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INTERNATIONAL ACCOUNTING STANDARDS, BANK CREDIT RATINGS, AND PERFORMANCE: AN EMPIRICAL STUDY

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ABSTRACT. This study aims to investigate how the obligatory adoption of IAS/IFRS has impacted the creditworthiness of a representative sample of Iraqi banks quoted on the Iraq Stock Exchange. In addition, it tries to identify the most important financial indicators that will be influenced by the required adoption of (IAS / IFRS) and the effect that these indicators would have on the credit ratings of Iraqi banks. The sixteen commercial banks listed on the Iraq Stock Exchange between 2011 and 2020 made up the study's cohort. The issue being investigated, as well as the hypotheses being tested, was whether the obligatory adoption of (IAS/IFRS) had an important and substantial effect on bank credit ratings. It was performed by inspecting and assessing the essential financial indicators for evaluating banks and calculating their credit rating. These indicators include profitability, efficiency, liquidity, capital sufficiency, asset quality, and financial solvency. The most important financial indicators that are used in the process of constructing credit ratings for Iraqi banks have been put through a battery of statistical tests using the statistical software (SPSS) and a series of analyses of variance (ANOVA) to see how the required adoption of (IAS/IFRS) would affect those indicators. The results of these tests have been analyzed to determine how the adoption of IAS/IFRS will affect the most important financial indicators. After putting the hypotheses to the test and demonstrating that they are correct, several conclusions were drawn, the most important being that. The mandated use of IAS/IFRS has a significant and critical impact on the credit rating of Iraqi financial institutions such as banks. The association and influence between the implementation of standards and bank financial strength ratings indicators have become much stronger. The findings indicate that the required implementation of (IAS/IFRS) has significantly affected Iraqi banks' credit ratings. This has been accomplished via an improvement in assessing profitability, efficiency, liquidity, capital adequacy, asset quality, and financial solvency indicators.

JEL Classification: H38, M41, R53

Keywords: Bank Credit Ratings, IFRS, IAS, Iraqi Commercial Banks, Financial Performance

Introduction

The credit ratings issued by the international agencies specialized in this field play an essential role in the contemporary business environment and the degree of evaluation and reputation of the countries and their various economic units [1,2]. In the last two decades, the reports of credit rating agencies have topped news releases and press reports in financial markets due to the importance of these reports, some of which determine the fate of countries [3,4]. In light of these reports, positive or negative conditions for countries' economies follow. Despite the importance of this issue, most of the economic units operating in Iraq have yet to have any credit ratings issued by international agencies specialized in this field. To advance the banking reality in Iraq, the government, through the decision of the Board of Directors of the Central Bank on September 1, 2019, took the initiative to adopt four international rating agencies as a step in the financial and economic reform of commercial banks registered in the Iraq Stock Exchange [5,6].

Also, the commercial banks listed on the Iraq Stock Exchange are required by the Central Bank of Iraq to take a proactive step toward standardizing and improving their procedures by adopting the mandatory application of the IAS/IFRS beginning with the fiscal year ending on (31/12/2016) [7], in the right direction to keep pace with the global development in the accounting fields and to increase the openness of the Iraqi market to the global capital markets to attract foreign investment and achieve economic growth [8]. It encouraged academics and professionals to unify efforts to get acquainted with the standards (IAS / IFRS) in all its aspects, especially about work in The banking sector, and ensuring its effective and practical application and achieving the goal and objective of its application to reach the provision of high-quality accounting information that enables investors to make the appropriate decision according to the data of that information. This study was motivated by the significance of these two issues, specifically, the impact of mandatory application of (IAS/IFRS) standards on the credit ratings of banks listed on the Iraq Stock Exchange and the extent to which such standards aid in bolstering the credit ratings of banks in Iraq [9]. The research derives its importance from two areas, the first of which is the importance of credit ratings and their essential role in the contemporary business environment, especially the banking sector. The second area gains its significance from the importance of standards and their essential role in preparing financial statements and ensuring the validity and quality of accounting information.

Credit Ratings and (IAS/IFRS) standards

A. Accounting information according to (IAS/IFRS) standards and the credit market

Accounting information plays a fundamental role in credit contract relationships, as it is embodied in two roles, the first helps banks and other lenders to assess credit risks, and the second role helps monitor credit risks over the life of the debt contract through financial covenants [10].

Assessments of the importance of accounting information to the credit market are based on the assumption that credit ratings reflect the economic situation of the borrower, and thus the accounting information that is provided and produced according to international financial reporting standards is more useful to creditors than the accounting information that was previously produced under local standards, as we expect to see an increase in the correlation between accounting information and credit ratings after the adoption of international accounting and financial reporting standards [11]. Previous studies have documented the existence of significant differences between local standards and international accounting and financial reporting standards with regard to profit recognition methods as well as transparency practices [12].

