The Choice of Accounting Standards under Competing Tax and External Reporting Preferences

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• Choice between K2 and K3
  • K2 close to tax accounting
  • K3 close to IFRS for SMEs
• Choice under K3 on whether to capitalise [what exactly?]
  • Differs from IFRS for SMEs which requires such expenditure to be expensed
A very useful paper

- Interesting setting that allows for empirical testing of hypotheses
- Comparison of empirical evidence with survey evidence
- Evidence about reporting choices for private firms
- Evidence about influence of the IFRS for SMEs
- Evidence about firms’ choices on capitalisation of IGIA
Choice between K2 and K3—findings

• Empirical results
  • Positive correlation with K3 choice
    ▪ Presence of IGIAS in prior years
    ▪ Low tax burden and use of profit periodization allocations
    ▪ Proxies for shareholder reporting demands
  • But observable characteristics explain the K3 choice for only about 50% of firms

• Survey results
  • 37% identified long-term planning considerations as driver of K3 choice
  • some identified specific accounting requirements
    ▪ IGIA reporting 13%
    ▪ Deferred tax 10%
    ▪ PPE components 9%
    ▪ Lease accounting 5%
  • 63% said auditors initiated choice of K3, 39% said they don’t remember what drove the decision
Choice between K2 and K3—questions

• Did previous accounting drive the choice?
  • Wide range of choices in previous accounting. Did firms simply choose which of K2 or K3 most closely aligned with existing practice?
• Higher than expected choice of K3 (14% compared to 5% expected), any thoughts on why?
• What other factors might drive the choice?
  • What influences the auditors, who seem to play an important role?
Choice for K3 adopters on capitalisation—findings

• Capitalisation brings forward the timing of tax payments
• Nonetheless, 45 (or 41 or 33?) of 586 K3 adopters choose to capitalise
  • More likely to engage in M&A activity
  • Less likely to have a high tax burden
  • May be trying to avoid reporting losses?
Choice for K3 adopters on capitalisation—questions

• Why does K3 allow capitalisation when IFRS for SMEs does not?
• Does previous accounting drive this choice?
• What does drive the choice?