

## The Impact of Management Structure and Bank Characteristics on the Level of Compliance with IAS 21: Evidence from Bahrain

Dr. Adel Mohammed Sarea<sup>1</sup>

Hesa Jasim Al Nesuf<sup>2</sup>

### Abstract

---

*This paper discusses the impact of management structure and bank characteristics on the level of compliance with IAS 21 in Bahrain Stock Exchange (BSE). Issues addressed include the management structure and bank characteristics and its impact on the level of compliance with IAS 21 in Bahrain. The data were collected from financial reporting and questionnaire as primary data and the literature review as secondary data. The main findings conclude that, there is an impact of the management structure and bank characteristics on the level of compliance with IAS 21 in Bahrain. In addition, banks of Bahrain have a high level of compliance with IAS 21 standard. Based on the findings, this paper concludes with various recommendations for future research, the most important of which is the need for future studies on how IAS 21 accounting standards can be made mandatory in all GCC countries. This paper also contributes towards a better understanding and acceptability of the need and adoption of International Accounting Standards.*

---

**Keywords:** Accounting, International Accounting Standards (IAS), IAS 21, Bahrain

### 1.0 Research Overview and Literature review

The Kingdom of Bahrain is among the very few countries in the region known for its economic free as well as acting as the hub for many financial institutions in the region in order to attract more investments and investors. The rapid growth of the economy has created ability to strength the financial sector through increasing the regulatory rule imposed by Central Bank of Bahrain (CBB).

The worldwide acceptance of International Financial Reporting Standards (IFRS) is one of the most important changing in the accounting rule of the modern accounting history. However, many researchers confirmed the need of international accounting standards to be applied locally and globally, according to Joshi and Ramadan (2002) they confirmed that the majority of banking sector in Bahrain strongly agreed that using IASs to improve their organization's ability to financial assistance. In related study, Barth et al. (2008) they examined the influence of the economic consequence of the implementation of IFRS, the adoption of IFRS generally improve the quality of accounting information. In another study, Whittington (2005) indicated a possible promoter for the adoption of IFRS is the requirement for an international language of accountancy because of the growing internationalization of capital markets. However, the adoption of IFRS may be differ from one country to another because of many factors, for instance, cultural factors such as religion, national satisfaction, language, accounting requirements that may affect regulators' decisions on the acceptance of the adoption of IFRS.

---

<sup>1</sup>College of Business and Finance, Ahlia University, Kingdom of Bahrain. Currently he is the Director of MBA program. He can be reached at asarea@ahlia.edu.bh.

<sup>2</sup>College of Business and Finance, Ahlia University, Kingdom of Bahrain

Bova and Pereira (2012) conducted a study on IFRS' compliance stages following mandatory IFRS acceptance, they examined the reasons of allowing firms to comply with IFRS and the benefits from IFRS compliance in a developing country where enforcement is weak for instance Kenya, an African country where the capital market is quite open and implementation of IFRS is generally negligent, they found that public firms have a higher level of compliance than private firms and there is a positive association between degree of acceptance of IFRS and foreign ownership.

However, in reference to Al-Mudhahki and Joshi (2001) they found that, certain listed companies in Bahrain were complying with the international accounting standards. In addition, it was found that, size, auditors' reputation, the percentage of foreign sales, levels of foreign activity, listing, and profitability were the main determinants of the compliance with international accounting standards

### **1.1 The need of International accounting standards**

Due to the current different regulatory requirements and legislations, the relevance and comparability of financial statements are the foundations upon which accounting standards are predicated. Lovett (2002) documented that, with financial statements prepared under different accounting standards a problem may exist in:

- Comparability of financial statements prepared globally,
- Reliability and creditability.

Barth et al. (2008) reported that the need to adopt the IFRS is increasing among financial institutions because of it represents superior accounting standards (especially in improving bank' comparability and information environment) in comparison to some domestic accounting standards.