Some researchers believe that the effect of applying international financial accounting and reporting standards on the importance of accounting information for creditors is not clear [13]. The accounting rules of international accounting standards may be useful and attractive to users because they are based on principles and focus on the economic essence of transactions at initial recognition and when measuring assets and liabilities. In addition, fair value accounting is an important aspect of international standards with potential advantages for creditors, as the use of fair value and related rules (such as impairment and recognition of liabilities) leads to timely recognition of economic losses. On the other hand, some argue that fair value accounting may not be compatible with creditors' needs to evaluate performance and show accounting information more realistically for the following reasons [11]:

- It will lead to the recognition of unrealized economic gains against the wishes of creditors.

- Unverifiable estimates may be used or far judgments imposed on the estimation of assets and liabilities.

- May lead to recognition of transient gains and losses, which may reduce the quality of profits.

Other researchers see an effect of incentives at the level of the economic unit on the quality of accounting information, noting that the quality of information often varies between economic units depending on the type of compliance in the application of international accounting and financial reporting standards [14].

Many firms take loans from more than one financial institution, in order to carry out the tasks entrusted to them to achieve their objectives, and the application of international standards for these economic units will help reduce information asymmetry, as we expect it to reduce the dispersion of credit ratings assigned to the borrower himself by donor financial institutions after adopting international financial accounting and reporting standards [11].

Therefore, we believe that adopting the application of international accounting and financial reporting standards in the presence of a strong law to protect investors (creditors) can help reduce capital costs by mitigating information asymmetry between managers and external users of financial information on the one hand, and on the other hand, the impact of adopting international standards on the quality of accounting information will have economic consequences (impact) on the credit market.

B. Quality of accounting information according to (IAS/IFRS) and credit ratings

The adoption of international accounting and financial reporting standards has economic consequences, as it has a strong impact on the stock and bond markets, in other words, it shows its impact on the main source of capital financing for economic units, and the impact of the quality of accounting disclosure on credit ratings is from the literature, because the quality of disclosure determines the cost of debt and thus contributes to the assessment of the credit rating of economic units in general [15].

Others believe that there is evidence that shows the impact of adopting international financial accounting and reporting standards on credit ratings and the cost of debt when taking a sample of companies listed in the US markets [16]. The application of international standards also affects the creditworthiness of foreign companies from the view of investors in the US market.

The relevant literature examines the effect of the quality of accounting information on credit ratings. As companies that have poor accounting information will necessarily lead to a decrease in the credit ratings of the issuers of investment grades (credit rating agencies), and this decrease is related to the quality of accounting for these borrowers, and that companies with high quality in producing accounting information will have higher credit ratings [15,17].

In this regard, the (S&P) agency for the years (2002, 2003, 2007, 2008) refers to a crucial aspect of credit, as the credit rating analysis includes assessing the quality of accounting information, and that the company's credit rating is determined through rating agencies' assessments of the possibility that the company's future cash or flow will be sufficient to pay debt obligations on time [17]. On the other hand, they believed that the separation between ownership and management leads to information asymmetry between managers and external stakeholders, and that this asymmetry of information reduces the ability of stakeholders to monitor the behavior of managers and their own actions, which in turn can reduce the expected cash flow of the company and thus affects the credit worthiness [18].

It is expected that the credit ratings of economic units will be affected by changes in the quality of accounting information and financial reports prepared according to international accounting and financial reporting standards for several reasons, including:

- Lenders prefer to deal with companies that enjoy more transparency, due to their lack of sufficient information that encourages them to invest, as lenders rely on fixed information contained in the financial statements issued by companies, and therefore changes are expected in the quality of financial information that is reflected in the credit ratings of those companies [19].

- The international accounting and financial reporting standards are of high quality, because they enable companies to adopt the economic essence on the legal form, in other words, it is expected that the quality of accounting information will improve by adopting the application of (IFRS) standards, which makes companies more transparent and therefore seen by investors as more creditworthy [20].

- Evidence indicates that compliance with international financial accounting and reporting standards can benefit companies and lenders alike, and international standards can improve the benefits gained by companies by reducing the cost of their debts. As for lenders, compliance with standards reduces the disadvantages of their information and improves the accuracy of their assessments, thus creating a better credit position [16].

- The mandatory application of (IAS/IFRS) standards has positive economic consequences on the terms of the loan contract (lower cost of debt, longer maturities, larger loan amounts, fewer guarantees).

