



ACCOUNTING STANDARDS AND THE JDM QUALITY IN THE FINANCIAL REPORTING OF PAYMENT PROCESSOR COMPANIES

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Abstract

The purpose of this conceptual paper is to examine the role of accounting standards in providing high-quality financial information of payment processing companies in the Digital payment Industry. However, the adoption of the high level of JDM quality by using conceptual framework and relevant accounting standards serves the benefit of having more transparency, relevancy and meaningful comparison of the firms. This paper aims to the revenue recognition standard, financial instrument standard and provision, contingent liabilities and contingent Asset standards, which require significant judgment on estimations on the related risk which is involved in the payment industry. A conceptual framework was developed to highlight the relationship between the Accounting standards and JDM (Judgment and decision making) quality in the financial reporting by integrating the strategic business reporting on financial reporting outcomes. This paper examined the quality of financial reporting with an increasing number of high-risk merchants in the business model of the payment processors and related disclosure of risks associated with dealing with high-risk merchants like legal issues reputational damages and financial loss in financial Reporting.

(Keywords: JDM, conceptual Framework, strategic Business Reporting, Payment Processor, High-risk Merchants).

Introduction

In recent years a significant transformation seen in the financial service sector because of technological innovations updated regulations and shifts in economic activity. With an Increase in Digital commerce in emerging Economics, the mode of payments is almost becoming cashless, as a result of this; the focus is shifting on the payment Industry. The processing company provides a technology platform that links the customer of the payment processing company. The customer consists of both merchants and consumers around the world to facilitate the processing of payment transactions. The processing company offers customers the flexibility to use their account for both purchase and receive payment for goods and services, as well as to transfer and withdraw funds. And also, it facilitates in using various funding sources, example the PayPal Company allows its consumers to exchanges funds with merchants using a variety of funding sources, which may include a bank account, a PayPal account balance, a PayPal Credit account, credit or debit card or other stored value products such as coupons and gift cards.

The primary revenue generation for the payment processing company is charging fees by providing transaction processing and other payment-related services based primarily on the volume of activity processed through the Payment Platform. The payment processing company provides generally a free service for consumers to deposit funds or draw from their accounts; however, Payment processing companies generate revenue from consumers on fees charged for foreign currency exchange and also, they earn revenue by providing value-added services to consumers and merchants. Due to the transformation in the financial service sector now the question arises about the areas of regulations that are impacted most, the shifting in payment modes from traditional to digital mode is bringing challenges for accounting regulators to give a regulatory framework to promote transparency and integrity in the payment industry business for providing the integrated financial report by involving the 360-degree view of the business.

Background of the Study

However, several studies have suggested that the role of finance in economic growth is weakening and, in some cases, negative, as there may be other factors, such as Financial institutional quality that influences the positive



effects of finance on growth (Breitenlechner et al. 2015; Rousseau and Wachtel 2011). The quality of the institution is determined by the relevant financial and business-related information which is given to the stakeholder. The relevant information will be very useful for the stakeholders to take further decisions in the business environment that ultimately promotes economic growth and also it reduces the information and transaction cost which allow intermediaries and markets to mobilize savings, allocate resources and facilitate risk management leading to capital accumulation and technological progress for economic growth (Levine 1997). The quality of the financial reporting is very essential to check the real-time financial health of the business. The quality will be increased by giving integrated financial reports which include strategic business reports and non-financial information. The inclusion of strategic business reports and non-financial information ultimately increases the quality of reporting which also promotes a healthy economy. The stable and sound integrated financial Reporting system promotes healthy competition which facilitates capital inflow and also avoids financial crises.

Problem Statement

Digital Transactions are increasing across the world by creating many opportunities for new participants in the financial sector to diversify into new services like e-commerce platforms, digital wallets, and mobile payments to generate new revenue streams. Due to the increase in the volume of the transaction the Payment ecosystems are facing many Regulatory challenges to provide quality financial reports to the stakeholders for taking economic decisions in the business environment. To eliminate such challenges in financial reporting the accounting regulators should come up with a conceptual framework in the accounting standards to provide the appropriate approach to increase the JDM quality of the financial reporting.