### **1.2 The need of IAS 21**

The IAS 21 was issued in July 1983 and on December 1993 it was updated by the IASC through recommending the accounting treatment for the transactions dominated in a foreign currency and it applied for the following:

- Accounting for foreign currencies' transactions excluding the (derivatives within the scope of IAS 39), financial instruments, recognition and measurement.
- Translating the financial position of foreign operations into a presentation currency.

### **1.3 Development of Banking Sector in Bahrain**

Cooperation Council for the Arab States of the Gulf region (GCC) has a rich history of banking sector, going back to 1918 when the British first opened a bank in Bahrain (Olson and Zoubi, 2008). A study on development of banking sector in Bahrain conducted by Al-Shammari (1994) shows that in 1944 a second bank was established is the British Bank. In 1957 it was the first bank exclusively owned by Bahrain's citizen the National Bank of Bahrain commenced activities. Since 1960 the Bahrain's dinar recognized as a strong internationally exchangeable currency, as a result several banks established their business in the country and by 1974 the number of commercial bank was reached to fourteen banks.

## **2.0 Research problem**

Due to international activities, companies hold many items that are denominated in foreign currencies. Fluctuating exchange rates may influence the companies' economic situation. However, Choi & Meek (2007) documented that in 1975 SFAS 8 (Accounting for the translation of Foreign Currency Transaction and Foreign Currency Financial Statements) method was adopted by FASB to solve the problem of variety of treatments which aimed to use temporal method for reporting translation gains and losses in income by all the companies that have foreign operations.

In another study, Chris Sebastian Heidrich (2004) examined some accounting aspects of foreign currency translation (IAS 21) and stated that due to fluctuating exchange rates, companies face risks which should be systematized to be able to create techniques for using of financial instruments and depending on the kind of risk that shall be hedged, the respective hedging instruments and strategies have to be applied.

However, In order to link this issue to the market needs in Bahrain and its impact on the level of compliance with IAS 21 in listed banks of Bahrain, the researchers evaluated the impact of management structure and bank characteristics on the level of compliance with IAS 21 in Bahrain. However, all the banks listed in Bahrain stock exchange are required to have an appropriate accounting treatment of these exchange differences. The lack of previous studies that cover the implementation of IAS 21 disclosures in banking sectors in Bahrain will encourage the researchers to conduct this study.

With financial statements prepared under different accounting standards a problem may exist in comparability of financial statements prepared globally, reliability and creditability (Lovett, 2002). Thus, the evolving literature offers different interpretations, high levels of compliance, moderate levels of compliance and low levels of compliance.

Most of the previous studies had concentrated on the acceptability of international accounting standards. This study focused on the impact of management structure and bank characteristics on the level of compliance with IAS 21, in which exist many scenarios that include high level, moderate level and low level of compliance (this is the research problem to be discussed in this research).

### ***3.0 Hypotheses development and theoretical framework***

A number of studies in different countries attempted to determine the extent of the level of compliance with IAS 21. However, many of the previous studies discussed and examined a number of IFRS standards to be adopted globally. However, there is a need to fill the gap and to examine the level of compliance with IAS 21 in terms of management structures and banks characteristics in banks of Bahrain.

Accordingly, the main Hypothesis is "There are an impact of management structure and bank characteristics as independent variables and the level of compliance with IAS 21 as independent variable". Based on that, the impact of management ownership, institutional ownership, foreign investments, and return on investment, return on asset and return on equity needs to be tested to answer the research questions.

#### **3.1 Study Hypothesis**

The following hypotheses explain the impact of management structure & bank characteristics on the level of compliance with IAS 21.

- H1: There is a positive relationship between management ownership and the level of compliance with IAS 21.
- H2: There is a positive relationship between institutional ownership and the level of compliance with IAS 21.
- H3: There are a positive relationship between foreign investments and the level of compliance with IAS 21.
- H4: There is a positive relationship between return on investment and the level of compliance with IAS 21.
- H5: There is a positive relationship return on assets and the level of compliance with IAS 21.
- H6: There is a positive relationship between return on equity and the level of compliance with IAS 21.

