

The level of compliance with International Financial Reporting Standards (IFRS 7)

The level of compliance with IFRS 7

Evidence from Bahrain Bourse

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Abstract

Purpose – The purpose of this paper is to examine the level of compliance with International Financial Reporting Standards (IFRS 7) by listed companies in Bahrain Bourse (BB).

Design/methodology/approach – First, the authors design disclosure compliance checklist of ten requirements of IFRS 7. Second, a score of 3 is assigned if high level of compliance, 2 is assigned if medium level of compliance, 1 is assigned if low level of compliance. The sample of the study comprises of (21) companies listed in BB for year 2013.

Findings – The main findings are, the level of compliance varied by industry and the highest level of compliance reported for the investment sector whereas the lowest for the insurance industry. This result indicates that all listed companies are complying with IFRS 7 in terms of the standard disclosure requirements.

Practical implications – In this paper attempt has been made to support the argument of previous studies. The paper attempts to test and answer the research question; does the financial sector in Bahrain comply with IFRS 7? These results could lead to high level of awareness about the financial instruments. Adoption of the IFRS 7 could lead to high level of compliance and play a significant role in attracting global investors' interest to the local markets, especially in a developing country like Bahrain.

Originality/value – This paper provides an insight from the reality of the financial market in Bahrain as a result of answering this question; does the financial sector in Bahrain comply with IFRS 7?

Keywords International Financial Reporting Standards (IFRS), Bahrain Bourse (BB), Level of compliance

Paper type Research paper

1. Theoretical framework, reserach problem and compliance issues

International Financial Reporting Standards (IFRS 7) – financial instrument disclosure consolidates all the requirements for the financial instruments disclosures and it is applied for all companies working with financial instruments. According to Sarea and Hanefah (2013), the compliance with IFRSs has become the focal point among the financial institutions, also defined the compliance of the standards as the degree to which entity comply with the multitude of issues in the IFRS.

In related study conducted by (Juhmani, 2012), a study included 27 standards on Bahraini listed companies for the year ending 2010 concluded that there is a positive relationship between the independent variables of the audit firm size and the company size and the disclosure level of the companies listed in Bahrain Bourse (BB). It also has been founded that large company's compliance level with IFRS requirements is higher than small companies (Juhmani, 2012). Banks, investment and insurance companies have a high influence within a financial system and the economy, so they are highly regulated in most countries.



IFRSs are known as the guidelines for financial performance and statement of financial position to present true and fair view statements. The standards help in the organization financial information users. Clearly, if not complied with the standards it will end up with some negative results and generally it will reduce the degree and scope of usefulness of financial information. However, the level of compliance of IFRS 7 by companies listed in BB has not been focussed by previous researchers. Joshi and Al-Mudhahki (2001) have examined the level of compliance of BB and select only IAS 1, their results showed a high level of compliance with the accounting standards in Bahrain. To fill the gap, this research will investigate the degree of compliance with disclosure requirements of IFRS 7 and moreover, it will add to knowledge by filling the gap in the academic literature regarding the level of compliance with IFRS 7 and the deviation from average industry for the sectors in companies listed in BB.

1.1 Research objectives

The research study aimed to study the existing reporting standard for the banking sector, investment sector and insurance sector listed in BB and find out the extent of compliance by them. Objectives are summarized as:

- (1) to find out the degree of compliance of the reporting standard by companies listed in BB; and
- (2) to find out the deviation from the average industry.

Most researches on IFRSs concentrates on the developed countries such as USA and UK. In addition, most of compliance studies on developing countries test compliance with some standards.

1.2 Research questions

This study aims to answer the following research questions:

- RQ1.* To what extent listed companies in BB comply with IFRS 7?
- RQ2.* To what extent listed companies in BB level of compliance deviate from the average industry?

In order to address the research question, the study will focus on some sub-questions:

- (1) Do companies disclose financial instruments that are in the statement of financial position under the correct classification?
- (2) Do companies disclose information helps in evaluating the significance of financial instrument?

