Team Play for Stretching IFRS in the European Enforcement System

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Abstract

There is a consensus that the quality of IFRS enforcement mechanisms in scrutinizing financial reporting varies across European member countries (Ball, 2016). Against this background, this paper investigates whether the IFRS enforcement system at a supra-national level can prevent opportunistic behaviors at a national level that conflict with the objectives of accounting harmonization. Through the theoretical lens of new institutional accounting (Wysocki, 2011), the paper presents the case study of the Bank of Italy share revaluation within the European enforcement system. The case illustrates how the complex interactions among key actors - at company, industry, national and supra-national level - can lead to a failure of the enforcement system. Findings indicate that opportunistic behaviors can occur in interstices between formal institutions under given circumstances, such as interpretation uncertainties of IFRS, cooperation between formal and informal institutions (at a national level), and weaknesses of accounting enforcement (at a supra-national level). The paper analyses those opportunistic behaviors identifying a new type of earnings management, new institutional earnings management, based on inter-firm cooperation arising in the interstices between formal institutions’ scopes. As a result, it stresses the need of a vigorous enforcement at a supra-national level, with relevant policy implications for European institutions.

Keywords: IFRS; enforcement; new institutional accounting; earnings management.

JEL descriptors: M41; M48; E58; G21.

1. Introduction

The adoption of high-quality international accounting standards undoubtedly constitutes a major achievement in the long path to the harmonization and enhanced transparency of financial reporting. This represents a first essential step that must be necessarily followed by other efforts to ensure a consistent interpretation and application of those standards in order to enjoy their benefits thoroughly. The accounting enforcement system plays a crucial role in this sense (Schipper, 2005; Ball, 2006, 2016).

In such a perspective, this paper aims at understanding whether the current IFRS enforcement system at a supra-national level can prevent opportunistic behaviors at a national level resulting in an effect that
seriously damages the aforementioned harmonization (Ball, 2006; Leuz, 2010; Pope and McLeay, 2011; Ball, 2016). This question is of particular interest for the European Union as member states declined to establish a supra-national body to scrutinize financial reporting at the time of IFRS adoption. This choice might result in a fragmented organization of enforcement activity, thus limiting consistency in compliance and enforcement processes.

Using the theoretical framework of new institutional accounting - hereafter referred to as NIA (Wysocki, 2011) - an extreme case is analyzed to address this question. The case is the revaluation of the Italian Central Bank shares (the Bank of Italy, hereafter referred to as BI), and the consequences of this operation on its shareholders’ financial statements and on the behavior of the players involved in the accounting enforcement system. This case includes all the basic NIA elements “for analysing the determinants and outcomes of both accounting institutions and non-accounting institutions: (i) institutional structure (formal vs. informal); (ii) level of analysis (macro institutions vs. micro organisations); (iii) causation (exogenous vs. endogenous institutions); (iv) interdependencies (complementarities); and (v) efficient vs. inefficient outcomes” (Wysocki, 2011, p. 2).

The BI case illustrates the possible outcomes of interpretation uncertainties and of the fragility of the accounting enforcement system, indicating that such conditions leave room for opportunistic behaviors that cannot be strictly defined as the typical earnings management investigated in accounting studies, but serve substantially similar purposes. The case analysis provides new perspectives for future research by displaying new, still-unexplored ways to manage accounting figures. It reveals the existence of a new kind of earnings management: new institutional earnings management (NIEM), namely, inter-firm cooperation that stems from the interstices existing between formal institutions’ scopes.

Starting from a specific technical issue - the application of IAS 39 to a particular and highly relevant operation – the case progressively expands to include more comprehensive considerations that carry theoretical and political implications. It is of considerable interest from an accounting perspective for two primary reasons. First, this case stimulates serious reflections on the IFRS enforcement system in the European Union, which is particularly important in light of the differences in IFRS application among its member countries. Second, the case illustrates that a “team play” between national players’ in applying
standards in line with shared interests might lead to outcomes substantially similar to those derived from earnings manipulation, even if preparers are still “formally” complying with the IFRS. The team play depicted markedly differs from the “classic” earnings management behaviors observed by accounting studies at a company level, as it consists of a system of actions undertaken by different actors, including informal institutions. Each actor is not individually responsible; nevertheless, the overall result is far from a substantial compliance with IFRS. Conversely, this team play differs from a group of companies’ typical lobbying actions that usually occur during the standard-setting process.

The case also offers a substantial opportunity to debate the relationships between formal institutional structures, such as accounting rules, and informal ones, such as the national public interest, or the banking system’s power within a national economy. Other relationships can be examined, such as the dialectic between micro-institutions, such as a single bank or banking industry, and macro-institutions, such as European Union member countries or institutions, or the IFRS. Further, the links between exogenous institutions, such as the European Union Treaty and the impossibility for institutions in the European Union to enforce national misinterpretations, and endogenous ones, such as IFRS adoption in doubtful cases, can be scrutinized. Additionally, the case offers interesting insights as to how national interests could influence accounting behaviors, and result in a possible conflict among institutions (ESMA and IFRS Interpretations Committee). Finally, the case illustrates how a desired “efficient outcome,” or the homogeneous international adoption of the IFRS, can also cause inefficient outcomes, such as specific national interpretations of IFRS rules.

This study’s findings have both theoretical and policy implications. From a theoretical perspective, they highlight the need to use all the NIA key concepts to understand how accounting rules are actually adopted and enforced in an IFRS context. Under this framework, it can be observed that IFRS introduction could leave room new forms of creative accounting, from an industrial and/or national level, to the typical, well-investigated earnings management at a company level. From a public policy point of view, this paper highlights how the IFRS enforcement system still requires substantial improvement to guarantee actual consistency and real global harmonization.
The remainder of this paper is structured as follows: Section 2 contains the necessary references to understand the differences in IFRS implementation in European Union countries and in the accounting enforcement system in the EU. Section 3 presents the research method and the case of BI shares’ revaluation, describing the operation, its accounting treatment, and the interplay among institutions. Section 4 draws upon the case study according to NIA framework and derives some reflections on the IFRS enforcement on the European level. Section 5 then focuses on the theoretical implications in presenting the NIEM, observed as a form of earnings manipulation that can occur given the aforementioned conditions, which have not been considered by previous literature. The final section concludes, and highlights implications for future research.

2. IFRS application and the European Union’s enforcement system

Several studies have highlighted the persistence of national differences after 10 years of IFRS in Europe, even if the rules “should” be the same (Kvaal and Nobes, 2010; Nobes, 2011; Christensen, Hail, and Leuz, 2013; Nobes and Stadler, 2014; Hellman et al., 2015).

Several possible reasons exist for those differences (Nobes, 2006), such as the influence of domestic GAAP, existing accounting traditions, and the national financial market development. These reasons support different national IFRS interpretations due to some of the standards’ features (Nobes, 2006). First, the IFRS are principle-based standards, and do not formulate specific, clear rules to account for every kind of possible operation (Carmona and Trombetta, 2008; Agoglia et al., 2011; Bradbury and Schröder, 2012). Moreover, even the specific provisions included in the standards could be interpreted differently depending on national orientation, consequently creating differences in practice.