However, the following equation should be applied to answer the research questions.

$$IAS21 = \beta_0 + \beta_1 MagOship + \beta_2 InsOship + \beta_3 FInvest + \beta_4 ROI + \beta_5 ROA + \beta_6 ROE + \varepsilon$$

Where:

- IAS 21=the level of compliance
- MagOship= Management ownership
- InsOship= Institutional ownership
- FInvest=, Foreign investments
- ROI= Return on investment
- ROA= Return on asset
- ROE= Return on equity

**Table1: The labels and measurements of the study variables:**

Variables	Label	Definition and Measurement
<b>Independent variables</b>		
<b>Management characteristics</b>		
Management ownership	MagOship	This is percentage of stocks owned by the executive directors and CEO
Institutional Ownership	InsOship	This is percentage of shares owned by other Institutional
<b>Bank characteristics:</b>		
Foreign Investments	FInvest	To measure the total of foreign ownership
Return on investment	ROI	A performance measure used to evaluate the efficiency of an investment
Return on Assets	ROA	To measure how effectively the firm's assets are being used to generate profits
Return on Equity	ROE	To measure how the profits earned for each dollar invested in the firm's stock
<b>Dependent variable</b>	IAS 21	To measure the level of compliance

#### 4.0 Research methodology

This paper discusses the impact of management structure and bank characteristics on the level of compliance with IAS 21 in Bahrain Stock Exchange.

This can be achieved through using a survey to collect information through Banks' websites and the independent variables data can be acquired through the financial statements for the year ended December 31 2011.

#### 4.1 The sample design and selection

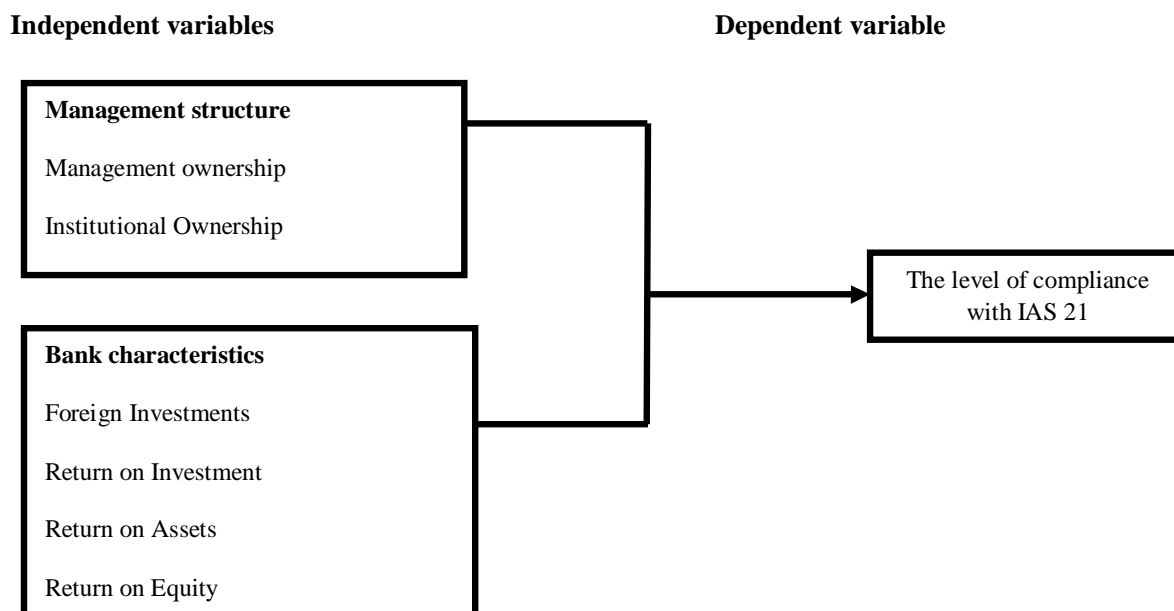
The sample size of this study all listed banks in Bahrain Stock Exchange. However, the sample size is 19 listed banks in (BSE) but one bank was eliminated because of suspension.

#### 4.2 Data collection

The primary data was obtained through the questionnaires which were distributed to the respondents as well as annual reports. The secondary data was obtained from previous studies.

