



**COMPARATIVE ANALYSIS OF IFRS PRACTICES OF  
ISLAMIC AND CONVENTIONAL BANKS IN  
BANGLADESH**

**BY**

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## ABSTRACT

The objective of this study is to analyse financial reporting practices of the listed Islamic and conventional banks in Bangladesh, in terms of their compliance with the measurement, presentation and disclosure requirements of International Financial Reporting Standards (IFRS), as well as the assertion of comparability of the reported figures. The study involved content analysis of the audited financial statements with year-ending 31 December 2014 of the 7 Islamic and 23 conventional banks that are listed in Dhaka Stock Exchange (DSE) and in Chittagong Stock Exchange (CSE). 29 of these banks are private commercial banks (PCBs) and 1 is state-owned commercial bank (SCB). For the purpose of evaluating compliance with IFRS presentation and disclosure requirements, the study selected 38 mandatory requirements of IAS 1. To examine the compliance with IFRS measurement requirements, the depreciation policies of the banks are selected and contrasted with IAS 16 and IAS 38 requirements. The comparability of the reported figures is also assessed based on the depreciation policies and the reported depreciation amounts. The Institute of Chartered Accountants of Bangladesh (ICAB) has adopted these standards as BAS 1, BAS 16 and BAS 38 respectively. Depreciation is selected for the purpose of this study due to its importance in directing financial performance of a reporting entity. Also, the flexibility IFRS allows in selecting a depreciation policy may result in differences in practices among the reporting entities, which may sacrifice comparability of the reported figures. The study finds that the Islamic banks in general comply with IFRS presentation and disclosure requirements more than the conventional banks, and the depreciation policies adopted by the Islamic banks asserts greater comparability as compared to the conventional banks. However, the study also finds that IFRS are not always observed by the Islamic and conventional banks in Bangladesh in presentation and disclosures of the financial statements and in adopting accounting policies. The study further finds that divergence in accounting policies exist that acts as a barrier to the efforts of achieving comparability in financial reporting. The findings of this research will allow the accounting standard setters, external auditors and the regulators in identifying some of the areas of non-compliance and the bottlenecks in achieving comparability of the financial statements.

## ملخص البحث

تهدف الدراسة إلى تحليل ممارسات إعداد التقارير المالية للمصارف الإسلامية والتقليدية المدرجة في بنغلاديش من حيث توافقها مع متطلبات القياس والعرض والإفصاح في المعايير الدولية للتقارير المالية، فضلا عن التأكيد على المقارنة بين الأرقام المعلن عنها. وشملت الدراسة تحليل محتوى البيانات المالية المراجعة للسنة المالية المنتهية في 31 ديسمبر 2014 لسبعة بنوك إسلامية وثلاثة وعشرون بنكا تقليديا مدرجة في بورصتي دكا وشيتاغونغ. 29 من هذه البنوك هي بنوك تجارية خاصة وبنكا مملوكا للدولة. لأجل تقييم امثال العرض والإفصاح مع متطلبات المعايير الدولية للتقارير المالية، اختارت الدراسة 38 متطلبا إلزاميا لمعيار المحاسبة الدولي رقم 1. ولدراسة الامتثال مع متطلبات قياس المعايير الدولية للتقارير المالية، يتم تحديد سياسات الاستهلاك بالبنوك قياسا بمتطلبات معيار المحاسبة الدولي رقم 16 ومعيار المحاسبة الدولي رقم 38. ويتم تقييم المقارنة بين الأرقام الواردة في التقارير أيضا على أساس سياسات الاستهلاك وكميات الاستهلاك المبلغ عنها. وقد اعتمد معهد المحاسبين القانونيين في بنغلاديش هذه المعايير كما في معايير المحاسبة ببنغلاديش 1، ومعايير المحاسبة ببنغلاديش 16، ومعايير المحاسبة ببنغلاديش 38 على التوالي. وقد تم اختيار نقص القيمة في هذه الدراسة نظرا لأهميتها في توجيه الأداء المالي للمنشأة مُعدة التقرير. وتسمح أيضا مرونة المعايير الدولية في إعداد التقارير المالية بتحديد سياسة الاستهلاك مما قد يؤدي إلى اختلافات في الممارسات بين المؤسسات المعدة للتقارير والتي قد تضحى بالمقارنة بين الأرقام الواردة في التقارير. وقد خلصت الدراسة إلى أن البنوك الإسلامية بشكل عام تتفق مع متطلبات العرض والإفصاح في المعايير الدولية للتقارير المالية أكثر من البنوك التقليدية، وسياسات الاستهلاك المتبناة من قبل البنوك الإسلامية أثبتت أنها أكبر بالمقارنة مع البنوك التقليدية. ومع ذلك فإن الدراسة توصلت أيضا إلى أن المعايير الدولية للتقارير المالية لا تراعى دائما من قبل البنوك الإسلامية والتقليدية في بنغلاديش فيما يتعلق بالعرض والإفصاح في البيانات المالية واعتماد السياسات المحاسبية. وتوصلت الدراسة أيضا إلى أن الاختلاف في السياسات المحاسبية موجودة وتقوم كعائق أمام جهود تحقيق المقارنة في إعداد التقارير المالية. والنتائج التي توصلت إليها هذه الدراسة تسمح لواضعي المعايير المحاسبية، والمدققين الخارجيين والجهات التنظيمية بتحديد بعض المناطق من عدم الامتثال والعوائق في تحقيق المقارنة بين البيانات المالية.

## APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Islamic Banking and Finance.

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## DECLARATION

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*This Dissertation is Dedicated to my Beloved Parents*

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## TABLE OF CONTENTS

Abstract .....	ii
Abstract in Arabic .....	iii
Approval Page .....	iv
Declaration .....	v
Copyright .....	vi
Dedication .....	vii
Acknowledgements .....	viii
List of Tables .....	xi
List of Figures .....	xii
List of Symbols .....	xiv
List of Abbreviations .....	xv
<b>CHAPTER ONE: INTRODUCTION .....</b>	<b>1</b>
1.1 Background of the Study .....	1
1.2 Statement of the Problem.....	3
1.3 Research Objectives.....	6
1.4 Research Questions.....	7
1.5 Significance of the Study.....	8
1.6 Limitations of the Study .....	8
1.7 Chapter Summary .....	9
<b>CHAPTER TWO: BANKING INDUSTRY AND FINANCIAL REPORTING ENVIRONMENT OF BANGLADESH.....</b>	<b>11</b>
2.1 Introduction.....	11
2.2 Commercial banking in Bangladesh.....	11
2.3 Islamic banking in Bangladesh.....	21
2.4 Financial Reporting Environment in Bangladesh.....	30
2.5 Departures from IFRS by the Banks in Bangladesh.....	33
2.5.1 Recognition of income from classified investments .....	34
2.5.2 Recognition of financial guarantee as off-balance sheet .....	34
2.5.3 Recognition of income from Islamic financial contracts .....	35
2.5.4 Measurement of investment in government securities.....	36
2.5.5 Measurement of investment in shares and securities .....	36
2.5.6 Impairment of financial assets .....	37
2.5.7 Classification of cash and cash equivalent items .....	38
2.5.8 Presentation of statement of other comprehensive income.....	38
2.5.9 Presentation of statement of cash flows.....	39
2.5.10 Presentation of provision as liability.....	40
2.6 Chapter Summary .....	40
<b>CHAPTER THREE: LITERATURE REVIEW.....</b>	<b>42</b>
3.1 Introduction.....	42
3.2 Importance of complying with IFRS .....	42
3.3 Importance of comparability in financial reporting.....	44
3.4 Challenges facing harmonisation of the accounting practices.....	47

