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Full Length Research Paper

The level of compliance with the International Financial Reporting Standards 10 (IFRS 10) The Case of Bahrain Listed Companies

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By the early 1970s, harmonization of accounting standards provoked heated debate between proponents and opponents. Proponents assert that harmonization facilitates understanding of financial statements and comparison between firms worldwide. Opponents, on the other hand, insist that social and cultural factors must be at the heart of accounting standards. Harmonization (Standardization) of accounting standards means developing a single set of accounting standards to be applied worldwide by multinational enterprises. At present uniform accounting standards (IFRS) are sweeping the globe with varying degrees of success. The purpose of this paper is to explore the level of compliance of International Financial Reporting Standard 10, (IFRS 10) by companies listed on the Bahrain Stock Exchange (BSE), and how it affected consolidated financial statements. As elsewhere listed companies that have a controlling interest in one or more subsidiaries must produce two sets of financial statements (dual reporting), one at a subsidiary level, another at the group level. Data used in this research was obtained from published financial statements on the websites of the listed companies on the Bahrain Stock Exchange (BSE). as well as questionnaire sent to CFO regarding size, age, and the external auditor. The paper concludes that listed companies in Bahrain comply with the IFRS 10, with varying degree across various business sectors. The study indicates that there is a direct positive relationship between size and type of external auditor, but scanty relationship exists with age.

Keywords: Consolidated Financial Statements Bahrain Stock Exchange (BSE)., International Financial Reporting Standard (IFRS 10), Listed companies.

INTRODUCTION

Attempts to harmonize accounting standards in the US and Europe started decades ago (1973) as part of the globalization movement. In the Arab world, in 1997,

representatives of the Arab League, recommended the use of IAS.

International Accounting Standards (IASs) were issued by the antecedent International Accounting Standards Council (IASC), and endorsed and amended by the International Accounting Standards Board (IASB).

The International Accounting Standards (IAS), published by the International Accounting Standards Committee (IASC), endorsed and amended by the International Accounting Standards Board (IASB). IFRS 10 replaced part of IAS 27 Consolidated and Separate Financial Statements that addresses accounting for subsidiaries on consolidation. IFRS is a set of accounting standards developed by (IASB). in response to the globalization movement that swept the world since the early 1980s. The purpose is to provide general guidance for multinational companies operating in different parts of the world to use the same standards to facilitate comparison that enables investors around the globe to take informed decisions. At present it is estimated that between 120 to 150 countries opted to adopt IFRS for publicly traded companies, but with slow motion. Opponents have claimed all along that culture has to be considered in setting accounting standards and accordingly resistance and rejection mounted.

IFRS 10 standard was initially issued in May 2011, to be applied to annual periods on or after 1 January 2013. The standard superseded SIC-12 Consolidation – Special Purpose Entities. IFRS 10, Consolidated Financial Statements is meant to establish accounting requirements for the presentation and preparation of consolidated financial statements. which are required when an entity controls one or more other entities. [IFRS 10:1.).

Bahrain has never developed its own domestic accounting standards simply because there are a large number of foreign banks operating in Bahrain that adopt international standards. Bahrain's long term plan has always been to become a regional financial harbor. Compliance with International Accounting Standards was imposed on all publicly traded companies since 1996. However, was only formalized in 2001 with the issuance of the Bahrain Commercial Companies Law (BCCL) (Al-Hussaini, et al., 2008).)The 1975, Commercial Companies Act (CCA), requires all limited liability companies to provide annual audited financial statements, (income statement, balance sheet, and Board of Directors' report on distribution of dividends). Currently, all companies listed on Bahrain Stock Exchange (BSE) are required to prepare their financial statements (annual, or interim reports) in compliance with the International Financial Reporting Standards 10 (Tait, D. 2005).

Definition of Control

IAS 27, defined control as the power to influence the financial and operating policies and procedures of an entity. Whenever an investor acquires a controlling interest

in an investee (50 % or more of the voting stock) control was deemed to exist. A parent (investor) thereby acquires a voting right to its board of directors., influence operating procedures and set policies of the acquired company (investee)

Further IAS 27 identified other instances where control is obtained without acquiring a controlling interest, such as contractual agreements or ability to appoint the majority of the members of the board of directors. Nevertheless, voting rights remains the primary, and probably the only, indicator of the relationship of control between investor - investee.