Based on the foregoing, we note the impact of the application of international accounting and financial reporting standards on the quality of accounting information, which in turn will affect the credit ratings of companies, because the quality of accounting information is an influencing factor in the ratings of credit ratings.

Research hypotheses

This research is based on the primary hypothesis that:

The research sample indicates an impact relationship between The compulsory adoption of (IAS/IFRS) and the credit rating of Iraqi banks.

The following sub-hypotheses are derived from this hypothesis:

H-1: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks, depending on the profitability index.

H-2: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks, depending on the efficiency index.

H-3: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks, depending on the liquidity index.

H-4: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks based on the capital adequacy index.

H-5: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks, depending on the asset quality index.

H-6: The compulsory adoption of (IAS/IFRS) significantly impacts the credit rating of the research sample banks based on the financial solvency index.

Results

This section is concerned with the central hypothesis of analyzing how implementing the (IAS/IFRS) as a legal requirement has affected businesses and organizations on the credit rating of Iraqi banks, the research sample.

The results of the first sub-hypothesis are shown in the table (I) below.

TABLE I. ANALYSIS OF VARIANCE SUMMARY FOR THE RESULTS OF TESTING THE FIRST SUB-HYPOTHESIS

Model	***R***	***R Square***	***Adjusted R Square***	***Std. The error in the Estimate***
1	.426[a]	.181	.176	.03008

a. Predictors: (Constant), IFRS

The results of testing this hypothesis using the return on assets scale show that the independent variable, The compulsory adoption of (IAS/IFRS), has achieved a significant impact on the credit rating of Iraqi banks, the research sample, depending on the profitability index at a substantial level of 0.05, and that the independent variable (the mandatory application The International Financial Reporting and Accounting Standards (IAS/IFRS) interprets its value (18%) of the dependent variable (the credit rating of banks), as the value of the determination coefficient was (R2 = 0.181).

The cost-to-income ratio was used to test the second null hypothesis, and the findings are shown in the table (II) below.

TABLE II. SUMMARY ANALYSIS OF VARIANCE FOR THE RESULTS OF THE SECOND SUB-HYPOTHESIS TEST

Model	***R***	***R Square***	***Adjusted R Square***	***Std. The error in the Estimate***

1	.399a	.240	.034	120.72292

a. Predictors: (Constant), IFRS

Results from a test of this hypothesis using the ratio of interest income to total assets indicate that the mandatory implementation of (IAS / IFRS) has a statistically significant effect on the credit ratings of Iraqi banks within the study's sample (as measured by the efficiency index) at the 0.05 level of significance.

The results of the third null hypothesis test using the present ratio scale are shown in the table (III) below.

TABLE III. SUMMARY OF THE ANALYSIS OF VARIANCE FORM FOR THE RESULTS OF TESTING THE THIRD SUB-HYPOTHESIS

Model	***R***	***R Square***	***Adjusted R Square***	***Std. The error in the Estimate***
1	.465a	.207	.221	.65281

a. Predictors: (Constant), IFRS

The results of the current ratio test indicate that the independent variable (the mandatory application of (IAS/IFRS) has achieved a substantial impact on the credit rating of Iraqi banks, the research sample, depending on the liquidity index at a significant level of 0.05, and that the independent variable (the mandatory application of (IAS/IFRS) interprets its value (21%) of the deviance.

The results of the ratio of equity to total assets test of the fourth null hypothesis are shown in the table below.

TABLE IV. SUMMARY ANALYSIS OF VARIANCE FOR THE RESULTS OF THE FOURTH SUB-HYPOTHESIS TEST

Model	***R***	***R Square***	***Adjusted R Square***	***Std. The error in the Estimate***
1	.066a	.544	-.442	.35668

a. Predictors: (Constant), IFRS

Results from a test of this hypothesis using the equity-to-assets ratio indicate that the mandatory adoption of (IAS/IFRS) has had a statistically significant effect on the credit ratings of Iraqi banks within the research sample, as measured by the capital adequacy index, at the 0.05 level of significance.

The findings of the ratio of total debts (loans) to total assets used to test the fifth null hypothesis are shown in the table below.

TABLE V. SUMMARY ANALYSIS OF VARIANCE FOR THE RESULTS OF THE FIFTH SUB-HYPOTHESIS TEST

Model	***R***	***R Square***	***Adjusted R Square***	***Std. The error in the Estimate***
1	.128a	.217	.210	.25738

a. Predictors: (Constant), IFRS

The results of this hypothesis test, conducted using the scale of the ratio of total debts (loans) to total assets, indicate that the mandatory application of (IAS / IFRS) has had a substantial impact on the credit rating of Iraqi banks, the research sample, depending on the asset quality index at a significant level of 0.05.