This paper focused on three standards mainly Revenue recognition standard, Financial Instruments and provisions, contingent liabilities and contingent Asset's standard to understand how the judgment and decision making in estimation brings an impact on the financial statement. The standards have given the flexibility to management in estimations including fair value estimation. The mandatory adoption of Principal based accounting standards for financial institutions lead to biased financial reporting; here is the aim to reduce the biasness by adding more JDM quality in the reporting by validating logically. In the current system of financial reporting, the initial recognition of the revenue in the books of account should be done by following the five steps process. However, the Revenue from Contracts with Customers requires significant judgments in the payment industry, understanding the payment ecosystem and the importance of knowing each payment industry participant in processing a transaction is very critical for the initial recognition of revenue. The 5-step process is very important to apply appropriately the new revenue recognition standard.

When to recognize revenue is challenging in the payment industry. **First**, Identification of customers and reliable measurement of revenue as per the standards the basic requirement to recognize the revenue. It's essential to define a customer as per standard for recording the transaction. In normal terms, a customer is a party that has contracted with an entity to obtain goods and services in the ordinary course of activity in exchange for consideration. Accordingly, a payment processing entity needs to identify the customer in each contract or each arrangement because both the merchant and consumer could be the customer for the payment processors. In a regular course of business, A merchant is often the customer of the Payment Processor. The requirement of accounting standards to recognize the revenue in the books of accounts is pretty straightforward when it is probable that future economic benefits will flow to the entity and that economic benefit is reliably measurable in the normal course of the business. The standard has provided guidelines to identify each circumstance and apply the criteria to recognize the revenue in the books of account unless these criteria did not meet the recognition of revenue cannot be done in the books of accounts. **Second**, identifying the number of performance obligations in each arrangement is to help recognize the revenue at one point in time or over the period in the books of accounts. When and how to recognize revenue depends on understanding whether a series of distinct goods or services is a single performance obligation or multiple performance obligations. **Third** identify themselves as a principal versus agent, because determining the principal versus agent is important to come to the conclusion



how much exact revenue has to be recognized in the books of accounts. If an entity acts as a principal in the transaction the performance obligation of the principal will recognize revenue as the gross amount. While for an agent the revenue will be recognized in the books of accounts on a net basis.

The management of the processing company has to make a reasonable estimation of future economic benefits. The specific judgment has to be taken for the initial revenue recognition by understanding all the factors which are going to affect the revenue of the processing company. The factors to be considered as a part of this determination such as terms of the contract, nature of the entity's relationship with the customer, number of the performance obligation, the ability of the entity, rights of the entity on the benefits before transferring to the customer and the entity's potential risk of loss arising from each transaction. The above factors will help to improve the JDM quality in financial reporting.

Another critical part is Analyzing the risk and managing the risk on time in the payment processing companies is the most challenging task. Many payment processors face heavy financial loss due to delays in recognition of credit losses on loans and on other financial instruments. The existing standard allows recognizing the credit loss until there is evidence of a trigger event. That allows the entity very little time to create reserves to adjust during bad times. To avoid uncertainty in the payment industry the most forward-looking process for the assessment of credit loss should be implemented. The estimation of expected credit loss should be done based on interest amount due, the time factor, category of the customer based on high risk or low risk, accordingly, the decision on impairment of financial instrument has to be taken to give a fair and true view of financial statement. The appropriate impairment of the financial instrument will reduce high volatility in the value of the financial instrument which leads to maximum stability in financial Statements.

The accounting standards require measuring the financial instrument at fair value and also standard has given clear instruction on disclosure of Fair Value measurement. The framework given by the standard on a different level of inputs is to be used for the valuation of fair value. The level 1 inputs are available in an active market, in level 2 inputs the similar financial instrument's air value will be considered for fair value measurement but level 3 inputs are not available in the market. Having more financial instruments which are based on level 3 inputs creates more volatility in the statement. To avoid uncertainty and instability in a financial statement, reliable information has to be collected in the market based on participant's assumptions. The impact of having more financial instruments based on level 3 inputs leads to fluctuation in the fair value of financial instruments in financial reports. Any increase or decrease of the fair value on the reporting period should appear on profit and loss accounts that will help the users to make decisions based on operational related activity which involves high or low volatility.

