requirements of the SEC. For many foreign companies, compliance with U.S. GAAP and with additional SEC disclosure requirements is prohibitively costly, in terms of both time and money. Even for a world-class company in a country with a highly sophisticated set of accounting and disclosure standards, the cost of conversion to U.S. GAAP can run into millions of hours. For companies in countries with lesser developed accounting systems can be even higher. Direct costs aside, some foreign companies choose to avoid public financial or stock listing in the United States because of the negative impact that U.S. GAAP would have on its reported profits and equity. Indeed, it was not until 1993 that the first German company the Benz Group had its shares listed on the New York Stock Exchange and equity under German accounting principle to corresponding amounts in accordance with U.S. GAAP (Dick & Missonier-Piera, 2019).

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2.1 Earnings Management

German and other European Systematically Important Banks are not the only ones that manipulate reported earnings. In fact, a number of U.S. systemically important banks also engage in such tactics. So much so that the SEC in 2016 launched a comprehensive initiative to curb earnings management in the United States. The SEC identified a handful of accounting practices employed by U.S. systemically important banks to accomplish their objectives regarding reported earnings. The more common ones, according to the SEC, involve restructuring, creative acquisition accounting, materiality, revenue recognition (SEC, 2019). Regarding restructurings, the SEC has accused companies of both overestimating the charges associated with a restructuring, and including costs in the restructuring that should be matched against future revenues of ongoing operations. This practice, knows as the "big bath" creates artificial earnings in years after the restructuring. In respect of acquisition accounting, one of the major issues is the treatment of goodwill arising in the purchase of one Systemically Important Bank (SIB) by another (Guermazi & Halioui, 2020). Under U.S. GAAP, the excess of the purchase prices over the fair value of the nest assets acquired for example goodwill is capitalized and amortized over an extended period not to exceed 40 years. This is viewed as virtually permanent earnings drain each year over the amortization period. In some international jurisdictions, goodwill may be entirely written off against income or equity in the year the acquisition takes place, thereby avoiding future charges against income. The SEC has accused acquiring SIB or SIFI (Systematically Important Financial Institutions) of overzealously allocation a portion of the purchase price to so-called in process research and development. By doing so, they newly "acquired" R&D must, according to U.S. GAAP, be written off immediately if it has no alternative future use. Hence, the purchase price that otherwise would have been assigned to goodwill. The misapplication of the materiality concept, though perhaps no more effective than other techniques, is somewhat more disconcerting to the SEC. The Commission alleges that in some instances, SIB or SIFI actually fabricate errors that increase reported earnings. They do so, however, in amounts that are deemed immaterial and thus are not subject to audit adjustments. The use of cookie jar reserves is a technique, that is commonly employed in Germany SIFI or SIB and certain other countries. Essentially, such a reserve is created through aggressive assumptions about future liabilities such as sales returns, uncollectible accounts, warranty costs (Zahid & Simga-Mugan, 2019). The excess accruals which are charged against current earnings when established are thus stored for release in future years, as needed, to increase reported earnings. The final practice identified by the SEC to manipulate income is the early recognition of revenue before all elements of the earnings process have been satisfied. In particular, the SEC is concerned about recording revenue prior to delivery of the product to customers, or at a point when the customer still has options to terminate, void, or delay the transactions (Hsu & Chen, 2020).

While acknowledging that the issues of earnings management is not new, the SEC notes that it has been exacerbated because of heightened pressure to meet or exceed analyst's estimates. Moreover, the impact of a few extra cents in reported earnings per share is magnified because recent share prices reflect staggeringly high price-earnings multiples not previously seen in the markets. Various recent research studies provide evidence of the specific techniques used to manage earnings. Manipulating revenue, which comprises every tactic from borrowing sales from the next accounting period to outright fictious transactions, is clearly set valuation allowances, followed by a variety of other tactics primarily relating to the inherent need for estimation in the financial reporting process (IFRS, 2020).

2.2 International Accounting Standards and the Concept of SIB Competitive Disadvantage

When foreign FIBs sell securities in the United States or list their shares on a U.S. stock exchange, their financial statements must either be prepared on the basis of U.S. GAAP or reconciled thereto. By doing so, such companies effectively compete for U.S. capital on an equal basis with U.S. domestic entities. Thus, investors assess the financial condition and operating performance of these foreign companies using amounts reported in accordance with U.S. GAAP, which is the same basis for evaluating U.S. companies. Thus, investors assess the financial condition and operating performance of these foreign companies using amounts reported in accordance with U.S. GAAP, which is the same basis for evaluating U.S. companies. However, the number of foreign SIBs that are actually subject to U.S. GAAP requirements is relatively small, approximating fewer than 2,500 at the end, of 2001. In addition, the U.S. securities laws permit foreign entities to enter the U.S. capital markets through means other than public offering and stock listings. Such FIBs, which utilize the private placement market to sell their securities to large institutional investors, are not required to present U.S. GAAP-basis statements nor must they reconcile earnings and equity to U.S. GAAP amounts. Also, in raising capital in other countries, all that is usually required of foreign FIBs is that they present their financial statements on the basis of their home country standards (Mantzari & Georgiou, 2019).