1.3 Significance of the study

The aim of the study to examine the level of compliance with IFRS 7 and find out the deviation from average industry by the different financial sectors listed in BB.

This study will help the reader to get full understanding of the compliance of IFRS by commercial banks, investment and insurance companies listed in BB.

IFRS 7 compliance is a big issue, according to Al Shammari *et al.* (2008), although the GCC countries had made the IFRS mandatory for companies, no company achieved the full compliance with the IASs disclosure requirement.

According to Acaravci and Çalim (2013), the banking sector is considered sensitive to the economy development. The significance of the recent study lies in the following points:

- (1) the study provides clear vision about the level of IFRS 7 compliance in three sectors of BB companies; and
- (2) the study is a unique addition to the body of literature about IFRS 7, level of compliance in different financial sectors (banking, investment and insurance) listed in BB.

According to Hossain and Baser (2011), it is essential to prepare and present the financial statements according to the international accounting standards. It is considered vital as it enhances the degree and usefulness of the accounting information. Moreover, complying with accounting standards attracts investments, makes financial statements more practical and enhances comparability (Sarea, 2012).

Turkish national instruments' in monitoring and enforcing compliance need to be improved as Turkey showed lower compliance level in compare to Australia and Germany (Demir and Bahadir, 2014). IFRS 7 requires more detailed information than IAS 30 (Bischof, 2009). There is a high need to embrace IFRS 7 which has a consequent of more detailed financial statements as many financial instruments are brought under the scope of balance sheet (Ojo, 2012; Bischof, 2009).

1.4 The need of IFRS 7

Disclosure quality of financial information is compulsory to minimize the irregularity in the corporate sector (Bhattacharjee and Islam, 2009; Alsaqqa and Sawan, 2013). Reduce the expensed incurred in preparing many financial statements for different national authorities (Irvine, 2008). According Abhimantra *et al.* (2013) implementation of IFRS in developed countries and developing countries are influences by the economic growth but have no significant difference.

According to Danescu and Spatacean (2007), IFRS afford guidelines to entities in the form of principles-based standards, IFRS 7 – financial instrument principles are as follows:

- recognition;
- measurement; and
- disclosure.

According to Bischof (2009), IFRS 7 outdated requirement of IAS 30 and replaced requirements of IAS 32 that dealt with the disclosure. All requirements were compiled in one IFRS which guided the disclosure of the financial instruments. The disclosure about the compliance exists in many scenarios which comprise of: high, moderate and low level of compliance (Sarea, 2011).

According to Al Saqqa and Sawan (2013), IFRS has reacted positively to the demand of the users and shows more transparency in disclosure.

There is a wide evidence of problems in the accounting for financial instruments globally and there is a need to improve the knowledge and understanding of the standard.

According to Madawaki (2012) adoption of IFRS has a number of benefits as financial disclosures required by the IFRS helps the financial analyst for better predicting earning per share which is relevant to the valuation of the firm's security.

In Nigeria adoption of IFRS helps in:

- (1) minimizing the cost of doing business internationally as it eliminates the need for additional financial information from Nigerian companies; and
- (2) ease the consolidation of financial information of the company with its subsidiaries.

On the other hand there are many challenges of IFRS adoption in Nigeria such as:

- (1) the level of awareness of the IFRS and its implication as it requires considerable preparation at country and entity level to ensure consistency; and
- (2) training resources are considered costly and not on hand.

In reference to Zeff and Nobles had clarified four categories for IFRS implementation methods, the categories called degrees of implementation as follows:

- (1) Full implementation of IFRS by adoption of the process of the standardize IASB. Therefore, standard of IASB are automatically adopted without passing through jurisdictional such as the adoption in Israel and South Africa.
- (2) Implementation of standard by standard. This degree is divided into three ranks:
 - close to the implementation process and is characterized by the adoption of IFRS published by the IASB without any transformation or deletion such as the implementation of Canada;
 - the standard by standard implementation is based on a total convergence of the national repository to the IFRS such as the implementation of Australia; and
 - the last rank is the application after modification or norms adoption of certain IFRS norms may decrease the similarity with the IFRS adopted and the IFRS issued by the IASB similar to the implementation of EU.
- (3) The optional adoption, it aims to enable the implementation of IASB standards in specific cases such as the publication of the consolidated accounts of listed companies, this implementation was in Switzerland.
- (4) The incomplete convergence: this aims to convergence the national referential but by preserving certain provisions of the national accounting referential or to conduct a convergence block such as the in China and Venezuela.