Judgment and decision making in accounting is very critical aspect to give a true and fair view of the company financial statement because it will help stakeholders and users of the financial statement to come up with the right economic decision. To get more clarity on how to JDM quality impacts the financial reporting statement let's understand these two terms and also influencing factors to provide a high quality of JDM. The Judgment refers to estimation, opinion, reliability on a specific event or about uncertainty in the business. Judgment in accounting is to make predictions about future events based on the experience, Probability of occurrence of an event, expert opinion. And The Decision refers to the course of action taken by the management to recognize the event in the accounting based on judgment and it should also involve analyzing various alternatives available to take a rational decision making. However, to reach the appropriate conclusion on reliable estimation following influencing factors to be considered which impacts JDM quality of the financial statement like 1) Risk 2) Return 3) Understanding the business model of the customer 4) Setting down standards for recognizing the high-risk merchants 5) Chargeback ratio 6) History of the Customers on defaults 7) Sales 8) Legal obligations of the customer 9) Best practices 10) Governance and ethics.



Other than operational related JDM, the Payment processor faces huge competition risks in the fetch era. If the company fails to recognize the threat of competition while making reliable estimations could adversely impact the profitability of the entity. Analyzing the risk, managing the risk and reporting the risk in the annual report to have a greater impact on user's decision making. Here is the following major risk that impacts the profitability of the business.

- If the merchants failed to fulfill the obligation towards the consumer in such case the payment processing companies will incur substantial; losses as a result of claims from the consumers even after seeking to recover the losses from the merchants but still the company will not be able to recover the full amount in case of high-risk merchants or if the merchant unable to pay.
- International transactions and operations are subject to high risks, which could harm the business due to fluctuations in the currency rates.
- The processing company enters into transactions involving derivative financial instruments with various financial institutions. Certain banks and financial institutions are also lenders under credit facilities. The exposure of counterparty credit risk is more even after mitigating risk by entering into the derivative market. Despite these efforts, entities are still exposed to the risk of default by, or deteriorating operating results or financial condition or failure of, these counterparty financial institutions. During an economic downturn, the uncertainty in the economy will lead to financial crises. The risk of counterparty default, deterioration or failure will be more during economic downturns and periods of uncertainty in the financial markets. The decreased inability to recover the loss will be more due to counterparties becoming insolvent or file for bankruptcy. In the event of default or failure of one or more counterparties, will lead incur significant losses, which could negatively impact the results of operations and financial condition. Interest rate fluctuation. General legal disputes and regulatory disputes are very common in the payment industry.

The accounting standard has given the flexibility to management in estimations, fair values, judgments and estimation in the valuation of financial assets and financial instruments which are associated with high exposure to credit risk and financial risk. The study observed that flexibility in accounting exists because of differences in management, the business model; the size of the company, the capital structure and strategies of the company differs from company to company. The corporate regulators need to ensure that every entity should fully disclose the critical estimates and judgments (including fair value estimations) by rating the hierarchy of the risk factors involved in the financial reporting. Disclosing the critical aspects of the estimates and judgment is very necessary for the users to know how necessary flexibility in accounting has been presented in the financial statements. The focus on continuous improvement in the JDM quality will have a positive impact on the financial reporting; integrating SBR with an Annual report will provide shareholders with a holistic and meaningful picture of an entity's business model, strategies, developments, performance, position and prospects. The strategic report serves the purpose of investors and other stakeholders in the decision making with the help of quality reporting. From an entity perspective preparing strategic business reporting to serve as best practice to prove the quality of their institution.

