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The Level of Adoption of the International Accounting Standard 34 (IAS 34.) : The Case of Bahrain Listed Companies

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Abstract

The purpose of this study to explore the level of adoption of the International Accounting Standard 34 (IAS 34) in the preparation of interim reports by listed companies on Bahrain Stock Exchange (BSE). The data used in this exploratory study were based largely on information already published in the interim financial reports that are available at Bahrain Stock Exchange and on the websites of the listed companies. Neither IAS 34, nor does the national accounting legislation in Bahrain require firms to prepare interim financial statements . However, as elsewhere around the globe, companies in Bahrain prepare interim financial reports in compliance with the IAS 34. Not least because it is required for a company to be listed on Bahrain Stock Exchange (BSE). In addition, in order to maintain investor confidence, listed companies often exert considerable effort to disclose all necessary information that shows their financial position and ability to continue as a going concern through preparing more timely, costly interim reports. The results of this exploration reveal that the listed companies actually comply with the requirements of IAS 34, regardless of the high cost involved.

Keywords: International Accounting Standard 34 (IAS, 34) Bahrain Stock Exchange (BSE), Interim Financial Report

Introduction

The function of accounting is to provide pertinent, reliable, and timely financial information for decision making by various users, including investors, creditors and government authorities. The information is often provided through annual financial statements (the balance sheet that shows the financial position of a firm at specific date (what it owns and what it owes), statement of income that shows the results of operation during a period, and statement of cash flows to provide information on cash position, which is difficult to obtain from the statement of financial position.

The financial statements are usually prepared on annual basis. However, in the current volatile and dynamic business environment, the demand for more frequent, up- to-date reporting has gained an increasing momentum. It is now widely claimed that annual reporting is not enough to assess the ever changing business environment. Indeed, in the US as early as 1933 -1934, the Securities and Exchange Commission (SEC), required listed

companies planning to issue securities on the stock exchange to provide up to date information for users both annual and interim. SEC requires that Form 10 Q, to be filed quarterly and form 10 K to be issued annually at year end. Equally Securities and Exchange Board of India (SEBI) issued guidelines on February 4, 2000, requiring the stock exchanges to amend their listing agreements requiring each company to furnish unaudited financial result on a quarterly basis. The SEBI further required each listed company to submit quarterly compliance report on corporate governance.

In effect, the need for frequent reporting has long been recognized, but only in June 1999, that IAS 34 was first issued, and amended in 2010, 2012, 2014.

An interim financial report is either complete or condensed set of financial statements that normally covers a period of less than a year, semiannual, quarter, or a month (IAS 34-4). According to (IAS 34.8 the statement has to be in a condensed form, which means that only headings and subtotals used in last annual financial statements are required (IAS 34.10), The statements often include statement of financial position, statement of comprehensive income, statement of cash flows, results of operations, statement of changes in equity, and selected explanatory notes. However, IAS 34 does not specify which entities must publish an interim financial report.

In Bahrain, the Commercial Companies Act (CCA- 1975), requires all limited liability companies to provide annual audited financial statements, (income statement, balance sheet, and Board of Directors' report on distribution of dividends). The CCA, 1975, does not require limited liabilities companies to follow a specific set of accounting standards. However, in 1993, the Ministry of Commerce and Agriculture advised the limited liabilities limited liabilities corporate companies to adopt IASs.

The Bahrain Stock Exchange (BSE), was established in 1987, but operations started only on 17 June 1989, with 28 listed companies. The Bahrain Stock Exchange (BSE), is an independent separate legal entity supervised by a Board of Directors, chaired by the Governor of the Central Bank of Bahrain. In 2010, the authorities issued a law to establish Bahrain Bourse (BHB) as a corporation under the 1975 Commercial Companies Act (CCA- 1975).m In 2017, the number of listed companies on the Bahrain Stock Exchange (Bahrain Bourse). Increased to 42. At present, there are 50 companies listed with a market capitalization of \$ 25.3 billion and 5 overseas listings. The Bahrain Bourse is currently a member of various regional and foreign organizations to enhance its operations, such as the Union of Arab Stock Exchanges, the Federation of Euro-Asian Stock Exchanges, the World Federation of Exchanges, the Africa & Middle East Depositories Association, and the Association of National Numbering Agencies.

As of 2015 foreigners are allowed to buy, own or sell bonds, units of mutual funds, and warrants of domestic joint-stock companies. Expatriates living in Bahrain are allowed to purchase, own, and/or trade up to 49% of a domestic joint-stock company's equities. However, an expatriate is not allowed to own more than 1% of a company's issued capital.