#### 4.3 Theoretical Framework

Regarding independent variables and dependent variable, this theoretical framework will explain the impact of management structure and bank characteristics on the level of compliance with IAS 21. See Figure 1:

**Figure 1: Theoretical Framework**

### ***5.0 Empirical Results: Research findings and discussions***

The findings are divided into two sections; the first section is summarizing the main results of the questionnaire (descriptive statistics). The second section discusses the results of regression analysis.

#### **5.1 Data analysis**

To achieve the research objectives, the data are expected to be evaluated using Statistical Package for the Social Science software (SPSS 17.0).

#### **5.2 Reliability test (alpha analyses)**

To ensure that the scales used in this study is consistently what were planned to be measured, the study has implemented reliability test, which is Cronbach's coefficient alpha test (Pallant, 2001). According to, Hair et al (2006) suggested that to accept the reliability coefficient  $\alpha$ , the result should be equal 0.70 or more.

In this study the result of coefficient alpha score for the independent variables used is 0.855, which specifies a high degree of internal consistency for the current scale.

#### **5.3 Descriptive statistical analysis**

Table 2 shows the descriptive statistics of the independent variables. The variables reflect the level of compliance with IAS 21. Overall, the mean of the variables is positive and that reflects the high level of compliance with IAS 21.

**Table 2: Initial recognition**

No	Statement	Mean
1	A foreign currency transaction is a transaction that is requires settlement in a foreign Currency.	4.9
2	A foreign currency transaction shall be recorded in the functional currency, by applying the spot exchange rate to total amount.	4.7
3	The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IFRS.	4.7
<b>Total</b>		4.8

Table 2 shows that, the total mean score is 4.8, i.e. the respondents' banks totally agreed and implemented the above statements in their accounting practices.

**Table 3: Reporting at the ends, of subsequent reporting periods**

No	Statement	Mean
1	Foreign currency monetary items shall be translated using the closing rate	4.8
2	Non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction	4.2
3	Non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined	4.8
<b>Total</b>		4.6

Table 3 illustrates that, overall the reporting at the end of subsequent reporting period's statements have a high mean score of 4.6, which is reflecting that the respondents' banks awareness of the above accounting measurements and translating standards.

**Table 4: Recognition of exchange differences**

No	Statement	Mean
1	Exchange differences shall be recognized in profit or loss in the period in which they arise	4.4
2	Exchange differences shall be recognized in profit or loss in the separate financial statements of the reporting entity	3.5
3	Exchange differences shall be recognized initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment	4
4	When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency	4.8
<b>Total</b>		4.2

The IAS 21 techniques of recognition of exchanges currencies difference are well understood and completely implemented by banks of Bahrain, as clearly indicated from the above table which shows that the statements are also high mean score of 4.2

**Table 5: Change in functional currency**

No	Statement	Mean
1	Change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency	4
2	An entity translates all items into the new functional currency using the exchange rate at the date of the change	4.8
3	The resulting translated amounts for non-monetary items are treated as their historical cost	3
Total		3.9

Table 5 indicates that the above mentioned change in functional currency statements, score is acceptable with a high level of compliance.

**Table 6: Translation to presentation currency**

No	Statement	Mean
1	Assets and liabilities shall be translated at the closing rate at the date of statement of financial position	4.2
2	Income and expenses shall be translated at exchange rates at the dates of the transactions	3.8
3	The financial position of an entity, whose functional currency is not stable and experience unstopable rates of inflation, shall be translated into a different presentation currency	4.3
4	Balance sheet and income statement items shall be translated at the closing rate at the date of the most recent statement of financial position	3.6
Total		4

Table 6 indicates that all statements should be translated from the functional currency to the presentation currency.

**Table 7: Translation of foreign operations**

No	Statement	Mean
1	When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements	3.7
2	In the consolidation procedures all of intra-group balances and intra-group transactions of a subsidiary shall be eliminated	4.8
Total		4.2

Table 7 shows translations of a foreign operation to the reporting entity statements are acceptable with a high level of compliance among banks in Bahrain.