Moreover, since the first studies on the international comparisons of accounting quality (Ball et al., 2000; Ball et al., 2003) an impressive number of papers demonstrated in a IFRS context how cost of capital, liquidity, and others measures of financial markets efficiency, are influenced by the enforcement intensity existing in the different countries (Daske et al., 2008; Armstrong et al., 2010; Li, 2010; Landsman et al., 2012; Christensen et al. 2013; Silvers, 2013). When the enforcement system is stronger, also financial analysts’ estimates are more accurate (Byard et al., 2011; Demmer et al., 2015; Preiato et al., 2015), the institutional investors’ ownership increase (Florou and Pope, 2012) and earnings management behaviors
reduce (Cai et al., 2008; Houqe et al., 2012). Finally, in countries with a stronger enforcement, financial disclosure improves as well (Glaum et al., 2013; Gros and Koch, 2015).

It is a widespread opinion that, in light of these considerations, only a strong and coordinated enforcement could minimize these differences in practice and lead to a homogeneous IFRS application (Schipper, 2005; Ball, 2006; Pope and McLeay, 2011; EY-CBS, 2014; Ball, 2016).

It is worthwhile to recall the role of actors and institutions involved in setting accounting standards, and of those in charge of controls and sanctions, to more closely examine European enforcement. It is relevant to consider three phases in this perspective, representing key and complementary elements, to achieve high quality, comparable financial statements: (i) the standard-setting activity; (ii) interpretation support after the accounting standards issue; and (iii) enforcement activities (Leuz and Wysocki, 2016). While a sizeable body of accounting literature addresses the first phase, this paper focuses on the other two, and is particularly attentive to the IFRS enforcement system.

Companies may still experience problems in interpreting IFRS after the adoption in a European context, when required to practically apply the standards to their specific activities and accounts. The IFRS Interpretation Committee, formerly IFRIC and hereafter IFRS IC, has an extremely relevant role in this regard as the only institution entitled to issue official IFRS interpretations. More specifically, it deals with issues such as divergent existing practices in accounting for particular transactions, doubts regarding the appropriate accounting treatment for a particular case or investors’ concerns with poorly specified disclosure requirements. The IFRS IC, in other terms, receives requests for clarification and discloses its tentative observations and conclusions through its agenda and decisions.

It is relevant to acknowledge that in practice the boundary between standard interpretation and enforcement is not always clear. Given the principle-based nature of the IFRS, many requests for interpretation consist of clarifying whether a specific transaction’s actual features parallel those described in standard principles, to identify IFRS-compliant accounting.

When observing the IFRS enforcement system in the EU, it is worth recalling that the IASB does not have the political or legal power to enforce IFRS, as it also cannot exert any control on where and how countries and companies are applying their standards.
Regarding the European level, each member country in the European Union has the autonomous power to enforce accounting behaviors of the national companies adopting IFRS through national authorities. The European Securities and Markets Authority (ESMA) safeguards the financial system’s stability on the European Union level by essentially fostering supervisory convergence among securities regulators. It defines guidelines for monitoring companies’ financial reports, and coordinates national enforcement with the EECS (European Enforcer Coordination Sessions), a roundtable to debate common issues and share experiences. If a topic discussed in EECS requires an official interpretation by the IASB, ESMA can broach that topic to the IFRS IC.

Under the NIA perspective, the European accounting system demonstrates a complex architecture of relationships among “formal” institutions, in which “formal” denotes having legal personality. Those institutions can be framed along two dimensions: the former is the distinction between institutions that are “exogenous” to the accounting system, namely, the European Union with its representative bodies, or the European Union member countries; and the “endogenous” institutions, which are specifically aimed at creating, interpreting, and enforcing accounting. A relevant exogenous factor for enforcement activity is the European Union treaty, with a delegation to its member countries, to enforce every type of European rule within their domain, including accounting rules. The latter dimension is the scope and variety of the interests involved, from a macro or supra-national level, which includes both the worldwide level, with the IASB and the IFRS IC, and the European level; to a meso-level, involving European member countries with their national standard-setters and national enforcement authorities, to a micro-level, in which single companies operate.

Figure 1 summarizes the standard setting and enforcement process, focusing on the bodies and authorities involved.

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1 In particular, Reg. EU 1606/2002 rules, “A proper and rigorous enforcement regime is key to underpinning investors’ confidence in financial markets. Member States, by virtue of Article 10 of the Treaty, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach to enforcement.”

This complex architecture, with many decisional levels, poses the risk of leaving interstices in which autonomous and opportunistic behaviors can arise.

To the best of our knowledge this paper is the first to address this risk by analyzing the enforcement system at work in a case showing all the complexity of interactions among players at different levels.

3. The BI’s share capital revaluation

Research method

The research design is based on a case study found to be particularly relevant both for the magnitude of its financial consequences and for the nature of the players involved, namely a national banking system.

The case study research strategy is suitable to explore these phenomena in light of their features and this paper’s research objectives (Eisenhardt, 1989; Gillham, 2000; Eisenhardt and Graebner, 2007; Yin, 2013; Gabbioneta et al., 2013). This study focuses on contemporary events that cannot be controlled by researchers, and must be interpreted in the context of the under-researched IFRS enforcement system in the European Union. Additionally, an analysis of the issue under investigation requires an in-depth understanding of actions from different players, which can only be achieved by collecting private information through direct contact with actors involved in the process.

These objectives parallel the choice of this research design, as this study aims to contributing to existing literature regarding the IFRS enforcement in the European Union, and earnings manipulation without a priori assumptions. Finally, the research questions can be formulated as “how” questions, as the paper’s purpose is to explore how the IFRS enforcement actually works in the European Union in order to understand whether it leaves room to preparers to cooperatively stretch the standard interpretation to achieve opportunistic outcomes under certain conditions.
The case study, as aforementioned, is the BI’s capital revaluation and representation in its shareholders’ financial statements. A single case study design was chosen as the BI case study constitutes a singular case (Yin, 2013) that is particularly relevant due to its impact and the number and nature of the actors involved. The interactions between players at company, industry, national, and international levels illustrate how the IFRS enforcement system in the European Union might leave room to a team play within an informal institution, consisting of an opportunistic interpretation of IFRS.

This case study was conducted by focusing on the European IFRS enforcement system’s institutional context, and its connections with national and international players, and particularly regarding preparers, national industry associations, enforcers, standard setters, and other regulators. Given the relevance and the number of actors involved, as well as the significant impact of the BI’s shares revaluation, information was collected from multiple sources, as summarized in Table 1, then analyzed to achieve convergence and triangulation (Yin, 2013).

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In summary, official documents from the BI, the ECB, and legislative sources were used to obtain an in-depth understanding of the operation. The BI shareholders’ annual reports and private documents were used as guidance for revaluation recognition – namely, two experts’ reports on the issue – that allowed for an identification of the accounting treatment adopted, and its basis. Interactions were analyzed between institutions by building on data from those public sources and from private information, but other informal contacts cannot be excluded that did not result from our sources.