There are ten companies that are completely open to foreign investors: Arab Banking Corporation (ABC), Arab Insurance Group (ARIG), Ahli United Bank (AUB), Al Baraka Banking Group (BARKA), Bahrain Middle East Bank (BMB), Ithmaar Bank (ITHMR), Investcorp Bank (INVCORP), Bahrain Shamil Bank (SHAMIL), Al Salam Bank (SALAM), and TAIB Bank (TAIB).

Foreign security holders are legally entitled to reap all the benefits of the ownership of securities of domestic joint-stock companies. They have voting rights on all matters submitted for approval, and receive dividends and other distributions tax free. The sale and purchase of a security creates a binding contract on the part of the seller to deliver

Over the last two decades listed companies on Bahrain Stock Exchange almost doubled from 27 in 2,000 to 50 in 2018 with a market capitalization of more than \$ 53 billion and 5 overseas listings.

Literature Review

Literature survey reveals that very few number of studies were carried out on interim financial reporting in developing countries (Joshi and Bremser, 2003); Omar and Simon, 2011). This clearly indicates that interim financial reporting has not received the necessary attention in the developing world including Bahrain in the contrast to the enorous attention in Europe and the US.

Joshi and Bremser, (2003). suggest that the size of a company in the developing countries is a driving force to adopt IAS 34), and further claim that their findings could be generalized to other developing countries. Equally, other studies suggest that overall disclosure in interim reports is directly related to the size of the reporting firms (Rahman *et al.*, 2007; Schadewitz, 2010; Spasic and Dencic- Mihajlov, 2014). Further, Omar and Simon (2011) found that companies listed in Amman Stock Exchange (Jordan) age, and industry type, along with a few other variables, are factors determine disclosure in interim reports.

IFRS, however, does not require the preparation of interim financial statements. Paragraph 36 in IAS 1 Presentation of Financial Statements only requires that:

'An entity shall present a complete set of financial (including comparative information at least annually.'

Nonetheless, it must be stressed that interim reports are by no means designed to provide reasonable assurance or reliable financial information as compared to the annual reports. Not least because of the shortness of the time period, not audited financial information, and that interim financial reports are subject to management manipulation. Furthermore, the variation between seasons of some businesses, the allocations of cost and expenses among interim periods, may render the benefits of unaudited interim financial statements to be limited.

IAS 34 does not specify the entities that are required to publish interim financial statements, the frequency of interim reports, nor the length of time required to be released after each reporting date. However, the standard encourages, publicly-traded entities to provide interim financial reports

"at least as of the end of the first half of their financial year, no later than 60 days after the interim reporting date".

Accounting Standards (AS-25), on the other hand, assert that ‘

"Timely and reliable interim financial reporting improves the ability of investors, creditors and others to understand an enterprise's capacity, to generate earnings and cash flows, its financial condition and liquidity."

An interim financial report may contain either a complete or condensed set of financial statements for a period less than a year. IAS 34.8 defines condensed to include only headings and subtotals used in last annual financial statements are required (IAS 34.10).,According to IAS 34 the minimum content requirement for the interim financial report is a condensed balance sheet, condensed income statement, condensed cash flow statement, condensed statements showing changes in equity, and selected explanatory notes. IAS 34 also requires an enterprise to apply the same accounting policies in its interim financial report as are applied in its annual financial statements. The accounting policy changes subsequent to the date of the most recent annual financial statements that will be reflected only in the next annual financial statements. The frequency of an enterprise's reporting annual, semiannually, or quarterly should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes are made on a year-to-date basis, w3hich poses a serious challenge for practitioners, in particular in dynamic economy.

FASB summarized the following objectives and uses for interim reporting to:

1. *estimate annual earnings.*
2. *make projections.*
3. *identify turning points.*
4. *evaluate management performance.*
5. *supplement the annual report.*

Nevertheless, despite its well-recognized advantages, interim reporting faces serious drawbacks.

1. Inventory Problems

For a commercial enterprise, inventory is a major current asset that directly affect working capital and generation of income. Interim reporting faces three different inventory problems, namely: quantity of inventory, valuation of inventories, and adjustments of valuation. Determination of inventory quantity depends largely on physical counts. However, physical counts are often taken on annual basis. Not least, because physical inventory counts are time consuming, daunting business. which hinders inventory count quarterly or monthly prohibitive Inventory valuation, on the other hand, depends on inventory flow assumption. Various inventory valuation methods are accepted by both GAAP and IFRS, namely FIFO, LIFO, average, and specific identification. However, each of these methods produces different inventory value, different cost of goods sold and consequently different income figure. Further, the use LIFO during inflationary periods often poses serious problems in particular in developing countries.

