Research in Accounting Regulation 000 (2017) 1–7

Contents lists available at ScienceDirect

Research in Accounting Regulation

journal homepage: www.elsevier.com/locate/racreg

Research report

Compliance with accounting standards by financial Institutions: Some evidence from Bangladesh

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ARTICLE INFO

Article history:
Available online xxx

Keywords:
Financial reporting practices
International financial reporting standards
Compliance
Factors motivating compliance

ABSTRACT

As Bangladesh is going through socio-economic and political changes, this paper investigates the disclosures required by 'Bangladesh Accounting Standards' or 'International Financial Reporting Standards', as adopted/adapted in Bangladesh and whether affiliation with Big-4 accounting firms leads to better compliance with disclosure requirements. We analyze the financial statements of 26 banks on liquidity, concentrations of assets, liabilities and off-balance-sheet items, related-party transactions, and unconsolidated entities. Our results indicate that banks are not ensuring essential compliance with all disclosure items in national standards. Banks audited by Big-4 affiliates display better compliance in financial statements than those audited by non-affiliates, with some exceptions. Our research provided evidence that, in contrast to general understanding and expectation, Big-4 associates in developing country may not absolutely outperform local firms. We also find systematic non-compliance with provisions of standards that would be useful for inferring group membership despite compliance with other disclosure provisions.

1. Introduction

This study aims to make a contribution to the international accounting literature on emerging economies by examining the compliance with accounting standards by the banks of Bangladesh—a country with market potentials and democratic perspectives. This paper will also focus on examining whether self-regulation and guidance by international accounting firms will improve the compliance with standards. As Bangladesh is going through changes for its economic development, specifically, organizational changes that are a part of accounting systems in Bangladesh, and as accounting needs to be viewed as combined within organizational change and process (Broadbent & Laughlin, 2005), this paper attempts to highlight some organizations that are passing through changes and shaping the accounting systems.

For this paper, the emerging economy construct is the one in which the country is in a less developmental and transitional economy state (Saudagaran, 2004), and in which the capital market is developing to the point of contributing to the national financial fund and is able to receive external investment (Salter, 1998; Saudagaran & Diga, 1997). Since its independence, Bangladesh has been trying to be more democratic and market-oriented, seeking the attention of international investors and institutions.

The primary objective of financial reporting is considered to be that of providing information for economic decision-making (IASC, 1988) by the users. Compliance with standards by corporations ensures the quality of reporting, because the standards provide a framework for the reporting of operations. However, the decision to disclose information involves many factors and sources that have influence on the quantity and quality of information (Archambault & Archambault, 2003). Disclosure is the process by which accounting measurements are transmitted to the users (Choi, Frost, & Meek, 2002), domestic and cross-border. Accepting this definition, disclosure *that might involve compliance with standards* [author's emphasis] depends on culture and market forces (Zarzeski, 1996). Douglas (1989) and Wildavsky (1989), demonstrated that financial reporting is influenced by the culture. The US Financial Accounting Standard Board (1978) documented that financial reporting is not indisputable but is affected by the economic, legal, political, and social environment in which financial reporting takes place.

Several studies have documented that corporate financial disclosure and compliance is influenced by culture, national systems, social norms, and corporate systems (Ali & Ahmed, 2007; Archambault & Archambault, 2003; Baydoun & Willet, 1995; Nobes, 1998; Salter, 1998; Saudagaran & Diga, 1997); however, not many studies have investigated the compliance with standards by banks of a

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https://doi.org/10.1016/j.racreg.2017.09.006
1052-0457/

developing country. This study examines the disclosure choices of the banks in Bangladesh. Bangladesh has become a lower-middle-income country with its Gross National Income per capita (GNI), joining those with annual incomes of $1046–$4125. This paper studies the intricacies of a developing country and provides insights into what kinds of turbulence could afflict such locations. It will also help Bangladeshi financial institution stakeholders reach a better understanding of the accounting culture and development in Bangladesh.