The impact of BI shareholders’ accounting choices was assessed, drawing upon their financial statements and the consequences of the state operation in terms of tax revenues. Transcripts of the parliamentary debate were consulted regarding political forces’ and market participants’ reactions to the BI’s capital revaluation, as well as equity research reports issued by financial analysts following the banks’ holding of BI shares. This study also considered audit reports and public documents from standard setters.
(IFRIC updates, IFRS IC staff papers, OIC requests for interpretation, and comment letters received by the IFRS IC) from ESMA, Consob, and the OIC, to obtain a comprehensive understanding of the interactions among involved players, with a particular focus on the IFRS enforcement system. Moreover, an interview was conducted with a member of Consob, and contacts with ESMA were directly emailed, to acquire private information on the roles played by these bodies.

Secondary documents were also used, such as books, academic articles, newspaper articles, websites, and social media, to collect contextual information, outline a comprehensive picture, and complement other sources.

These multiple data sources allowed for development of the case in four phases: (i) understanding the operation, considering its context and the initiatives taken by different actors; (ii) observing the accounting treatment adopted by BI shareholders, and identifying the sources used as a guide; (iii) assessing the impact of the operation and its accounting treatment on the BI shareholders’ financial statements, and on state tax revenues; and (iv) examining the role of the bodies involved in IFRS enforcement at different levels.

These phases were not strictly consequential, but part of the iterative process characterizing the systematic combination of case studies (Dubois and Gadde, 2002). The framework, theory, empirical world, and case simultaneously evolved, with continuous matching of the theoretical and empirical dimensions.

**Research setting: the revaluation of the BI’s share capital**

The BI is the Italian central bank, a public law institution whose shares are primarily owned by Italian banks. The BI commissioned an experts’ report in 2013, in which the evaluation of its capital, unvaried since 1936 at 156,000 euros, instead ranged between 5 and 7.5 billion euros.

The Italian Ministry of Economy and Finance addressed a consultation request to the European Central Bank (ECB) in light of this evaluation, asking for an opinion on a draft of decree authorizing a revaluation of the BI’s share capital. The BI shares are owned by 53 banks (84.5 percent of the shares), 5 insurance companies (9.8 percent), and the Italian Social Security Agency and the Italian Workers Compensation Authority (5.7 percent altogether).
capital increase by converting statutory reserves. The Italian government, in November 2013, authorized the BI to raise its capital to 7.5 billion euros (decree-law n.133/2013, later converted into law in May 2014), without waiting for the ECB’s official opinion.

The new bylaw has become effective from December 31, 2013, and the BI has issued new shares from the revised bylaw’s derived rights, attributing them to shareholders to replace previously held shares. Through decree-law n.66/2014, the government also required banks to pay a compulsory substitute tax, equal to 26 percent of the value increase of the BI’s shares. Thus, part of the BI’s capital revaluation profits were destined to the state through income taxes.

The ECB expressed its first opinion on the operation in December 2013, stressing that the recapitalization “fully complies at all times with the existing Union prudential and accounting frameworks and in particular that the rules on the reclassification of financial instruments as laid down by the IAS-IFRS are not infringed.” It is worth noting in this regard that the majority of BI shareholders are listed companies, and that more generally, all Italian banks must adopt IFRS to prepare their financial statements.

This type of financial asset substitution is not explicitly handled by IAS 39. The standard rules that a regular revaluation of available for sale (AFS) financial instruments must only impact equity reserves, but does not particularly provide a specific guidance as to how a shareholder must account for an exchange of a financial asset with a similar financial asset issued by the same counterparty.

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4 The decree has substantively amended the bylaw, from essentially two perspectives. First, new rules for dividend distribution set a maximum of 6 percent of the capital per year, and excluded any distribution of reserves, which thus far had been the primary source of dividends. Second, it established an individual holding limit of 3 percent of the BI’s share capital, with shares exceeding that limit granting only dividend rights for no more than three years. Any dividend right after that period is allocated to BI statutory reserves, and the shares must be sold either to European entities or to the BI itself.

5 It is worth recalling that the reform was strictly connected to a change in government fiscal policy. Decree 133/2013 particularly provided for the abolition of the second tranche of the municipal property tax, financed through revenues derived from the BI shareholders’ gain taxation. Later, Law n.147/2013 stated that the higher share value would have been approved through the payment of a 12 percent substitute tax. The government then made a more definite step by issuing Decree-Law n.66/2014, which increased the compulsory substitute tax to 26 percent of the value increase of the BI’s shares.

6 Opinion of the ECB on December 27, 2013, regarding a BI capital increase (CON/2013/96), p.4.
In 2013 annual reports, the BI shareholders followed experts’ opinion requested by a single bank and shared by the Italian banking industry association (Associazione Bancaria Italiana, ABI) within its network. As a result, they classified BI shares as AFS instruments, as in previous financial statements, recognizing the revaluation in the profit and loss (P&L) section of the Comprehensive Income statement, even if this was not the usual treatment for a revaluation of AFS shares (that increases equity reserves).

They stated that they were compliant with IAS 39 and quoted the aforementioned experts’ reports, often adding that Consob, the national enforcer, did not issue any guidance on the matter. For example, an excerpt follows from the notes of a BI shareholder’s annual report:

*In view of the uniqueness of the transaction, and based on authoritative legal and accounting opinion released by the Italian Banking Association, the accounting treatment described above was deemed appropriate (...).*

*It should be noted that at the date of preparation of these financial statements, the above transaction, especially the accounting treatment thereof, is still open to review by the competent authorities and bodies responsible for the interpretation of accounting standards. It cannot therefore be excluded that the outcome of this review may lead to a different approach to the accounting treatment of the transaction.* (From the BPER Group annual report 2013, p.147)

It is notable that the BI shares were already classified as AFS\(^7\) in shareholders’ previous financial statements, and they remained in the same portfolio after the capital increase. The accounting treatment, based on this opinion, was not the regular revaluation of existing AFS shares with an increase in equity reserve (IAS 39, para. 55(b)). Shareholders, on the contrary, derecognized the cancelled shares at their book value, and recognized the new shares at their estimated current value, recognizing the difference between those values in their P&Ls.\(^8\)

However, a more substantial view of the operation could challenge that interpretation. First, in this case the contractual rights to cash flows do not expire, as shareholders do not lose the right to perceive dividends. The change in the limits also seems to be irrelevant, given that the amount of dividends perceived

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\(^7\) With the exception of Intesa Sanpaolo, which evaluated the shares at cost.

\(^8\) As the shares’ current value had been estimated using unobservable inputs, a majority of banks classified shares as level 3 in the fair value hierarchy, with only a few classifying them as level 2.
is variable. The change regarded only formal aspects, while the rights’ substance and nature remained essentially intact.

Therefore, following the general principle of prevalence of substance over form and IAS 39, para. 55(b), the case could have been treated as a revaluation of already existing AFS shares, without any impact on shareholders’ P&Ls. It is compelling to note that some companies also referenced this accounting treatment as more substantial, as shown in the following excerpt:

_Had the Directors applied a different interpretation of IFRS to this transaction, the alternative treatment would have resulted in the recognition of the revaluation through Revaluation reserves of the Available-for-sale financial assets. Such alternative treatment is based on an interpretation according to which the continuity of rights and cash flows from the shares (before- and after-reform) would prevail. Assuming that the reform is intended to be fair, i.e., it did not modify the shareholders’ economic rights (granting a future inflow of dividends having a net present value equal to the estimated current value of the shares of Bank of Italy before the reform), under this alternative accounting treatment, no substantial discontinuity was observed between the shares before reform and the new shares and therefore there should be no derecognition of the existing shares (nor initial recognition of the newly issued ones) and the revaluation gain should be recognized within Equity (against Revaluation reserve)._ (From the Unicredit Group 2013 annual report, p.374)

The internal bodies involved in the enforcement process, namely the auditors, agreed on the BI shareholders’ choice. Only some cases were found during a search for comments on the topic, in reports attached to banks’ financial statements, in which the operation’s uniqueness was stressed and reference was made to a detailed disclosure provided in the notes.