2. Matching Problem

There are two accounting bases, accrual and cash bases. Both GAAP and IFRS prefer the accrual basis of accounting rather than the cash basis. Under the accrual basis, cash receipts from customers do not necessarily occur in the same period in which a firm recognizes revenues. Equally, cash payments to employees, suppliers, and governments do not necessarily occur in the same period in which expenses are incurred. Because of this time lag between cost and revenues, matching of costs and revenues becomes a daunting task. Moreover , certain adjustments, such as accrued payroll, prepaid items, depreciation management bonuses or income taxes are often determined at the end of a fiscal year. Accordingly, such vital adjustments are often not performed in interim reports.

In general, it is important that in assessing firm's results of operations and financial position, the analyst has to take into consideration that interim reports are far less reliable than annual data. Also, interim financial reports are subject to management manipulation.

3. Disclosure Problem

According to both GAAP and IFRS, companies listed on the stock exchange are required to include full disclosures of all useful, relevant and reliable information in their annual financial statements. IFRS 8 requires an entity to:

“disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates” (IFRS 8, para 1).

Interim reports, on the other hand, do not require mandatory interim disclosure. In effect, the interim reporting practices are likely to vary across companies. In addition, the question of determining materiality in order to decide the nature and amount of disclosure poses yet a serious problem. not least, because Measurements for interim reporting purposes should be made on a year-to-date basis, so that the frequency of the entity's reporting does not affect the measurement of its annual results. [IAS 34.28]. indeed, IAS 34.26, requires change in estimates during interim year the nature and amount of that change must be disclosed in the notes to the annual financial statements.

External Audit

In Bahrain, as elsewhere, the Commercial Companies Act (CCA) 1975, requires that annual reports must be audited by an external auditor to add credibility, verify reliability of the financial information and assess that appropriate accounting practices are in place. Interim reports, on the other hand, are based on internal verification, normally by internal auditors. In effect, they are not audited by an independent auditor, which render the value of information less reliable and less credible internal reports.

Further, IAS 34 does not specify which entities must publish an interim financial report. That is generally a matter for local laws and government regulations. The IAS 34, requires the interim report include condensed current period financial statements and comparative information for previous period, namely statement of financial position, statement of comprehensive income, statement of cash flows, statement of changes in equity, and selected explanatory notes.

In addition, IAS 34 requires companies to apply the same accounting policies in the interim report as used in in the annual report, and that full disclosures are required when there are changes in accounting policy. Assets and liabilities are reported and measured for interim reporting purposes on the basis of information available on a year-to-date basis. Although both annual and interim financial statements are based on reasonable estimates, however, the preparation of interim financial reports often requires a greater use of estimation methods than annual financial statements, which hinders their usefulness.

METHODOLOGY

The data used in this exploratory study was based largely on information published in interim financial reports that are available at Bahrain Stock Exchange and on the websites of the listed companies.

Analyses of Results

Financial statements provide a summary of all the financial activities of an entity during specific period. These statements are used to evaluate the results of operations of a business entity (income statement), the financial position (balance sheet) and the cash position. According to the Commercial Companies Act (CCA) 1975, all companies are required to prepare annual financial statements. However, due to the ever changing business environment following globalization, the demand for more timely, detailed interim financial information gained an increasing momentum.

Interim financial reporting involves frequent financial statements throughout the year (monthly, quarterly or semiannual). These statements are often used by external users, mainly creditors and investors or internally by business executives. These reports, although unaudited and often based on estimates, are a useful tool to predict future performance to facilitate more informed business decisions. In addition, interim reports may reveal significant information concerning changes affecting the business and seasonality effects, both of which annual reports could conceal. However, there are certain inherent limitations to interim reporting as a result of their condensed time period. Also interim reports cannot account for fluctuations in revenue, temporary market conditions, or limited disclosures.

This study was carried out to determine the extent of adoption of IAS 34, by listed Bahraini companies. The study reveal that in the first year of the implementation date, more than 75 % of the listed companies had adopted IAS 34. At present, there are 50 companies listed on Bahrain Stock Exchange all adopting IAS 34, and all unanimously prepare interim reports in compliance with requirements of IAS 34.1. All the companies that prepared interim reporting in the early years in Bahrain prepared income statements, balance sheets and cash flow statements, indicating a high degree of compliance to IAS 34. Moreover, all firms published their interim reports on their websites. Companies prepared interim reports for various reasons namely, for a management control, to maintain investor confidence and satisfy listing requirements. The majority of respondents stressed that interim reports are highly relevant for their firms. Further, it has been claimed that interim reports improved performance. A good example is possibly Investcorp (a leading global provider and manager of alternative investment products). On February 5, 2019, management of Investcorp asserted that.