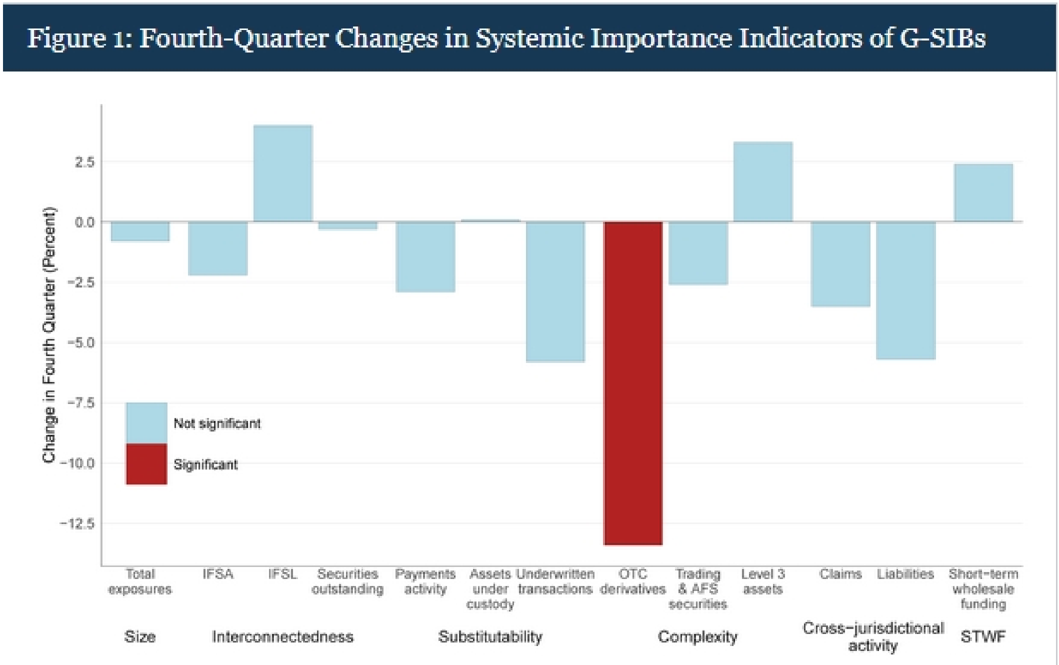

Figure 1. Federal Reserve Board (2020)

3. Technical Discussion

3.1 Other Issues for SIB and SIFI

Many of the problems encountered by users and issuers of foreign SIB financial statements would be alleviated if there were a single set of accounting rules to be applied universally. However, although developing such as set of standards is an enormous task, development is not the main problem obtaining worldwide acceptance is the principal obstacle facing those who would promulgate a worldwide GAAP. Whatever success has been achieved in harmonizing accounting standards is attributable almost entirely to the work of the International Accounting Standards Committee. Conversely, international standards have heretofore been of little interest to highly industrialized nations, some of which have elaborate standard-setting schemes. Standing alone, neither the IASB nor the accounting profession has the power to make IASs mandatory. For many years, the major criticism leveled against international standards has been that they allowed too many alternative ways of accounting for the same transactions, at least from a U.S. point of view, as illustrated by the following examples (Mnif & Znazne, 2020).

A key player in determining the future role of IASs is the International Organization of Securities Commissions (IOSC), which comprises over 60 securities regulatory agencies around the world. One of IOSCO's major objectives is the facilitation of cross-border securities offering and multiple stock listing without compromising the presentation of financial statements. IOSCO recognizes that diversity in accounting principles and practices is the primary impediment to the free flow of capital. In a bold step, the FASB has issued a document discussing the implication of adopting a so-called principles-based approach to setting U.S. accounting standards. Such an approach is now applied by national standard-setters in other countries for example United Kingdom and by the International Accounting Standards Board (IASB). If adopted, a principles-based approach would lay out broad concepts and principles but would leave matters of implementation largely to the professional judgment of preparers and auditors. In contrast, current U.S. accounting standards are considerably more rule driven and complex, with emphasis on specificity of application details (Mongrut & Winkelried).

3.2 The Certainty of the United States Case

IASs are already accused of leaning too much toward U.S. GAAP. Despite Europe's attempt to get more actively involved in the international standard-setting process, the U.S. SEC is likely to act as a juggernaut within IOSCO, which in turn is likely to push the IASB even harder to pattern new and revised standard after those in the United Statas. At a theoretical level, without considering the separate agendas of national standard setters and regulators, the fact remains that international standards are significantly influenced by U.S. standards. This clearly implies that U.S. standard setters are right and that standard setters in other jurisdictions are wrong (Nalukenge, 2020). Under U.S. GAAP, all such transactions are remeasured at the balance sheet date with unrealized gains and losses recognized in income. In some other countries, only unrealized gains and losses on transactions expected to be settled in the short-term are recognized in income. In still other countries, only unsettled transactions yielding unrealized losses are remeasured, and transactions producing unrealized gains are not remeasured, and thus recognition of such gains is postponed until realized. A legitimate conceptual argument could be constructed to support any of these accounting treatments (Napier & Standler, 2020).

4. Conclusion

Finally, consider the way deferred income taxes are determined. In the United States, only comprehensive interpterion allocation is permitted for example all temporary differences between financial income and taxable income are taken into account in the determination of deferred taxes. In some other countries, including the United Kingdom, Mexico, and Singapore, partial allocation is used. Under this approach, temporary differences that are not expected to reverse in the foreseeable future because they will be replaced by differences of the same type are not considered in computing deferred taxes. Partial allocation is based on the premise that each entity has a core of transactions that creates temporary differences on an ongoing basis and thus indefinitely postpones payment of a deferred tax liability. In the opinion of many, including many in the United States, partial allocation is unquestionably the conceptually superior approach. There are dozens of other examples of differences between U.S. and foreign standards, each one of which represents the end result or a well-thought-out process. While not everyone would characterize the U.S. influence as imperialism, there is a restlessness around the world that the entire notion of a uniform set of standards with or without a heavy dose of U.S. standards may actually be counterproductive to the rest of the World.

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