Below is a table displaying the results of a test of the sixth null hypothesis using the total liabilities to equity ratio:

TABLE VI. SUMMARY ANALYSIS OF VARIANCE FOR THE RESULTS OF TESTING THE SIXTH SUB-HYPOTHESIS

Model	*R*	*R Square*	*Adjusted R Square*	*Std. The error in the Estimate*
1	.004a	.122	.126	4.17320

a. Predictors: (Constant), IFRS

The results of the test of this hypothesis using the ratio of total liabilities to equity indicate that the compulsory adoption of (IAS/IFRS) has had a significant impact on the credit rating of Iraqi banks, the research sample, based on the solvency index at a substantial level of 0.05 and that the variable The independent (The compulsory adoption of (IAS/IFRS)) explains its value (12%) of the dependent variable (the credit rating).

Conclusions and discussion

Due to their high levels of transparency, IAS/IFRS have been adopted by most countries worldwide due to the globalization of business and cross-border financing. These standards improve financial market efficiency by identifying opportunities and risks and fostering greater company comparability. Adopting international accounting standards helps reduce capital costs by identifying risk aspects and accounting for hedges precisely while minimizing information asymmetry risks. The credit ratings issued by international rating agencies have an essential role in the contemporary business environment, as they depend on the degree of evaluation of the reputation of countries and the economic units operating in them. The importance of credit rating has increased in the contemporary economic system, especially after the integration of markets, as the role of banks changed and investors directed them more to use new financial tools to obtain the financing necessary to continue their business. A higher credit rating for any economic unit means increased domestic and foreign investments due to lower potential financial risks. Credit rating agencies are essential in helping investors make their own investment decisions by providing them with credit ratings.

The credit rating briefly expresses the opinion of the credit rating agency in assessing the financial strength of the economic units and what is the ability and willingness to pay off debts and meet financial obligations in full and on time, and that the rating degree determines the level of financial risks and that the relationship between the credit rating degree and the level of potential financial risks is a relationship reverse. Economic units worldwide face oligopoly by the three major credit rating companies (S&P, Moody's, (Fitch), and although there are regional and local rating companies, they cannot compete with those agencies, noting here that credit rating agencies in their various forms use factors The credit rating agencies, in general, did not provide an appropriate early warning system about risks, as some international banks collapsed despite having high ratings. These agencies argued that their ratings are forward-looking opinions about the ability of the economic unit to fulfill its financial obligations in full and on time. The entry of the sovereign rating of Iraq within the global rating agencies was recently compared to the emergence of credit rating agencies that have been operating since the beginning of the last century, with reference here to the absence of rating agencies or organizations specialized in rating or even offices in Iraq at the regional or global level. Many Iraqi banks are not rated to obtain a credit rating to ensure easy access to the capital markets or to obtain privileges from the Central Bank of Iraq. The transition to adopting IAS/IFRS has dramatically affected the quality of reported information used by credit rating agencies in the rating process. Credit rating organizations are motivated to do their best to award these banks strong credit ratings because of the widespread acceptance of the required use of IAS/IFRS. Change depends on the financial environment of a country's banking system, and the essential tool that contributes to the growth of the banking sector is the level of credit ratings granted by international rating agencies. Hence, adopting IAS/IFRS has positive repercussions on the economic development of any country. Study Subsample Once Iraqi banks were mandated to adopt IAS/IFRS, their credit ratings improved. Research sample banks in Iraq benefit significantly from the improved quality of profitability indicator assessment made possible by the mandatory adoption of IAS/IFRS. Research sample banks in Iraq benefit considerably from improved efficiency measurement made possible by the mandated implementation of IAS/IFRS, which substantially impacts the banks' credit ratings. By improving the measure of their liquidity indicators and determining the extent to which the banks can fulfill their obligations and debts in the short term, the mandatory application of IAS/IFRS significantly affects the credit rating of Iraqi banks, the research sample. By improving the measurement of capital adequacy indicators and more accurately identifying potential risks that banks may be exposed to, the mandatory application of IAS/IFRS substantially impacts the credit rating of Iraqi banks, the research sample. By improving the measurement of the quality of assets index and determining the financial health of the bank's assets against their depreciation, the mandatory application of IAS/IFRS substantially impacts the credit rating of Iraqi banks, the research sample. As a result of improved measurement of their solvency index and the ability of banks to fulfill their obligations over the long term, the credit rating of Iraqi banks, the research sample, is significantly impacted by the mandatory application of IAS/IFRS.

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