3.5 Previous research on IFRS compliance .....	49
3.6 Financial Reporting experience in Bangladesh .....	51
3.7 Relevant terms and definitions .....	53
3.7.1 Depreciation concept.....	53
3.7.2 Relevant accounting standards.....	54
3.7.3 Determining the useful life .....	56
3.7.4 Residual value .....	58
3.7.5 Depreciation methods .....	58
3.7.5.1 Straight line method.....	59
3.7.5.2 Reducing balance method.....	60
3.8 Chapter Summary .....	62
<b>CHAPTER FOUR: RESEARCH METHODOLOGY .....</b>	<b>64</b>
4.1 Introduction.....	64
4.2 Compliance with IFRS disclosure requirements .....	65
4.2.1 Presentation and Disclosure Index .....	66
4.3 Compliance with IFRS recognition requirements .....	69
4.4 Comparability of the financial statements .....	70
4.4.1 Straight line method.....	71
4.4.2 Reducing balance method .....	72
4.5 Chapter Summary .....	72
<b>CHAPTER FIVE: RESEARCH FINDINGS .....</b>	<b>74</b>
5.1 Introduction.....	74
5.2 Compliance with IFRS disclosure requirements .....	74
5.3 Compliance with IFRS recognition requirements .....	79
5.3.1 Depreciation commencement policy.....	79
5.3.2 Depreciation cessation policy .....	82
5.4 Comparability of the financial statements .....	83
5.4.1 Buildings .....	87
5.4.2 Furniture and fixtures.....	90
5.4.3 IT and office equipment.....	93
5.4.4 Intangible assets .....	95
5.4.5 Vehicles.....	98
5.4.6 Books .....	100
<b>CHAPTER SIX: DISCUSSION AND CONCLUSION.....</b>	<b>103</b>
6.1 Introduction.....	103
6.2 Compliance with IFRS disclosure requirements .....	103
6.3 Compliance with IFRS recognition requirements .....	105
6.4 Comparability of the financial statements .....	106
6.5 Conclusion and recommendations.....	109
<b>BIBLIOGRAPHY .....</b>	<b>112</b>
<b>APPENDIX A .....</b>	<b>119</b>

## LIST OF TABLES

Table 2.1	Banking System Structure – December 2013	12
Table 2.2	Banks in Bangladesh	15
Table 2.3	Islamic Banking Commencement Timeline	22
Table 2.4	Islamic banking in Bangladesh at a glance (31 December 2014)	23
Table 2.5	Islamic banks, branches and windows in Bangladesh (December 2014)	24
Table 4.1	Presentation and disclosure index	67
Table 5.1	Compliance with IFRS disclosures – Islamic banks	75
Table 5.2	Compliance with IFRS disclosures – Conventional banks	76
Table 5.3	Summary of Compliance with IFRS Disclosures	78
Table 5.4	Depreciation Commencement Policies	82
Table 5.5	Depreciation Cessation Policies	83
Table 5.6	Measuring Disparity of Depreciation Ratios	86
Table 5.7	Depreciation Policies and Rates of Buildings	88
Table 5.8	Depreciation Policies and Rates of Furniture and Fixtures	91
Table 5.9	Depreciation Policies and Rates of IT and Office Equipment	94
Table 5.10	Depreciation Policies and Rates of Intangible Assets	96
Table 5.11	Depreciation Policies and Rates of Vehicles	98
Table 5.12	Depreciation Policies and Rates of Books	100