**Table 8: Disposal or partly disposal of foreign operations**

No	Statement	Mean
1	The cumulative amount of the exchange differences relating to that foreign operation, shall be reclassified from equity to profit or loss when the gain or loss on disposal is recognized	4.9
2	An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of that entity	4.2
Total		4.5

Table 8 results reflect that the respondents are aware of the IAS 21 disposal or limited disposal of a foreign operation issues; the mean score of 4.5 indicates a high level of compliance.

**Table 9: Disclosure**

No	Statement	Mean
1	The amount of exchange differences recognized in profit or loss except for those arising on financial instruments measured at fair value through profit or loss shall be disclosed	4.3
2	When the presentation currency is different from the functional currency, the reason for using a different presentation currency shall be disclosed	4.7
3	When there is a change in the functional currency, the reason for the change in functional currency shall be disclosed	4.6
4	When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Financial Reporting Standards	3.8
5	When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency it shall disclose the currency in which the supplementary information is displayed	3.8
Total		4.3

The disclosure requirements based on IAS 21 indicates a high level of compliance due to more understanding and acceptability of the requirements of IAS 21.

Generally, most of IAS 21 accounting standards has similar mean scores and high level of compliance with the IAS 21 accounting standards; initial recognition standard, reporting at the ends of subsequent reporting periods standard, recognition of exchange differences standard, translation to the presentation currency standard, translation of a foreign operation standard, disposal or partial disposal of a foreign operation standard and disclosure standard. Overall, the findings of the study indicate that, banks in Bahrain comply fully with the IAS 21 accounting standard. However, these findings reflecting that the respondents in banks of Bahrain are aware of the IAS 21 accounting measurements and disclosure standards.



#### 5.4 Regression analysis

The regression analysis was implemented to measure the level to which the management structure and banks characteristics variables influence the level of compliance with IAS 21 requirements.

#### 5.6 Testing of Hypotheses and Discussion of Findings

The hypothesis aims to test the impact of management structure & bank characteristics on the level of compliance with IAS 21.

The multiple regression results are shown in tables 10, 11 and 12.

**Table 10: Regression Model**

Model	R	R Square	Std. Error of the Estimate
1	.919 <sup>a</sup>	0.844	0.49082

Table 10 presents the results of the regression model that examine the change in the level of compliance with IAS 21 accounting standards in terms of independent variables. The model is significant with  $R^2$  of 0.844. This means the independent variables as above influences 84% of the level of compliance with IAS 21.

**Table 11: ANOVA**

Model		Sum of Squares	Df	Mean Square	F*	P-Value
1	Regression	15.635	6	2.606	10.817	.000
	Residual	2.891	12	0.241		
	Total	18.526	18			

\* F-Critical and confidence level of 95% is 2.29

Table 11 shows that the independent variables are significantly related to the levels of compliance with IAS 21, F-value = 10.8,  $P < .000$ .

These results indicate that the accountant's perceptions on the level of compliance with IAS 21 influence their decision to comply with IAS 21 accounting standards.

**Table 12: Predictors Coefficients**

Model 1	Unstandardized Coefficients		Standardized Coefficients	T*	P-Value
	B	Std. Error	Beta		
(Constant)	4.296	0.35	0.1	12.273	0
MagOship	-0.368	0.295	-0.18	-1.245	0.237
InsOship	0.656	0.263	0.309	2.495	0.028
Finvest	0.559	0.273	0.283	2.048	0.063
ROI	0.028	0.025	0.144	1.148	0.273
ROA	0.165	0.027	0.96	6.191	0
ROE	-0.668	0.318	-0.315	-2.098	0.058

Dependent Variable: the level of compliance with IAS 21

\*t-Critical and confidence level of 95% is 1.658

The results reveal that, the level of compliance with the IAS 21 accounting standards are affected by independents variables. The results support the research hypotheses that, hypothesis 2, 3, 4 & 5 are supported due to a positive relationship between these factors and the level of compliance with IAS 21. The rest hypothesis not supported due to a negative relationship with IAS 21.