The players most affected by the consequences of this revaluation, in addition to the BI itself, were essentially: (i) shareholders, who reported a positive effect in their P&L; and (ii) the state, which had significant tax revenues from this operation.

The most direct consequences of this revaluation have had a considerable impact on banks’ assets (Appendix 1, Table 1) and on their net profits (Appendix 1, Table 2). Specifically, the estimated current

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9 According to paragraph 4.6. of the Conceptual Framework for Financial Reporting, “attention needs to be given to its underlying substance and economic reality and not merely its legal form.”
values recognized by banks sum over 6.3 billion euros, and the overall gross revaluation amount recognized by financial institutions was 5.02 billion euro. For example, in their 2013 consolidated financial statements, the two financial groups playing the most significant roles in the BI shareholding structure (64.53 percent) recognized new shares in the AFS portfolio for 4.84 billion euro, and improved their economic results due to an overall gross gain of 3.93 billion euro.

Regarding the impact of the revaluation for the State, the minimum state tax revenue derived from this operation, due to a compulsory substitute tax introduced by the government through a Decree-Law, amounts to an overall 1.52 billion euro or 26 percent of the BI shares’ value increase.

Figure 2 summarizes the steps leading to the BI’s shares revaluation and its main consequences by displaying the interactions among the key players.

Searching for an official interpretation

The BI case is an ideal setting to observe the behaviors of the different actors involved in the IFRS enforcement system, which can be analyzed by adopting the NIA’s theoretical framework. This section debates the positions and reactions of the institutions composing the IFRS interpretation and European Union enforcement system regarding the aforementioned accounting behavior.

The national enforcer, Consob, became involved following a specific request from a listed BI shareholder, submitted after the Italian banking industry (ABI) shared experts’ opinion with its members.

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10 The considerable change in assets, equal to 5.02 billion euros for the 41 banks considered, made European regulators fear the possibility of bias in forthcoming European stress tests. However, banks neutralized the effect through a negative prudential filter when determining the regulatory capital level. The revaluation, in other words, had no impact on the capital ratios or on the stress test results referred to in the 2013 financial statements. However, it is worth noting that banks neutralized this effect for 2013, but not for 2014, as their financial statements indicate.
On March 10, 2014, Consob answered\textsuperscript{11} that, given the case’s uniqueness it would delve deeper into the matter, to consider the issue jointly with competent national and international bodies. The following day, the Italian financial supervisory bodies (Consob, BI, and IVASS) issued a joint press release with similar content, also compelling shareholders to adopt the IAS-IFRS’ most compliant behavior in their accounts and the most exhaustive explanatory information. However, the national enforcer did not mention any explicit guidance, preferring to recall a generic need for IFRS compliance.

Consequently, the interpretation request was received by both national and international bodies. Consob addressed a particular request to the European Securities and Market Authority (ESMA), and the Italian standard setter OIC made a submission directly to the IFRS IC, the only technical body officially responsible for IFRS interpretation.

However, neither request ended with an official interpretation or guidance. So far, and to the authors’ knowledge, Consob’s request to ESMA had no public response. The IFRS IC discussed the OIC’s request in July 2014\textsuperscript{12} and, in line with 16 answers to its outreach request, tentatively decided not to add the issue from its agenda. The IFRS IC decided in November of the same year to finalize its decision, and did not add this issue to its agenda or refer it to the IASB, following two of three comment letters received regarding its tentative decision.

The OIC’s request for interpretation is particularly interesting as it reached not only the IFRS IC, but also many national and international bodies contacted by the IFRS IC. The OIC fully described key issues in its request, positing a view based on the idea that operation should be accounted against the aforementioned paragraph 17(a) of IAS 39. This view was supported by the idea that in application of paragraphs 10 and 11 of IAS 8, the same considerations made by IFRS IC in September 2012 regarding the restructuring of Greek government bonds could be applied to the BI capital revaluation.

The IFRS IC summarized the two alternative views in its July 2014 meeting, and described the accounting treatment omitted by the OIC:

\textsuperscript{11} Comunicazione n. DIE/0018881.

\textsuperscript{12} IFRS Interpretation Committee staff paper, November 2014.
An alternative view, not put forward by the submitter [the OIC] but described to the staff by another stakeholder, is that the Cancelled Shares should not be derecognised by the holder. Those who hold this view argue that the exchange of shares is not substantive, and hence, there has been no expiry of the central bank’s shareholders’ contractual rights to cash flows. (IFRS IC Staff paper, p.4)

It also referenced the 16 answers received from its outreach request, sent to securities regulators (2 responses), members of the International Forum of Accounting Standard Setters (10 responses: 1 from North America, 1 from South America, 3 from Europe, and 4 from Asia-Oceania), and the IFRS technical teams of large international accounting firm networks (4 responses). All of these informal responses\textsuperscript{13} stated that the respondents were not aware of any other similar transaction, or that such specific circumstances were rare.

The IFRS IC presented its tentative decision in July 2014, stating that: (i) due to the operation’s unique nature, the issue was not widespread; and (ii) there was not significant diversity in accounting for this transaction among BI shareholders.

The Committee then received three comment letters regarding the summer’s tentative agenda decision, with two respondents (Deloitte and the Brazilian Accounting Pronouncements Committee) agreeing with the tentative decision. The third comment letter (dated October 2, 2014) came from ESMA, which urged the IFRS IC to reconsider its decision and refer the broader issue to the IASB, to be addressed comprehensively. Specifically, the authority agreed on the transaction’s unique nature, but expressed that guidance is needed regarding the accounting for financial asset modification. The following excerpt from the comment letter clearly demonstrates the ESMA’s position:

\textit{Even though no diversity in practice was identified in relation to the particular transaction described in the submission, the examples of accounting for Greek sovereign debt and accounting for increase of share capital of an entity from its reserves provide evidence that although this type of transaction is not widespread, it can have a significant impact on a number of entities and their reported financial performance. Furthermore, in the current economic environment, it is expected that other significant transactions that include modification of financial assets will occur in the near future, thus increasing the risk that divergent accounting practices will become entrenched.}

\textsuperscript{13} It is worth recalling that they do not reflect the formal views of those organizations and they are not publicly available.
For all these reasons, and in order to promote transparency, achieve constant application of IFRS, and to set standards that are enforceable, ESMA urges the IFRS IC to reconsider its decision (...).

Nevertheless, in November 2014 the IFRS IC decided to finalize its decision, and did not add this issue to its agenda or refer it to the IASB. The primary reason to confirm this decision, noted in the November staff analysis available on the IFRS IC’s website, was that the wider issue of financial assets’ modification and exchange was too broad for the IFRS IC to handle. The staff highlighted in its analysis that, due to its complexity, the topic could not be addressed in isolation from the more general derecognition model for financial assets as well as financial liabilities.