IFRS 10, on the other hand, amended the definition of control which is currently based on several conditions. The control principle in IFRS 10 sets out three main elements of control:

1. *power over the investee;*
2. *exposure to variable returns from the investee; and*
3. *ability to use power to affect the returns.*

Power obtained through voting rights or included in contractual arrangements. An investor that “holds only protective rights cannot have power over an investee and so cannot control an investee [IFRS 10:11, IFRS 10:14]”. According to IFRS 10, a parent need to assess whether it controls one or more investees. An investor controls an investee when it is

“exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee”. [IFRS 10:5-6; IFRS 10:8].

Further, the parent is required to understand the purpose and design of the investee and its relevant activities, not least because are likely to significantly affect the investee's returns.

Accordingly, the new definition of control seems more general than those in IAS 27. Consolidated financial statements are required when an investor has power over investee (subsidiary) or a controlling interest of investee voting stock. The parent is required to produce two sets of financial statements – one at individual level, the other at the group level, where a single set of financial statements is prepared, by consolidating assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented for the group as a whole. However, the standard identified instances where a parent need not present consolidated financial statements if it meets all of the following conditions: [IFRS 10:4(a)]

1. *“it is a wholly or partially-owned subsidiary of another entity and its other owners, have been informed about, and do not object to, the parent ...”*
2. *“its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange)”*
3. *“it did not file its financial statements with a securities commission for the purpose of issuing any class of instruments in a public market”,*

Consolidation procedures often require consolidating similar accounts (assets, liabilities, equity, income, and cash flows of the parent with those of subsidiaries). Eliminate investment balance in subsidiary, equity of subsidiary at beginning of year, and inter-entity accounts relating to transactions between investor and subsidiary. In case of a partially owned subsidiary the investor presents non-controlling interests (minority interests) in its consolidated statement of financial position as part of the equity section, separately from the equity of the owners of the parent. [IFRS 10:22]. In 2014, Amendments were due to become effective for accounting periods beginning on 1 January 2016. However, the proposed amendments resulted in inconsistency between IFRS 10 and IAS 28 and accordingly, the amendments were postponed.

METHODOLOGY

Data was obtained from published financial statements of sample of companies listed on the Bahrain Stock Exchange (BSE) is used in this research. on the websites of these companies as well as questionnaire sent to CFO regarding size, age, and level of compliance. High level of compliance is assigned 3, moderate level is assigned 2, and 1 assigned for low level.

ANALYSES OF RESULTS

The move towards globalization in the early 1980s was the major driving force for the development of International Financial Reporting Standards (IFRS 10.). However, a decade since inception in 2011, adoption is distance away from initial expectations. Although globalization remains high on the national agenda worldwide, however, major commercial activity remains local, indicating that adoption of harmonization of accounting standards does not alone will lead to uniform reporting behavior around the world. In order for the claimed benefits of IFRS to be realized, uniform implementation would have to materialize in a large number of countries, which seems unlikely. Indeed, major large and highly influential economies, such as the US and China are unwilling to adopt. Nevertheless, some evidence of actual adoption has been documented, but by and large the evidence to date is at best scanty. Indeed, in a study by Lopez (2019) using a sample of companies from Germany, France and UK concluded

“ results suggest that the adoption of the new IFRS 10 affected the composition of a large number of entity groups but that their financial information and economic-financial indicators do not present material changes.”

Equally, Ray J. Ball has shed doubt about the overall cost of the international standard; he argues that:

“the enforcement of the standards could be lax, and the regional differences in accounting could become obscured behind a label”

On the other hand, the International Federation of Accountants (IFAC) survey shows adoption of international standards to be on the increase, but far behind expectations.

In developing countries, however, empirical studies on the compliance of IFRS 10 is limited, if not nil. and Bahrain is no exception. The following statement of compliance was repeated for companies audited by the big four international auditing firms operating in the Kingdom of Bahrain.