In related study, Yu (2010), the percentage of firms' adoption IFRS in 2007 for different countries varied. In Finland, Newzeland and Greece it shows 100 percent. Australia shows 99 percent and 99.25 percent in Philippines, whereas UK and Germany shows 80.8 and 90.7 percent, respectively. Moreover, France showed lower rate of adoption in 2007 as it was 52 percent. Adding to that it was 17.5 percent in Venezuela which was considered a very low rate of adoption.

2. Contextual assessment on compliance with IFRS: compliance issues

In this paper attempt has been made to support the argument of previous studies. The paper attempts to test and answer the research question; does the financial market in Bahrain comply with IFRS 7?

According to Yiadom and Atsunyo (2014), the overall mean compliance rate of companies listed in Ghana Stock Exchange was 85.8 percent with 62.2 and 85.8 percent being the minimum and maximum scored by a company, the compliance level ranges between 97.4 percent in 2008 and 98.2 percent in 2009 (Amoako and Asante, 2012). In Nigeria there is a positive relationship between the level of compliance with the standards and the performance of the Nigerian banks except for only some few standards which are related to the disclosure of the accounting policy, foreign transactions and employees' benefits (Yahaya *et al.*, 2012). In related study Santos *et al.* (2013) in Brazil there is a mandatory adoption of full IFRS and it was effective in 2010. Although, the low level of compliance with IFRS disclosure requirements in the Brazilian organizations. Adoption of IFRS in Brazil purpose is to add more amount of information disclosures which were not required in GAAP requirements as well as to increase the transparency of information. This leads to large adoption for many organizations. Also, in Bangladesh the banks owned by the state are having good level of compliance and there is no significant difference in compliance of IFRS 7 among the nationalized banks as all of the banks follows similar items needed to comply with the standard in order to provide accountability and transparency in financial reporting (Hossain, 2014). On the other hand, in Turkey, financial statement compliance levels range from 64 to 92 percent, with an average of 79 percent. Disclosure compliance varies by leverage and audit firm size. Other company characteristics, such as profitability, company size and age, however, are not significant in explaining the level of disclosure compliance with IFRSs. National monitoring and enforcement mechanisms for IFRS compliance in Turkey needed to be improved (Demir and Bahadir, 2014). In Jordan, the Jordanian Industrial Corporations considerable high level of compliance 79.3 percent of IAS 16 and as of: recognition, measurement and components of fixed assets (Seiam and Sarea, 2007). Al-Shammari (2011) and Juhmani (2012) found a positive influence of company size on the level of compliance with IFRS. However, IFRS 7 compliance level increases and also improved the disclosures of financial instruments disclosure which is considered as an advantage of adopting IFRS in UAE especially for the investors this indicates the good level of compliance of the standard (Al Saqqa and Sawan, 2013). In Oman, the level of compliance is 79 percent and the lower level of compliance is 41 percent (Al-Jabri and Hussain, 2012), finally, in Bahrain companies generally comply with the IFRS manufactory disclosure requirements of the regulatory bodies. The level of compliance of IFRS ranges from 61 to 94 percent, with an average of 80.7 percent. Also it reveals that large company's compliance level is greater than smaller companies (Juhmani, 2012). Moreover, accounting information in Bahrain are more relevant than in UAE. This shows the high level of compliance with IAS in Bahrain.