2. Applicability of accounting standards in Bangladesh

Although the desire for the implementation of International Financial Reporting Standards (IFRS) within the Bangladeshi accounting system is present, the possibility needs to be assessed. Since numerous variables (political, economic, social, etc.) are constantly evolving and are inherently different for each country, experiments cannot be controlled adequately to pinpoint whether a mandatory enforcement of new accounting standards can be beneficial or not (Madsen, 2013). The only way to understand Bangladesh's behavior toward the implementation of standards would be to directly put the new regulations in place. On the other hand, Ahmed, Neel, and Wang (2013) have argued that mandatory implementation of standards can be beneficial to a country under the conditions that (i) the IFRS are of higher quality than the domestic GAAP and that (ii) the domestic enforcement mechanism is efficient. In the case of the first condition, where there is strong enforcement, IFRS would help to produce better quality reports as well as to increase comparability for users. On the other hand, if the IFRS are of lower quality than the domestic GAAP, managers would be able to exercise discretion in their own interest. Ahmed et al. (2013) have reported that the implementation of looser standards in strict-enforcement countries has resulted in lower accounting quality. The implementation of new standards would require appropriate adaptation to the economic situation in Bangladesh to ensure proper acceptance.

3. Economic, cultural, legal, and accounting background

3.1. Socio-economic

Bangladesh is a country with considerable potential but is trapped in a low-growth cycle. However, it is expected that Bangladesh will be a different country in the 21st century (The World Bank, 1996). Bangladesh, with its estimated 158 million market population as at July 1, 2014 (www.worldometers.info), and economic ties with regional countries is positioned strategically, linking east and west Asia with the rest of the world. With its international, commercial, and regional ties and with its accounting and economic memberships in the SAARC, the International Federation of Accountants (IFAC), the South Asian Federation of Accountants (SAFA), and others, there is great potential for accounting bodies in Bangladesh to play a role in the activities of other regional accounting bodies.

3.2. Cultural factors

Of the numerous cultural factors affecting the economic fabric of Bangladeshi society, the existence of a powerful elite group, widespread corruption, and the importance of the concept of family is important (Walker & Robonson, 1993). In Bangladesh, a small, socially important group dominates the upper echelons of government, industry, commerce, and higher education. It is understandable that accounting has a role in the following four specific aspects of economic development, in particular to a developing country like Bangladesh: resource mobilization, especially domestic resources; resource allocation; control; and national planning.

3.3. Religion

As Muniandy and Ali (2012) reported in their study on influential factors in accounting, religious beliefs are of great importance in the regulation of the environment of a country's accounting system. In Bangladesh, the populace is predominantly Muslim. As Bangladesh's population consists of almost 90% Muslims (Bangladesh vs. India, 2014), it may be argued that the country's regulations are influenced by the beliefs of the religion. At present, out of 49 banks in Bangladesh, seven banks and 19 branches of nine conventional banks within the private sector follow Islamic Shariah principles (Sarker, 2005). These entities make use of Islamic financial instruments (contracts that are deemed legal and confined within the Shariah principles) (Muniandy & Ali, 2012).

3.4. Legal

A country's legal system may influence financial reporting disclosure (Ali & Ahmed, 2007; Archambault & Archambault, 2003). The common law country is typified by solutions to specific cases drawn from practice and may create an environment to increase disclosure to meet the increased demand of the stockholders (see Ball, Kothari, & Robin, 2000; Doupnik & Salter, 1995).

3.5. Corruption

Bangladesh has been listed as being among the most corrupt nations according to the Corruption Perceptions Index of 2013, with a score of 27 out of 100 (0 being perceived as the most corrupt). Police, customs, the taxation sector, the central secretariat, bureaucracy, and excess patronage are many examples of the Bangladeshi sectors that are afflicted by corruption. It is not unusual for governmental ministers and public officials to become involved in corrupt activities, avoiding practices that could make the accounting system more transparent.

4. Background in perspective of theory development

In Bangladesh, the focus of most technical assistance activities has been on the adoption of standards and the training of accountants and auditors in their application. Relatively little attention has been paid to the issue of enforcement. Bangladesh is one of the countries that received technical assistance to upgrade accounting and auditing standards and the skills of accountants. The Asian Development Bank and the World Bank has sponsored the Financial Institutions Development Project and provided a grant to the Institute of Chartered Accountants of Bangladesh (ICAB) to promote standard setting and to provide training to auditors. This paper looks at the ability of the ICAB as a powerful entity that shapes and enforces high-quality financial reporting by examining compliance with disclosure requirements (Cortese & Irvine, 2010; Hasan, Karim, & Quayes, 2008) of the IAS or Bangladesh Accounting Standards (BAS) in the financial statements of publicly listed financial institutions.

With an interest in the soundness of the banking system, banks and other financial institutions are subject to regulation and oversight by national authorities and international bodies such as the International Monetary Fund, the World Bank, and regional development banks. IAS 30, Disclosures about Banks and Similar Financial Institutions, is a set of additional disclosures for banks designed jointly by the Bank for International Settlements (BIS) and the International Accounting Standard Committee (IASC). This