The final decision of the IFRS IC has been in line with the aforementioned informal answers received after the outreach request, and the other two comment letters. It might seem surprising that, regarding the former, only three European national standard setters have decided to answer the IFRS IC request on an issue that the ESMA deemed so relevant to be referred to the IASB. Additionally, replies from all respondents were substantially unanimous, regardless of their origin. This might have two possible explanations: (i) they could have perceived the issue as actually unique and exceptional, thus, considering it irrelevant; or (ii) they could have preferred not to intervene in a matter that did not cause them any harm. This might derive from the idea that in other transactions, more discretion in interpreting IFRS could also ultimately provide possible future benefits for them, following a laissez-faire approach.

The final decision regarding the IFRS IC might seem to contrast with its tasks as the only technical body competent in issuing official IFRS interpretations, in addition to the IASB itself. Moreover, its decision is not actually influenced by the ESMA’s clear position on the matter, even if this authority represents the national enforcers of European Union countries. On the other hand, the IFRS IC’s behavior seems consistent with the IASB’s approach of issuing principle-based standards primarily addressing widespread issues, without taking a position on national matters or specific transactions ruled by local company laws.

After this decision, neither ESMA nor Consob decided to issue any kind of guidance for the accounting of this transaction, even if no answer had come from the international standard setter. It is also noteworthy that the IFRS IC made its final decision in November 2014, approximately one year after the transaction, and several months after the approval of 2013 annual reports.
The only common interpretation available to banks preparing their financial statements, as a result of observing the entire process from a substantial perspective, was the one commissioned by a single bank then shared by its industry association. Other national supervisors and bodies did not explicitly express conflicting views that could challenge their analysis and conclusions. Despite their formal roles, and requests from national authorities, international and European bodies did not have significant roles in the process. Table 3 illustrates the interactions between the involved institutions.

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INSERT FIGURE 3 ABOUT HERE

--------------------------------------------

4. Case discussion: Interstices between formal institutions, the role of informal institutions, and the failure of the enforcement system

This section debates the facts previously described. It also attempts to explain how decisions made within formal institutions, such as the Italian government or Consob, can create interstices in which an opportunistic composition of private interests can potentially arise at a national level, and especially when effective direct control does not exist at an upper level (European instead of the single country level).

The BI case demonstrates the following key points:

1) A governmental decision for the central national bank at a national level creates a new accounting issue for shareholder banks, referring to an IAS 39 interpretation for an imposed substitution of BI shares. This is the first interstice. The governmental decision generates new taxes, and is compliant with European financial stability rules;

2) One bank proposes an interpretation for this accounting issue with a strong net positive effect on P&L; the banking industry association, acting as an informal institution, shares this interpretation with the rest of its associates. Their auditors agree, and the overall effect is 4.3 million euros’ increased profit for the banking industry;

3) Another bank asks Consob, as the national public enforcer, for an official accounting opinion. The national enforcer is uncertain as to whether the interpretation can invade the
interpretation domain of the IFRS IC. This is the second interstice. The national enforcer then involves both the national standard setter (OIC) and the supervisory European institution (ESMA) for guidance on the topic.

4) The national standard setter requests an interpretation to IFRS IC that, in its turn, launches an outreach consultation regarding general interest in the question. The results induce IFRS IC to deny the need for an official interpretation (the third interstice) due to the matter’s specificity and the substantial convergence among different shareholders. The ESMA is disappointed with this result.

Three resulting interstices can be observed in this accounting institutional architecture: the new accounting issue, the uncertainty of the national enforcer, and the need for an official interpretation by IFRS IC. The interstices derive from the uncertain “borders” among formal institutions’ domains (the IFRS, the national enforcer, and the IFRS IC). An informal institution in these interstices promotes a team to propose and apply a favorable accounting interpretation, substantially allowed by official institutions at the end of the process.

The BI case also reveals the influence of exogenous forces on the accounting endogenous system, both as a dynamic force (i.e., a European member country’s generation of a new country-specific operation as a triggering event) and as a structural condition (i.e., the European Union’s general clause to leave common rule adoption’s enforcement at the national level). The accounting system cannot address these political forces.

The complexity of several decisional levels (company-specific, industry, European Union member country, European level, international level with the IFRS) generates friction that leaves room for opportunistic behaviors, and especially if supported by strong informal institutions.

The BI case also outlines the difficulties of the IFRS enforcement system at a European level, and the weak role of ESMA in driving IFRS IC to provide guidance for a specific issue in a single European country. ESMA expressed concerns over the lack of IFRS guidance on the exchange of equity instruments, as this could produce diversity in practice, and reduce the standard’s enforceability. The ESMA concluded in its comment letter to the IFRS IC that the BI issue must be addressed by the IASB for comprehensive consideration, to guarantee a common interpretation among national enforcers.
Despite ESMA’s strong position on the topic, the IFRS IC confirmed its decision not to add the issue to its agenda after an outreach request and feedback from three comment letters. This choice was explained not only by the unique nature of transaction, as the issue was not widespread, but also by the absence of a significant diversity in accounting policy among the BI’s shareholders. Despite ESMA’s position to reconsider the IFRS IC decision and to refer the issue to the IASB, in other words, the IFRS IC acknowledged the practical relevance of a common micro-level accounting policy as a possible interpretation. Simultaneously, this fact substantially feeds the relevance of a common industry position and its team’s play.

Specifically, the convergence of all Italian banks towards the same opportunistic interpretation of the standard, formalized in the ABI position, could be interpreted as a way to strengthen the position against the enforcer’s potential opposition, at both national and European levels. The higher number of entities holding the same position, the lower the probability that the enforcer could decide to resolve the issue outside existing IFRS, and especially in a context in which the emerging interpretation is permitted, and a supra-national enforcement does not exist.

Again, the BI case demonstrates the existence of a strong interdependence, and a consequently unclear distinction, between issues concerning a standard’s interpretation and enforceability. This grey area is even more relevant for unusual operations involving national interests and public institutions, as in the BI’s case. The generation of national-level events could be observed as a tool to produce some desired accounting effects, given the outlined difficulty to clearly separate interpretation from enforcement issues.

The BI case displays the ESMA’s substantially weak role in the IFRS enforcement process at a European level. This reveals that even if a single national enforcer expresses concern over the lack of guidance in the IFRS, an actual support for interpretation cannot be obtained if the IFRS IC decides not to address the issue. This evidence casts doubt regarding the completeness of the “contract” the European Union arranged with the IASB when it decided to mandate IFRS for all European listed companies.

Another interesting point in the BI case is the convergence of all Italian banks towards a common interpretation of the standard that reflects the changes in the BI’s bylaw more favorably in banks’ financial statements. Banks’ behavior could have alternative explanations. First, following the herding theory
(Banerjee, 1992), in an uncertain situation a single decision maker, such as a bank, could follow the crowd, or the main player, with the perception that the crowd is better informed. Additionally, rational herding literature states that an infusion of early, precise information can have a domino effect on followers, leading to a consensus view (Arya and Mittendorf, 2005). Alternatively, this phenomenon is also consistent with cooperative behavior between banks to serve their own interests or, in other words, with a team play approach. The latter explanation seems to be plausible in this case, as it emerges from the aforementioned cooperative behavior, and namely, the close alignment of banks’ financial statements with experts’ guidance, requested by a single bank and shared by ABI.