In short, the relationships between IAS 21 disclosure and institutional ownership, foreign investments, return on assets and return on equity are positives. However the other independent variables have negative relationships with the level of compliance with IAS 21 requirements.

### **6.0 Summary, Conclusion and Recommendations**

Through examining the impact of relatively independent variables on the level of compliance with IAS 21, it indicated that 76.6% of the variation in the dependent variable (the level of compliance with IAS 21 requirements (constant)) was explained by the independent variables ((MagOship) management ownership, (InsOship) institutional ownership, (Finvest) foreign investments, (ROI) return on investment, (ROA) return on assets and (ROE) return on equity)).

As results, the institutional ownership, foreign investments, return on assets and return on equity had significant a positive relationships with the level of compliance with IAS 21 and the other remaining variables were found to be insignificant in explaining the level of compliance with IAS 21. Moreover, the most of financial controller's perceptions have a high level of compliance with the IAS 21. Additionally, these results reflect that, the respondents are aware of the IAS 21 accounting measurements and disclosure standards.

### **6.1 Limitation of the study**

this study does not attempt to capture all of the factors that are affecting the level of compliance with IAS 21 in Bahrain, it focuses on the factors that are commonly found in practice and the comparison was done only for specific banks listed in Bahrain Stock Exchange (BSE) website and the underlying accounting standard and local regulations are important in understanding the findings.

### **6.2 Contribution of the study**

The contribution of the study is to evaluate the impact of management structure and bank characteristics on the level of compliance with IAS 21. In addition, to understand the conceptual framework of IAS 21 and its requirements to be adopted, also it is excessive concern to all users of annual reports and of particular interest to accounting regulators to improve the level of compliance as well as the findings will increase the acceptability of annual reports, and to support in assessing the extent of required disclosure by Bahrain's banks to clarify the variation of disclosure in light of banks characteristics and management structures.

### **6.3 Future research**

This study examined the factors that affect the level of compliance with IAS 21 in Bahrain's banks and included the factors investigated by previous studies. Moreover, the study recommends future research to develop future factors that might influence the level of compliance with IAS 21. Furthermore it recommends future studies to explore the level of compliance with IAS 21 in GCC countries.

### **References**

- Al-Mudhahki, Jawaher& Joshi, PremLal (2001). "Empirical study of compliance with international accounting standards (IAS-1) by stock exchange listed companies in Bahrain". *Journal of financial management and analysis*. Vol. 14 Issue 2; ABI/INFORM Global. pp 43-54
- Al-Shammari, Atiya (1994) "Management development practices and national culture: the case of the Bahraini sector". PhD thesis, *University of Glasgow*.
- Barth, M., W. Landsman, and M. Lang (2008) International Accounting Standards and accounting quality. *Journal of Accounting Research* 46 (3): pp 467-498
- Bova, Francesco and Pereira, Raynolde (2012) "the Determinants and Consequences of Heterogeneous IFRS Compliance Levels Following Mandatory IFRS Adoption: Evidence from a Developing Country". *Journal of International Accounting Research: Spring*, Vol. 11, No. 1, pp. 83-111.
- Choi, D.S., Frederick and Meek, K.G. (2007), "International Accounting" *Pearson Education*, pp 207-227
- Joshi, PremLal&SayelRamadhan(2002). "The adoption of international accounting standards by small and closely held companies: evidence from Bahrain". *The International Journal of Accounting*. Vol. 37. pp 429-440
- Lovett, Robert. (2002) "The adoption of international accounting standards: A diffusion of an innovation". (PhD thesis). *Nova Southeastern University*. USA.
- Olson, D and Zoubi, T. A(2008). "Using accounting ratios to distinguish between Islamic and conventional bank in the GCC region", *The International Journal of Accounting*. Vol.43, No.1. pp 45-65.
- Pallant, J. (2001). *SPSS Survival Manual: A Step by step to data analysis using SPSS for windows*, (Version 10), *Open University Press*, Philadelphia
- Whittington, G. (2005) "The adoption of international accounting standards in the European Union", *European Accounting Review*. Vol. 14, No. 1. pp.127-153