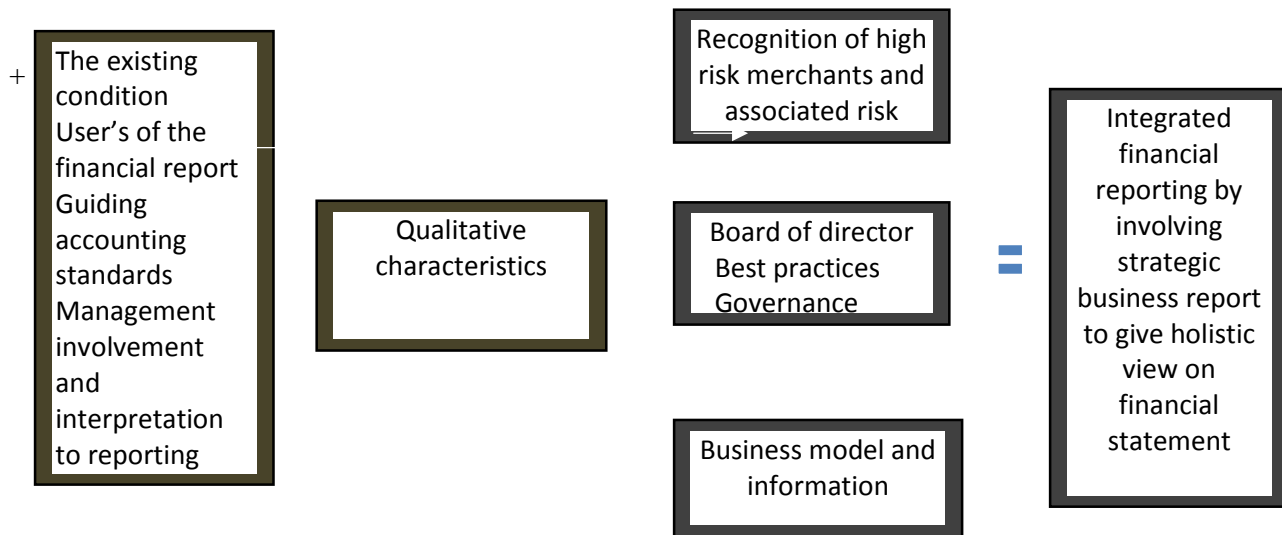
The gap in the research

The research gaps identified in the Literature of review on the JDM quality in financial reporting involving the factors impacting JDM quality which may significantly impact the quality of the financial disclosures of the processing companies by (Bazerman, 2012) The relationship between internal governance and JDM quality explored by using a longitudinal approach and the assessment of the quality of financial reporting (Wang & Wu, 2011; Chakroun & Matoussi, 2012; Habek & Wokniak, 2015; Wen, Mong, Liu, Wise, & Carey, 2015; Beest, Bram, & Boelens, 2009).how the reporting should be improved by (Muzira, 2019). To examine the association between investment efficiency and financial reporting quality by (Shekespeare, 2020).Financial reporting

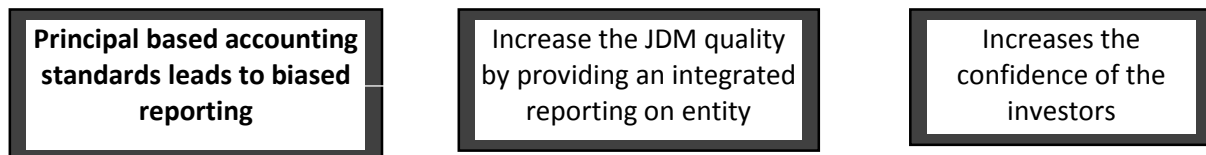


standards and their relationship to quality reporting (Yurisandi, & Puspitasari, 2015; Sherman & Young, 2016; Chakroun, & Matoussi, 2012; Wen, Mong, Liu, Wise, & Carey, 2015; Bach, 2016). Impairment modeling for financial assets under IFRS 9 (SY, 2017), Do principles-based accounting standards lead to biased financial reporting (psaros, 2007). Other studies are also focused on a single element such as disclosure, revenue recognition by referring to accounting standards and annual reports of financial institutions. The proposed framework is to provide a high level of JDM quality by integrating the strategic business report with the annual financial report and influencing factors to improve the transparency and integrity in reporting.

**The proposed conceptual framework for the high JDM quality in financial reporting
 MODEL 1**



MODEL 2



Conclusion

The high-quality reporting represents the economic activity of the payment processing company during the year. Despite the adoption of principle-based accounting standards in the reporting, the users of the financial statements are losing confidence in the financial reporting because of the Quality of JDM in financial reporting and its impact on financial statements which has been discussed in the paper. And also this paper focused on the disclosure of highly influential transactions and their measurement in the financial statement. The factors which influence the JDM quality are studied in reporting to give a fair and true view of the financial position of the entity. To provide meaningful and relevant information to decision-makers, quality information related to finance and strategic business reports is required. Ultimately the paper aims to improve the quality of reporting to reduce the biases logically. The new model proposed on the terms of the judgment in estimation by considering the conceptual framework of accounting regulations, factors influencing JDM quality and Providing integrated reporting which includes strategic business reports.