This cooperative behavior is also rooted in the banking industry’s influence as a relevant informal institution for several reasons (North, 1990; Axelrod, 1997). First, banks play an essential role for the national economy’s development. Second, due to this role, they are subject to strong industry-specific regulations under the BI’s supervision. Additionally, such a context empowers the ABI’s role as an informal roundtable, used to debate the accounting issues most relevant to the banking industry. Therefore, the ABI activity, in coordinating dialogue among banks regarding the BI’s share revaluation, creates a specific industry identity. The case under investigation confirms ABI’s relevant role in promoting a convergence to a common favorable accounting treatment, starting from the position of a single major bank.

Considering that one of the reasons why IFRS IC has not addressed the issue was the absence of differences in practice, the cohesiveness between banks resulted in a relevant role of an informal institution permitting opportunistic interpretations of IAS 39. Thus, the lack of power, left by the absence of an effective interaction between formal institutions, was appropriated by an informal institution to meet its own targets. As already highlighted by North (1990), when formal institutions break down, or cannot deal with certain contingencies, informal institutions can fill this void to prevent a total breakdown or, as in the BI’s case, to obtain private interests.

14 The accounting rules for banks’ financial statements in Italy have been traditionally under the power of the national Central Bank. This influence continued even after the IFRS’ adoption in the European Union (2005), when the BI imposed (Communication n. 262/2005) mandatory formats for financial reports to all the national banks (public and private), interpreting the IAS 1 according to its specific needs. This is an example of formal mechanism and micro-rule.
A potential opposition to a “national” accounting standard interpretation could have come from other European banks. However, a single bank should have pushed for clear opposition through its national banking association that, in turn, could solicit a country’s position through its national Central Bank to reach a significant result. Accordingly, it could be inferred that only the opposition of most national formal institutions could create a context to promote interpretations significantly divergent from those indicated by formal and informal institutions at a single country level.

The BI case ultimately demonstrates that the scopes of formal institutions in the endogenous accounting domain could not interact effectively at different levels. This generates a potential lack of power that can be assumed by informal institutions. The situation can lead to inefficient outcomes, producing different accounting treatments among countries.

5. The new institutional earnings management

The BI case highlights the existence of earnings management not only at a company level (or micromanipulation, see Gowthorpe and Amat, 2005), but also at a macro-level through different players’ convergence towards an opportunistic interpretation of IFRS. Under this macro-level perspective, the present section focuses on the “new institutional” earnings management (NIEM). Evidence notes that interstices generated by an “apparently” external event, such as the revaluation of the BI’s shares, provide opportunities for earnings management that some powerful informal institutions can exploit, such as the banking industry and the active role of its association, ABI.

In light of the NIA framework, a “new institutional” earnings management (NIEM) can be observed, intended as the earnings management performed by a group of companies acting as an informal institution to create and/or exploit accounting issues unaddressed by formal institutions, for example, a specific unregulated accounting issue or an inefficient enforcement mechanism, among others.

Figure 4 summarizes earnings management avenues, highlighting some noteworthy elements emerging from the analysis.

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INSERT FIGURE 4 ABOUT HERE
Traditionally, academic literature has defined earnings management at the entity level (micromanipulation; see also A.1 in Figure 4). Accordingly, earnings management has been defined as a “purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain,” (Schipper, 1989) or management’s use of “judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company” (Healy and Wahlen, 1999). Accounting literature, in other words, has usually considered earnings management as the single company’s intent to obtain some private gain through accounting manipulation choices under a definite set of GAAP. The BI case offers a more complex depiction of this phenomenon under an IFRS context contributing to the theoretical debate by illustrating the specific, different ways to engage in earnings management, a substantially unexplored dimension.

The first element is the proposition of an accounting-favorable treatment at a company level (A.2 in Figure 4) resulting in an “aggressive” interpretation of the IFRS, made possible by the generation of a new particular, country-specific operation. It is difficult from an auditing perspective to disagree on accounting policy when it is initially applied to a new and unusual operation without any prior example for comparison. This is especially true when all companies in an industry cooperate to avoid differences in practice. In this context, and compared to traditional managerial discretion regarding the typical operations described in GAAP, the proposition of an interpretation, even with favorable accounting effects, can be interpreted as an effort to handle a new accounting issue, rather than as an earnings management practice to enforce.

The second element offered in the debate is the key role of “industry,” as an informal institution that actively promotes “team play,” a crucial feature for the development of NIEM.

Negligible evidence exists concerning the industry’s role in earnings management literature. A stream of research (Gowthorpe and Amat, 2005) has primarily focused on lobbying regulators, to persuade them to produce standards more favorable to preparers’ interests, or to prevent disadvantageous changes (B.1 in Figure 4). This type of manipulation could also be interpreted as a negotiation between regulators and preparers, with little attention to financial reporting users’ interests (Zeff, 2002).
The BI case demonstrates another side of cooperation at the industry level: that a common accounting treatment’s adoption by all companies in an industry could facilitate substantial endorsement by enforcement institutions (B.2 in Figure 4). The industry association’s role, in this sense, involves a strong substantial power, both economically and politically, and is crucial in sharing the original interpretation to be adopted. The widespread acceptance of a common interpretation enables actors at the same level of a hierarchy to indirectly compete with higher levels, increasing their opportunities to protect an opportunistic interpretation of a standard against an emerging alternative.

The third element addresses the role of national public institutions. These institutions under the IFRS have incentives to “create” events that produce relevant accounting effects to gain national economic advantages (C.2 in Figure 4). This acts as a kind of indirect, real earnings management. The national public incentive in the BI case is the final objective to collect new taxes through BI shares revaluation.

This third element indicates the great potential of unexplored links between macro-level economic decisions and their accounting impact on the involved companies (Arnold, 2009; Hopwood, 2009). Further research might particularly focus on macro-level decisions, to investigate whether and how they interact with an endogenous accounting system to reach some point of potential equilibrium, or at least as a second-best Pareto optimum.

The above three elements pose increasing enforcement difficulties, with a higher complexity in industrial and macro-manipulative instances.

Additionally, even if these elements can occur independently, together they further increase actors’ difficulty in enforcing accounting choices at different levels of the interpretation/enforcement system (auditors, national enforcement authority, European Union authority, and the IASB).

6. Conclusions

This paper addresses the IFRS accounting enforcement system, in which many formal institutions interact at different levels. The current investigation aims to understand whether this system leaves room for opportunistic behaviors that may conflict with the achievement of the expected benefits of IFRS adoption.
The question is particularly relevant as IFRS have been formally adopted and endorsed as global accounting standards. In particular, compared to national GAAP, they are characterized by a sharper divide between the standard setter and the enforcer due to both the IASB’s private nature and the number of jurisdictions opting for complete versus partial adoption. This poses a risk of fragmented enforcement activities and of inconsistency in compliance and enforcement processes.