Overall, compliance with IFRS will help investors to better decision making and it will allows comparability overall financial markets regardless of the country of origin. It will also reduce the information asymmetry and the risk of expropriation (Fox *et al.*, 2013). In addition to that and according to Hossain and Baser (2011) and Abhimantra *et al.* (2013), it enhances the credibility of information provided and this compliance with IFRS would be helpful for the credit rating purpose and will make the management more accountable to fulfill the objectives of specialization (Hossain and Sultana, 2014). It was founded that compliance help so better predict earning per share and valuation of firms security (Hodgdon *et al.*, 2008). Also, improve the quality of financial reporting by improving the comparability of financial reporting among countries (al Saqqa and Sawan, 2013; Sarea, 2012). Furthermore, IFRS have a stronger economic and business orientation,

with a particular focus on the information needs of capital markets, whereas Italian regulations show clear huge differences from IFRS. This was determined by the concentration on the conformity of financial statements with the regulation of taxes and reduces the cost of capital. Therefore, Joshi *et al.* (2010) studies the level of compliance with international standards by auditors in Bahrain. Compliance with the standards directly influences the supervisory work on the basis of calculating the ratios; the noncompliance with the standards influences the financial ratios and reports negatively (Yahaya *et al.*, 2012).

3. Research methodology

3.1 Research design

This study uses the quantitative method, the data collected first. Then, ten requirements of IFRS 7 disclosure by using checklist tested, the checklist was designed referring to IFRSs issued by the IASB, checklist used in prior researches for instance, (Yiadom and Atsunyo, 2014; Hossain and Sultana, 2014). Second, testing the deviation from the average industry compliance (above or below average) and third, three sectors were ranked and compared based on their percentage of compliance level and based on deviation from the industry average. Finally, simple statistical was to analyze the level of compliance. The research methodology is shown in Figure 1.

3.2 Method of data collection and analysis

The population of the study was the listed companies in BB and the sample was limited to the financial sectors. The decision to focus on these sectors was based on that financial sectors are considered as the largest sectors representing more than 50 percent of the companies listed in BB. In 2013, there were 48 companies listed in BB, 42 Bahraini companies and three non-Bahraini companies. However, five companies are going to be eliminated from the sample of companies because of suspension from BB. The banking sector, investment sector and insurance sector will structure the sample of the study for a total of 21 companies (44 percent of companies listed in BB).

A compliance checklist which contains ten disclosure requirements of IFRS 7 was developed to collect data as it is consistent to previous studies.

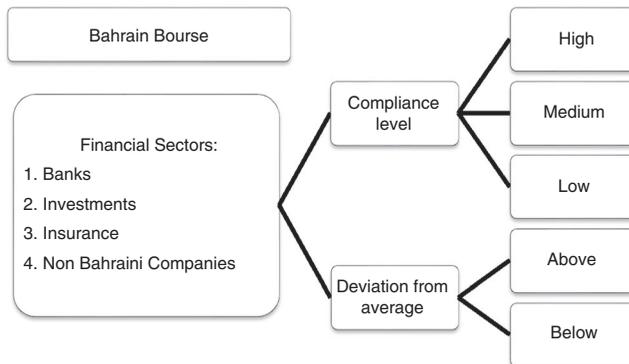


Figure 1.
Research
methodology

Source: By Author(s)

Descriptive analysis conducted to find out the average percentage of the level of compliance with IFRS 7. First, we design disclosure compliance checklist of ten requirements of IFRS 7. Second, a score of 3 is assigned if high level of compliance, 2 is assigned if medium level of compliance, 1 is assigned if low level of compliance (Table I).

Different interpretations of the level of compliance are discussed in the previous studies. For instance, Hewaidy and Al Mutawaa (2010) mentioned the level of compliance is distinguished into four levels. If the disclosure level of compliance equals or above 80 percent then it is considered as a high level of compliance. The intermediate level of compliance is between 60 and 79 percent, low level of compliance when it is between 40 and 59 percent. Below 40 percent represents huge gap between the requirements of disclosure and the IFRS requirements. In related study, Al Fraih (2009) IFRSs compliance is divided into three groups:

- (1) high-level compliance group: above 80 percent;
- (2) medium-level compliance group: between 61 and 80 percent; and
- (3) low-level compliance group: 60 percent or below.