“The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and in conformity with Bahrain Commercial Companies Law and the Central Bank of Bahrain (CBB) and Financial Institutions Law” (KPMG, 2018)

The concept of control holds a major role in determining the scope of consolidation in the international, American and European accounting standards (Müller, Cardos and Ienciu (2010). In a study, Muller et al (2010), summarized the development of approaches to the concept of control. Similarly Nobes (2014), outlined differences between ownership and control. Further, recent studies described the consolidation requirements brought by IFRS 10, (Gornik-Tomaszewski and Larson (2014); Zelenková (2014), Bűdy-Rósz (2012).

The amended concept of control introduced by IFRS 10 was not expected to cause vast changes to the conclusion whether control over a company exists. Such were the opinions presented by IASB (2013). In their analysis, IASB explains:

“...IFRS 10 does not introduce new concepts. Instead, it builds on the control guidance that existed in IAS 27 and SIC-12 but adds additional context, explanation and application guidance...”

Despite the widely claimed increased standardization of accounting standards over the last few decades, however, localization is yet evident in most important economies of the world. It is perhaps no coincidence that so far local standards have been retained by the world's four most populous countries (China, India, the US and Indonesia). Moreover, complete adoption of IFRS has been hindered in some parts of the world. In Europe for instance, were limited by the EU regulations and rules, while in the Muslim world both IFRS and the Islamic Sharia Laws are in place along with IFRS. Indeed, this low level of compliance, not only with IFRS 10. but also with IFRS 8 on Segment Reporting. In a study by Dr. Taylan ALTinas concluded that

“switching to IFRS 8 did not cause major changes in segments reported and segmental information provided by Turkish listed companies in ISE 30 Index.”

Regardless of the above backdrop, IFRS adoption is likely to result in a series of expected benefits: First, IFRS is thought to improve quality of information that could reduce information risk to both creditors and investors. In addition, standardized accounting principles is likely to improve understanding and comparison across firms around the globe which facilitates improved decision making. Second: the fact that IFRS improve quality of information, could reduce cost of capital for publicly traded companies, not least because availability of reliable information would reduce risk and consequently investors and creditors would demand a lower return on their investment. Third, IFRS adoption is expected to improve corporate governance through standardized timely information. Finally, IFRS adoption is likely to facilitate entry into new markets, which is likely to increase the volume of international transactions leading to increased higher returns, in particular for multinationals that have high levels of international activities

CONCLUSION

An attempt was made in this research to explore whether listed companies on Bahrain Stock Exchange has adopted IFRS 10 on a voluntarily or compulsory basis and the extent of adoption of IFRS 10. In fact, IFRS 10 does not change the consolidation procedures but does change whether an entity is consolidated, by redefining the concept of control. Power arises from voting rights, ability to appoint, reassign, or remove members of an investee’s key management personnel, direct the investee to enter into or veto any changes to transactions for the benefit of the investor.

The results of this investigation indicate that there is scanty evidence that listed companies on Bahrain Stock Exchange, (with parent – subsidiary relationship), in some sectors adhered with the standard compliance requirements of IFRS 10. However, the level of compliance vary across business sectors. The banking and investment sectors showed the highest level of compliance, while the insurance industry showed the lowest level. The following table summarizes the level of compliance across various sectors.

Sector	Number	Compliance with IFRS 10
Commercial banks sector	7	100 %
Investment sector	14	100 %
Insurance sector	6	Less than 30 %
Services sector	8	Less than 50 %
Industrial sector	3	50 % - 75 %
Hotels & tourism sector	6	Less than 30 %
Overseas companies	5	Less than 20 %

Moreover, the findings reveal that there is a direct relationship between firm size, and type of auditor and level of IFRS10 compliance. The larger the company, the higher the level of compliance. simply because these firms are able to recruit highly qualified staff in charge of the preparation of the financial statements. In addition, these companies are often sensitive to maintain their market standing, goodwill, and public confidence.

Equally, the companies that are audited by the big four international auditing firms operating in Bahrain, the level of compliance seems high. However, we failed to establish a significant relationship between age and level of compliance. These findings are consistent with previous researches carried out by O. Juhmani (2012), Hossain and Hammami (2009), and Al Shammari and Al-Sultan (2010). Budaraj I and Sarea

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