This issue is investigated by conducting the BI case study, which was analyzed in a European context by adopting a NIA perspective. This analysis illustrates how the enforcement system actually works under stressed conditions, such as country-specific operations not specifically regulated by IFRS. The interstices left by formal institutions involved in enforcement processes can leave room to new forms of earnings management, in which informal institutions operating at an industry level play relevant, active roles.

The paper also identifies a manipulative behavior neglected by past studies that almost exclusively focused on micro-manipulation at a company level or on macro-manipulation, interpreted as the lobbying of regulators and negotiation between regulators and preparers. Another type of earnings management could emerge from traditional micro- and macro-manipulations, observed as the outcome of a team play between a single state and a strong informal institution such as the banking industry. We label it NIEM, intended as the earnings management performed by a group of companies, acting as an informal institution, to create and/or exploit accounting issues unaddressed by formal institutions. This includes the acquiescent attitude of some formal institutions toward the interest of the informal ones.

These players could interact to pursue their private interests, thus producing a national de facto interpretation, resulting in more favorable accounting figures. This type of manipulation could occur under four main conditions: (i) interpretation uncertainties in an IFRS; (ii) cooperation between formal and informal institutions at a national level; (iii) weaknesses in accounting enforcement at a supra-national level; and (iv) existence of interstices between formal institutions at different levels. These conditions generate potential opportunities for informal institutions to propose favorable accounting interpretations as a new method to manage earnings.

In terms of theoretical implications, this study highlights that the NIA framework is particularly appropriate to study the actual European enforcement system at work. Additionally, this paper contributes to
accounting manipulation literature by outlining the NIEM emerging from the interaction between formal and informal institutions. Thus, it offers a broader spectrum of analysis, in line with relevant studies (Arnold, 2009) calling for a reassessment of accounting research to devote more attention to linkages between micro-accounting and other levels, such as regulatory, political, and macroeconomic environments. In other words, it suggests enlarging the research scope beyond the technical aspects concerning company-level manipulation, to a more comprehensive investigation of the avenues that a group of players could explore to force a fragmented enforcement system and gain private benefits.

Relevant policy implications stem from these results.

First, the paper stimulates reflections on the ESMA’s role in the European Union enforcement system. As enforcement activities are substantially conducted on a national basis, the ESMA’s role is essentially to coordinate national enforcers and to effectively interact with the IASB and the IFRS IC to clarify application doubts. However, as demonstrated by the BI case, the ESMA’s efforts do not necessarily receive attention from those international bodies, that are answerable to over 100 countries. This risk is even higher when the issue seems to be circumscribed only to a European or a national context.

Second, the objective of uniformity in reporting practice requires vigorous enforcement at a supranational level, suggesting the need for European institutions to have direct enforcement power regarding specific national accounting practices. A more effective role played by regional institutions could address critical issues highlighted in the interplay of global and local institutions. This point seems to accord with conclusions reached by Ball (2016) after ten years of widespread adoption of IFRS: “Globalization remains a potent economic and political force, and drives the demand for globalization in accounting. Nevertheless, most political and commercial activity remains local, so adoption of uniform rules does not by itself lead to uniform reporting behavior around the world”.

References


Ball, R., 2016. IFRS - 10 years later, Accounting and Business Research, forthcoming.


## Table 1. Bank of Italy’s shareholders and recognized shares’ estimated current value at the consolidated level (€/mln)

<table>
<thead>
<tr>
<th>BI Shareholders</th>
<th>Shares No.</th>
<th>Shares %</th>
<th>Shares Estimated Current Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTESA SANPAOLO</td>
<td>127,264</td>
<td>42.422</td>
<td>3,181.621</td>
</tr>
<tr>
<td>UNICREDIT</td>
<td>66,342</td>
<td>22.114</td>
<td>1,658.561</td>
</tr>
<tr>
<td>CARIGE</td>
<td>12,095</td>
<td>4.032</td>
<td>302.377</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI ASTI</td>
<td>9,100</td>
<td>3.033</td>
<td>227.502</td>
</tr>
<tr>
<td>BNP PARIBAS</td>
<td>8,500</td>
<td>2.833</td>
<td>212.501</td>
</tr>
<tr>
<td>MONTE DEI PASCHI DI SIENA</td>
<td>7,500</td>
<td>2.500</td>
<td>187.501</td>
</tr>
<tr>
<td>CREDIT AGRICOLE</td>
<td>6,360</td>
<td>2.120</td>
<td>159.001</td>
</tr>
<tr>
<td>BANCO POPOLARE</td>
<td>3,668</td>
<td>1.223</td>
<td>91.701</td>
</tr>
<tr>
<td>BANCA DELLE MARCHE</td>
<td>2,559</td>
<td>0.853</td>
<td>63.975</td>
</tr>
<tr>
<td>UBI</td>
<td>1,259</td>
<td>0.420</td>
<td>31.475</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI FERRARA</td>
<td>949</td>
<td>0.316</td>
<td>23.725</td>
</tr>
<tr>
<td>BIPEMME</td>
<td>873</td>
<td>0.291</td>
<td>21.825</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI SAN MINIATO Group</td>
<td>846</td>
<td>0.282</td>
<td>21.150</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI RAVENNA Group</td>
<td>769</td>
<td>0.256</td>
<td>19.225</td>
</tr>
<tr>
<td>BPER</td>
<td>759</td>
<td>0.255</td>
<td>18.975</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI FOSSANO</td>
<td>750</td>
<td>0.250</td>
<td>18.750</td>
</tr>
<tr>
<td>BANCA POPOLARE DI VICENZA</td>
<td>687</td>
<td>0.229</td>
<td>17.175</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI CESENA</td>
<td>675</td>
<td>0.225</td>
<td>16.875</td>
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<tr>
<td>VENETO BANCA</td>
<td>480</td>
<td>0.160</td>
<td>12.000</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI RIMINI</td>
<td>393</td>
<td>0.131</td>
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<td>CASSA DI RISPARMIO DI BOLZANO</td>
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<td>0.126</td>
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<td>CASSA DI RISPARMIO DI CENTO</td>
<td>311</td>
<td>0.104</td>
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<tr>
<td>CASSA DI RISPARMIO DI ORVIETO</td>
<td>237</td>
<td>0.079</td>
<td>5.925</td>
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<tr>
<td>CASSA DI RISPARMIO DI SAVIGLIANO</td>
<td>200</td>
<td>0.067</td>
<td>5.000</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DELLA PROVINCIA DI CHIETI</td>
<td>151</td>
<td>0.050</td>
<td>3.775</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI FERMO</td>
<td>130</td>
<td>0.043</td>
<td>3.250</td>
</tr>
<tr>
<td>BANCA POPOLARE DI BARI</td>
<td>123</td>
<td>0.041</td>
<td>3.075</td>
</tr>
<tr>
<td>CREDITO VALTELLINESE</td>
<td>101</td>
<td>0.034</td>
<td>2.525</td>
</tr>
<tr>
<td>CASSA DI RISPARMIO DI SALUZZO</td>
<td>4</td>
<td>0.001</td>
<td>0.100</td>
</tr>
</tbody>
</table>

**Total - IAS/IFRS Adopters**  
253,462 84.488 6,336.592

| CASSA DI RISPARMIO DI SAN MARINO       | 36         | 0.012    | 0.900                          |

**Total**  
253,498 84.500 6,337.492
SHARES No. represents the amount of the stake held in the Bank of Italy at the consolidated level by financial institutions’ groups. SHARES % is the proportion of the Bank of Italy’s shares held at the consolidated level. SHARES ESTIMATED CURRENT VALUE represents the amount of the BI’s AFS shares recognized by banks.