4. Results, analysis and discussion

The degree of compliance with IFRS 7 was measured by compliance checklist as IFRS 7 requires financial sector companies to disclose more information (Bischof, 2009).

The average compliance level of all financial sectors is shown in Table II, as well as the minimum and maximum percentage for the compliance level and the number of companies' represents each sector.

Table II clearly shows the average level of compliance for the three industries. An adequate level of compliance in all of the ten requirements of IFRS 7 in almost all of the three sectors, although insurance sector shows 79 percent which is considered as a medium level of compliance. In the banking and investment sectors, it is clearly founded that they have high level of compliance of 90 and 87 percent, respectively.

Compliance status	No. of requirement	Weight	Weight score
High compliance	10	3	30
Medium compliance	10	2	20
Low compliance	10	1	10
Total			60

Table I.
Average number of compliance

Financial sectors	No. of companies	Maximum compliance level (%)	Average compliance level (%)	Minimum compliance level (%)
Banking	7	100	90	80
Investment	9	93	87	80
Insurance	5	87	79	70

Table II.
Average level of compliance with IFRS 7 for the financial sectors

4.1 Banking sector

Figure 2 shows the percentage of compliance fulfilled by the banks and the deviation from the industry average. In terms of the level of compliance, Bank of Bahrain and Kuwait showed the highest level of compliance among all companies in the three sectors sampled representing 100 percent compliance percentage. In terms of deviation from the industry Bank of Bahrain and Kuwait shows 12 percent followed by Al Ahli United Bank showing 8 percent above the average.

In terms of percentage of compliance of individual IFRS 7 disclosure requirements for banking sector, Table III presents the percentage of compliance of the individual disclosure requirements of IFRS 7. Almost 60 percent of the requirements were highly complied with represented by classes of financial instruments and the presentations of

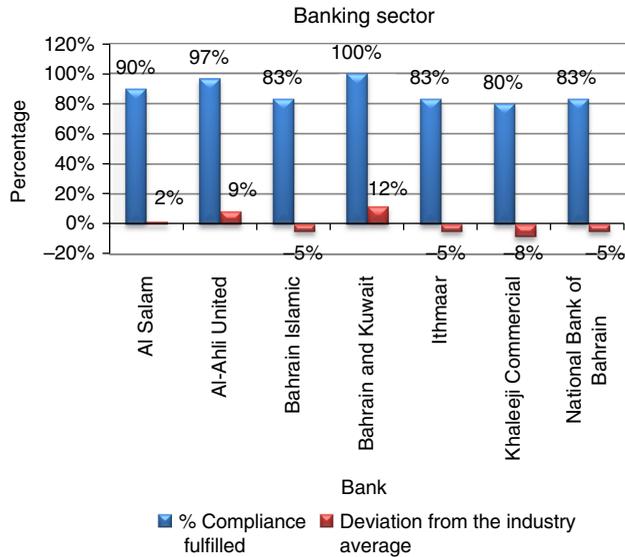


Figure 2.
Level of compliance and deviation from the industry – banks

No.	Requirement/disclosures	No. banks high	No. banks medium	No. banks low	Compliance (%)
1	Classes of financial instrument	7	0	0	100
2	Balance sheet presentation	7	0	0	100
3	Balance sheet disclosures	3	4	0	81
4	Collateral	7	0	0	100
5	Items of income, expense	5	1	1	86
6	Accounting policies	7	0	0	100
7	Disclosure about hedge	2	0	5	52
8	Qualitative risk	7	0	0	100
9	Quantitative risk	7	0	0	100
10	Nature of the transferred assets	2	2	3	62
	Average				88

Table III.
Percentage of compliance of the individual requirement – Banks

the balance sheet, collateral and the qualitative risk and the quantitative risk disclosure also scored very high level of compliance. Only 52 percent represents the disclosure about hedge which is considered a low level of compliance in this requirement.

The level of compliance with IFRS 7

4.2 Investment sector

Figure 3 presents the investment sector level of compliance for nine companies. Majority of companies in these sectors shows high level of compliance of more than 90 percent and a low deviation from the average industry compliance level.

