Executive summaries of the accounting wizardry behind banks strong earnings

Finance

The Accounting Wizardry behind Banks' Strong Earnings al Affiliation On the announcement of the fourth-quarter gains (January 14, 2014), as per the financial year, JPMorgan Chase (JPM), which was the most profitable U. S. bank as per the initial bank review, was overtaken by Wells Fargo (WFC) which recorded its personal best. WFC incurred profits of $5. 6 billion whilst JPM had $5. 3 billion. However, JPM made profits amounting to $17. 9 billion at the end of the financial year 2013. Although JPM spent more on its legal settlements up to $23 billion, the gains for the year 2013 were deemed productive and worthwhile. Even though profits were realized in the two companies, they were not that solid. This followed after a further review of the latter. It was noticed that up to 31% of JPM's profits of the financial year 2013 averaging $5. 6 billion and 10% of WFC's profits gained the same year amounting to $2. 2 billion were not realistically earned. That money accrued came from the two bank's loan-loss reserves.

Loan-loss reserves, as mentioned, are set aside by the banks' lenders given a financial crises is prevalent or when the U. S. economy is on the worst side. This goes hand in hand with the inflation projections on the economy with consumers experiencing hard times in financing their mortgages, credit card bills and other loans. Evidently, according to Josh Rosner, a Graham Fisher industry analyst based in New York, running out of reserves makes it in order to cuts costs on loans. It is imperative to note that one of the effects of this is the depreciation in the growth in revenue.

Bank of America (BOA), which is ranked fourth among the largest American banks, flaunts turning losses into profits as a result of offsetting the loan-loss reserves. Since 2010, BOA had accrued losses of up to $11. 8 billion, but from embracing change, it has surpassed all the setbacks and seen profits up to $11. 4 billion on the better side. Additionally, Citigroup (C), which reported enormous profits of $40. 4 billion about the same time, would have gained half of what their income was disregarding the accounting benefits. Evidently, when BOA was relying on reserves, profits were not well off in comparison to when they would not have used the boost from the reserves. In 2009, BOA would have realized profits of up to $55 billion were it not for the $48. 6 billion reserve money they owed. On the same breathe, profits from other banks, which relied on their reserves during inflation were affected accordingly.

It was noted that despite bank earnings poor performance, investors notably still embraced them. This was concluded by a bank analyst by the name Paul Miller who works at FBR capital markets (FBRC). However, not all investors have the same thoughts on this. Considering the accounting standards set for American banks - the banks are urged to release the loan-loss reserves given the loan is performing well - what results is that no meaningful profits are realized. Widespread usage of loan-loss reserves is not advised in the banks. Jamie Dimon, Chief Executive Officer (CEO) of JPM, admitted all the occurrences above to be ‘ okay.’ Notably, BOA dropped its profits accrued by 44. 6% over a period of 12 months whereas JPMorgan, Citigroup and also Wells Fargo gained in their realized profits with their percentages being 25%, 27. 5% and 31. 3% respectively.

Personally, I would agree with the statement that behind the banks’ enormous earnings, there is a great sense of accounting wizardry involved.

Reference

Dawn Kopecki (2014). Banks: The Accounting Wizardry behind Banks' Strong Earnings. Retrieved April 1, 2014, from http://www. businessweek. com/articles/2014-01-14/jpmorgan-wells-fargo-earnings-boosted-by-accounting-maneuver