“Despite the challenging macroeconomic environment, the Firm’s net income for the period was \$58 million, up 5% compared to \$55 million for the six months ended December 31, 2017 (H1 FY18). On a fully diluted basis, earnings per ordinary share were \$0.74 for H1 FY19, up 6% from \$0.70 for H1 FY18. Investcorp attributes its resilient performance to the Firm’s continued focus on delivering the strategic objectives”.

Further, consistent with the requirements of IAS 34.11, all companies listed on Bahrain Stock Exchange present basic and diluted earnings per share (EPS) for the interim period. However, the respondents were not on voice regarding the cost of compliance to IAS 34, expensive or not.

Summary and Conclusion

Regardless of its serious limitations outlined earlier, interim financial reports are now sweeping across all industries worldwide. At present, companies listed on the Bahrain Stock Exchange (BSE) unanimously prepare interim financial reports in compliance with IAS 34, regardless of cost. Not least because, compliance is required by the listing requirements, listed companies are often keen to boost investor confidence, and interim financial reports are often used as a management control tool. Nevertheless, the fact that these reports are reviewed rather than audited by an independent auditor, render their level of assurance moderate and reliability limited. Further, seasonal business variation affect their predictive ability, whole the possibility of management manipulation hinders their usefulness.

This study concludes that all companies listed on the Bahrain Stock Exchange (BSE) prepare interim reports in compliance with IAS 34. Moreover, they use the same accounting policies in the interim report as used in the annual report, and provide full disclosures whenever there are changes in the accounting policy. This is consistent with earlier studies. (Joshi and Bremser, 2003;) Omar and Simon, 2011; Bayoud *et al.*, 2012; Elzahar and Hussainey, 2012; Al-Hamadeen and Badran, 2014; Spasic and Dencic-Mihajlov, 2014).

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Appendix**Companies Listed on the BSE**

Sector	Number	Apply IAS 34
Commercial banks sector	7	Yes
Investment sector	14	Yes
Insurance sector	6	Yes
Services sector	8	Yes
Industrial sector	3	Yes
Hotels & tourism sector	6	Yes
Overseas companies	5	Yes

Commercial banks sector

Stock symbol	Company
AUB	Al-Ahli United Bank
AUB.PREF.A	AUB Class A Preference Share
SALAM	Al Salam Bank
BISB	Bahrain Islamic Bank
BBK	<u>Bank of Bahrain and Kuwait</u>
NBB	National Bank of Bahrain
BSB	The Bahraini Saudi Bank

Services sector

Stock symbol	Company
BASREC	Bahrain Ship Repairing & Engineering Company
CPARK	Bahrain Car Park Company
CINEMA	Bahrain Cinema Company
DUTYF	Bahrain Duty Free Shop Complex
BMMI	Bahrain Maritime & Mercantile International
BATELCO	Bahrain Telecommunications
TRAFCO	General Trading & Food Processing Company
Nass	Nass Corporation

Insurance sector

Stock symbol	Company
BKIC	Bahrain & Kuwait Insurance Company
AHLIA	Al-Ahlia Insurance Company
AIIC	Arab International Insurance Company
TAKAFUL	Takaful International Company
ARIG	Arab Insurance Group
BNH	Bahrain National Holding Company

Investment sector

Stock symbol	Company
BARKA	Al Baraka Banking Group
INOVEST	Inovent
ABC	Arab Banking Corporation
BCFC	Bahrain Commercial Facilities
BMB	Bahrain Middle East Bank
ESTERAD	Esterad Investment Company
GFH	Gulf Finance House
GMG	Gulf Monetary Group
INVCORP	Investcorp Bank
ITHMR	Ithmaar Bank
TAIB	TAIB Bank
UGB	United Gulf Bank
UGIC	United Gulf Industries Corporation
SICO-C	Securities and Investment Company

Industrial sector

Stock symbol	Company
ALBH	Aluminium Bahrain
BFM	Bahrain Flour Mills Company
POLTRY	Delmon Poultry Company

Hotels & tourism sector

Stock symbol	Company
FAMILY	Bahrain Family Leisure Company
BHOTEL	Bahrain Hotels Company
BTC	Bahrain <u>Tourism</u> Company
SEEF	Seef Properties B.S.C.
BANADER	Banader Hotels Company
NHOTEL	National Hotels Company

Overseas companies

Stock symbol	Company
BMUSC	Bank Muscat
GLOBAL	Global Investment House
SIIG	International Investment Group
SDTL	<u>Sudan Telecommunications Company</u>
UFC	United Finance Company