In terms of percentage of compliance of individual IFRS 7 disclosure requirements for investment sector, Table IV presents that all companies showed high percentage with 90 percent of the requirements of the standard, except for nature of the transferred assets disclosure which showed 63 percent which is a medium level of compliance.

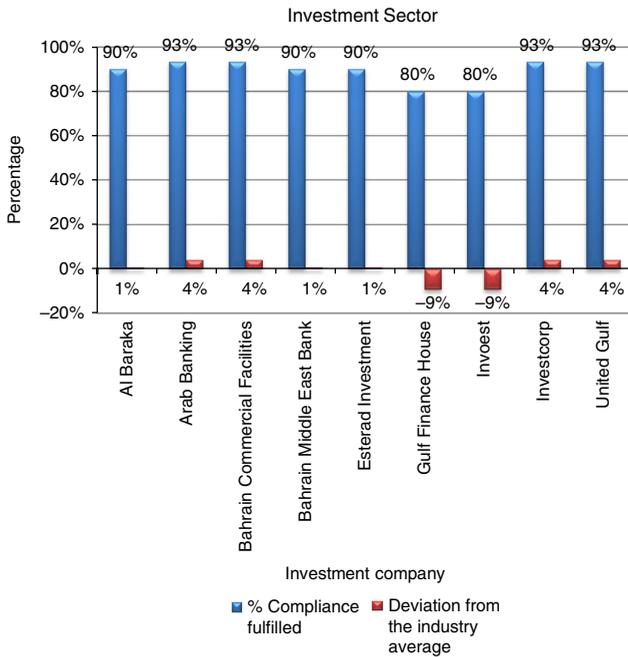


Figure 3. Level of compliance and deviation from the industry – investment

No.	Requirement/disclosures	High	Medium	Low	Compliance (%)
1	Classes of financial instrument	9.00	0.00	0.00	100
2	Balance sheet presentation	9.00	0.00	0.00	100
3	Balance Sheet disclosures	9.00	0.00	0.00	100
4	Collateral	6.00	1.33	0.33	85
5	Items of income, expense	4.00	2.67	0.33	78
6	Accounting policies	9.00	0.00	0.00	100
7	Disclosure about hedge	5.00	0.67	1.00	74
8	Qualitative risk	7.00	1.33	0.00	93
9	Quantitative risk	9.00	0.00	0.00	100
10	Nature of the transferred assets	2.00	2.67	1.00	63
Average					89

Table IV. Percentage of compliance of the individual requirement – Investment

4.3 Insurance sector

Figure 4 presents the level of compliance in the insurance sector. As seen in Figure 4, the majority of the insurance companies were showing medium level of compliance with the disclosure requirements of IFRS 7. Arab Insurance Group showed the higher level of compliance represented by 87 percent whereas Al Ahlia Insurance showed the lowest level of compliance represented by 70 percent.

In terms of disclosure of individual requirement of IFRS 7, Table V showed a high amount of requirements is fully complied with , except for some requirements like of items of income, expenses, gains and losses disclosure,collateral and the nature of transferred assets had a low