Note: To outline a picture of this impact on banks’ annual reports, we focused on changes in values determined using hand-collected data from banks’ 2013 financial statements. First, the 2013 annual reports were investigated for the 53 banks holding BI shares. Separate P&Ls were then analyzed, as well as all quantitative and qualitative disclosures on the operation that referenced the impact on both the balance sheet and the P&L. Banks were excluded whose 2013 annual reports were unavailable, as well as those banks that did not disclose sufficient information regarding the revaluation’s accounting treatment (i.e., at least the revaluation amount, directly or indirectly). The resulting sample includes 41 banks (Table 1), holding 83 percent of the BI’s shares.

Table 2. Reported 2013 average profit (loss) and net average result in absence of revaluation of IAS/IFRS Adopter Shareholders (€/mln)

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>N</th>
<th>Shares %</th>
<th>Shares Estimated Current Value</th>
<th>Average 2013 profit (loss) before revaluation</th>
<th>Average 2013 profit reported (loss)</th>
<th>Increase of the average result 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>GROUP 1 (loss reduction)</td>
<td>18</td>
<td>64.84</td>
<td>4,863.00</td>
<td>(1,330.87)</td>
<td>(1,144.57)</td>
<td>14.00%</td>
</tr>
<tr>
<td>GROUP 2 (from loss to profit)</td>
<td>10</td>
<td>8.61</td>
<td>645.75</td>
<td>(21.36)</td>
<td>35.53</td>
<td>266.31%</td>
</tr>
<tr>
<td>GROUP 3 (profit increase)</td>
<td>13</td>
<td>9.29</td>
<td>696.75</td>
<td>12.73</td>
<td>43.45</td>
<td>241.30%</td>
</tr>
</tbody>
</table>

SHARES % represents the percentage of the Bank of Italy’s shares held by banks as of 12/31/2013. SHARES ESTIMATED CURRENT VALUE is the current value of the Bank of Italy’s shares, as estimated by an expert panel, and as consequently reported in the shareholders’ balance sheets. AVERAGE REPORTED PROFIT (LOSS) represents banks’ reported average 2013 result. NET AVERAGE PROFIT (LOSS) is the average 2013 result that banks would have reported in absence of the revaluation amount recognition in the P&Ls.

Note: Considering the 41 banks separately, 10 of them passed from a net loss to a net profit simply from accounting for the revaluation. The table illustrates the economic results before and after the revaluation.
effect, by distinguishing the 18 banks that reported a smaller net loss (group 1), the 10 banks passing from net loss to net profit (group 2), and the 13 banks that increased their net profit due to the revaluation (group 3). Institutions passing from a loss to a profit due to the revaluation recognition could increase their average result by 266.3 percent. Shareholders belonging to group 3 could increase their results by an average of 241.3 percent.
## Tables

**Table 1. Summary of data sources**

<table>
<thead>
<tr>
<th>Data source</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BI documents</strong></td>
<td>BI previous and revised bylaws, official documents on the updating of the BI’s equity capital (including the experts’ valuation report), and the BI’s annual reports (1997 - 2014).</td>
</tr>
<tr>
<td>Legislative sources</td>
<td>(Draft and final) decree and law, resulting in a series of amendments to the BI’s bylaws, and the following decree and law ruling state fiscal revenues from the operation.</td>
</tr>
<tr>
<td>ECB opinions</td>
<td>The three ECB opinions regarding the operation (December 2013 - May 2014).</td>
</tr>
<tr>
<td>Banks’ annual reports</td>
<td>All 52 IAS/IFRS annual reports issued by financial institutions holding BI shares (2008 - 2014). Also includes hand-collected data from notes (operation description, accounting choice motivations, impact on capital ratios) and from financial statements (impact on P&amp;Ls, financial and economic results, and dividends).</td>
</tr>
<tr>
<td>Experts’ reports on accounting treatment (private documents)</td>
<td>The two reports concerning the appropriate accounting and juridical representation, released by qualified experts at a bank’s request.</td>
</tr>
<tr>
<td>Interview (private information)</td>
<td>An in-depth interview conducted by the Authors with the national enforcer.</td>
</tr>
<tr>
<td>Audit reports</td>
<td>All audit reports on the 2013 IAS/IFRS annual reports, by financial institutions holding BI shares (52 annual reports; see Appendix, Table 1).</td>
</tr>
<tr>
<td>OIC request for interpretation</td>
<td>The OIC’s request for adding the issue of the operation’s accounting treatment to the IFRS IC agenda.</td>
</tr>
<tr>
<td>IFRIC updates</td>
<td>July and November 2014 newsletters regarding the IFRS IC’s activities.</td>
</tr>
<tr>
<td>IFRS IC staff papers</td>
<td>July and November 2014 IFRS IC staff papers, establishing the agenda to examine the accounting treatment issue.</td>
</tr>
<tr>
<td>Comment letters</td>
<td>All three comment letters received by the IFRS IC regarding its tentative agenda.</td>
</tr>
<tr>
<td>ESMA documents</td>
<td>Excerpts from the EECS Database on Enforcement, available on the ESMA website’s archive.</td>
</tr>
<tr>
<td>Consob documents</td>
<td>Newsletters, communications, and press releases available on the Consob website.</td>
</tr>
<tr>
<td>Private requests for information to ESMA</td>
<td>The Authors’ requests, addressed to the ESMA to obtain information regarding the regulator’s position on the accounting treatment.</td>
</tr>
<tr>
<td>Parliamentary debate transcripts</td>
<td>All the transcripts of the Parliamentary debate held by political exponents opposing the BI’s bylaw amendments (January 2014 - March 2014).</td>
</tr>
<tr>
<td>Equity research reports</td>
<td>The 29 reports available on the Italian Stock Exchange website, issued by nine banks’ financial analysts (October 2013 - March 2014).</td>
</tr>
<tr>
<td>Newspaper articles, websites, and social media</td>
<td>National and international press available on Reuters.com and the ABI INFORM databases (June 2013 - September 2014). Also includes national press on the topic from the most relevant national newspapers’ archives and their social media profiles (June 2013 - September 2014).</td>
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<td>Books and academic articles</td>
<td>National academic publications on the issue (Sept 2013 - Dec 2014).</td>
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Figures

Figure 1. Formal institutional structures in the European accounting architecture

Figure 2. The BI case, Part I: the revaluation of the BI’s equity shares, and its accounting treatment in shareholders’ annual reports.
Figure 3. The BI case, Part II: searching for an official interpretation

Banking industry and its association (ABI) as informal institution

Accounting treatment: a IAS 39 particular interpretation

Figure 4. A view of earnings

management possibilities

(A) Micro-manipulation
1. Classic EM
2. Proposing interpretations

(B) Industry - manipulation
1. Lobbying for standards
2. Supporting interpretations

(C) Macro-manipulation
1. Proposing specific rules/interpretations
2. Creating events