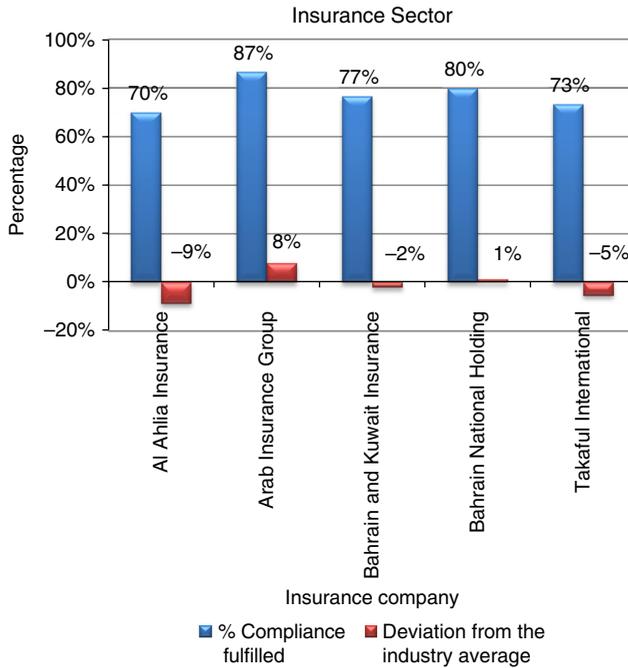


Figure 4.
Level of compliance and deviation from the industry – insurance

Table V.
Percentage of compliance of the individual requirement – Insurance

No.	Requirement/disclosures	High	Medium	Low	Compliance (%)
1	Classes of financial instrument	5.00	0.00	0.00	100
2	Balance sheet presentation	5.00	0.00	0.00	100
3	Balance sheet disclosures	5.00	0.00	0.00	100
4	Collateral	1.00	0.00	1.33	47
5	Items of income, expense	0.00	2.00	0.67	53
6	Accounting policies	4.00	0.67	0.00	93
7	Disclosure about Hedge	1.00	2.00	0.33	67
8	Qualitative risk	4.00	0.67	0.00	93
9	Quantitative risk	4.00	0.67	0.00	93
10	Nature of the transferred assets	0.00	0.67	1.33	40
	Average				79

level of compliance of 20, 30 and 10 percent, respectively. The low level of compliance due to lack in compliance with collateral which requires the entity to disclose the fair value of the financial assets pledged collateral as well as sold along with the terms and conditions of that.

5. Conclusion and recommendation

5.1 Conclusion

Using the disclosure compliance checklist, the extent of the three sectors listed in BB compliance with IFRS 7 for year 2013 has been measured. Secondary data were obtained from the annual reports of 21 companies among three financial sectors in BB. The results shows the average level of compliance for companies in BB was varying depends on the sector, the insurance sector showed the lowest level of compliance with IFRS 7.

Financial instrument disclosure was checked using a compliance checklist. A compliance checklist based on a revised checklist consistent with prior compliance studies (Al-Shammari, 2011; Hossain and Sultana, 2014). Moreover, for the purpose of investigation the compliance level with IFRS 7 by listed companies in BB, the financial sectors were selected. The level of compliance differs between companies in the same sectors; one company fully complied with all of the disclosure requirements. Also, the deviation from standard has been measured showing deviation from industry average between companies. The highest deviation from industry was in two companies of the investment sector represented by 9 percent below average, one company in the banking sector representing 8 percent below average and one company in the insurance sector representing 9 percent below average. The results shows that all companies try to follow similar items needed to comply with the IFRS; this finding is in line with Hossain and Sultana (2014), who concludes that all of the banks were consistent in following the requirements to comply with IFRS 7 in order to provide accountability and transparency in financial reporting.

The compliance also shows a significant role in improving the quality of information; these findings also in line with Al Saqqa and Sawan (2013), the level of compliance with IFRS increases the quality of information and it has been founded that there is considerable variation between individual companies in the level of compliance of IFRS 7 disclosure. This is consistent with the findings of Al-Jabri and Hussain (2012). It is evident from the study that the insurance sector does not fully comply with all requirements of IFRS 7, though it is evident that proper accounting and reporting helps in a better functioning of the companies. Thus, IFRSs is developed to provide standardization of accounting reporting. Findings of the study are in consistent also with previous studies that companies respond adequately to the IFRS in Bahrain (Juhmani, 2012).

5.2 Recommendation

Although the degree of compliance of the companies listed is acceptable, following recommendation should considered be concerned: BB listed companies should strive time to highly comply with all disclosure requirements of the standard. The accounting profession staff for the companies as well as the team, who manages the risk of the organization, should have training to update all new issues related to the standard and give practical guide on fully compliance of the all of the requirements in the standard. Strengthening the professional education and training in IFRS application is crucial for increasing the level of compliance with the standards.

However, this study examines the compliance level with IFRS 7 requirements only; further research could examine the compliance level with both disclosure and measurement of financial instruments.

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