## LIST OF FIGURES

Figure 2.1	Banks in Bangladesh and their Islamic banking coverage	13
Figure 2.2	Listed Banks in Bangladesh	14
Figure 2.3	Market capitalisations of listed banks in Bangladesh (BDT Million)	19
Figure 2.4	Total assets of listed banks in Bangladesh (BDT Million)	20
Figure 2.5	Islamic banking deposits by type of contract (31 December 2014)	27
Figure 2.6	Islamic banking investments by type of contract (31 December 2014)	28
Figure 3.1	Total ownership cost	62
Figure 5.1	Depreciation to Fixed Asset Ratios of the Listed Banks	87
Figure 5.2	Depreciation Expense Over First 40 Years – Building	89
Figure 5.3	Standard Deviation of Depreciation Expenses Over First 40 Years – Buildings	90
Figure 5.4	Depreciation Expense Over First 10 Years – Furniture and Fixtures	92
Figure 5.5	Standard Deviation of Depreciation Expenses Over First 10 Years – Furniture and Fixtures	93
Figure 5.6	Depreciation Expense Over First 5 Years – IT and Office Equipment	94
Figure 5.7	Standard Deviation of Depreciation Expenses Over First 5 Years – IT and Office Equipment	95
Figure 5.8	Depreciation Expense Over First 5 Years – Intangible Assets	97
Figure 5.9	Standard Deviation of Depreciation Expenses Over First 5 Years – Intangible Assets	98
Figure 5.10	Depreciation Expense Over First 5 Years – Vehicles	99
Figure 5.11	Standard Deviation of Depreciation Expenses Over First 5 Years – Vehicles	100
Figure 5.12	Depreciation Expense Over First 5 Years – Books	101

Figure 5.13	Standard Deviation of Depreciation Expenses Over First 5 Years - Books	102
Figure 6.1	Differences in Depreciation Expense if Rate is Same	107
Figure 6.2	Difference in Depreciation Expense if Useful Life is Same	107

## LIST OF SYMBOLS

<i>C</i>	Capitalised amount
<i>D</i>	Depreciable amount
<i>n</i>	Number of total items
<i>R</i>	Residual value
<i>V0</i>	Opening net book value

## LIST OF ABBREVIATIONS

CAGR	Cumulative annual growth rate
DFI	Development financial institutions
FCB	Foreign commercial banks
FSs	Financial statements
FVTPL	Fair value through profit or loss
IFDI	Islamic Finance Development Indicator
OCI	Other comprehensive income
PCB	Private commercial banks
SCB	State-owned commercial banks
SCF	Statement of cash flows
SCI	Statement of comprehensive income
SFP	Statement of financial position
SOCE	Statement of changes in equity
SPL	Statement of profit or loss
TDS	Total disclosure score

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 BACKGROUND OF THE STUDY**

Adoption of International Financial Reporting Standards (IFRS) by the publicly traded companies (i.e. the listed companies) has been a subject of great interest and pressure of international agencies, financial reporting standard setters, regulatory authorities, accounting professionals, and academicians throughout the world. Through adoption of IFRS, the financial statements aim to provide high quality financial information and achieve harmonisation in local and international level. Bangladesh is one of the countries that require mandatory application of IFRS for financial reporting of the listed companies including the listed banking companies.

Individual users of financial information, many of whom cannot require reporting entities to provide customised information directly to them (Conceptual Framework, 2010: Para OB5), have different, and possibly conflicting, information needs (Conceptual Framework, 2010: Para OB8). This constrains a wide and diverse range of users to rely on information provided in the general purpose financial statements that do not and cannot provide all information required by the individual users (Conceptual Framework, 2010: Para OB6). The IFRS aims to improve the quality of the financial reporting following a principle based (Carmona & Trombetta, 2008) one-size-fit-all approach (Mir & Rahaman, 2005). The adoption of IFRS results in improved comparability (Ampofo & Sellanib, 2005) of the financial statements and makes it more understandable to a wide range of users.

The IFRS deals with recognition, measurement, presentation and disclosures of the transactions in financial reporting. While recognition and measurement drives



accounting practices into comparability, presentation and disclosures ensure reported figures are understandable to the users of the financial statements and assure the users that the management of the reporting entity applied appropriate judgment in determining the accounting policies.

The International Accounting Standards Committee (IASC), predecessor of the International Accounting Standards Board (IASB), was born in 1973 with the primary goal of generating a single set of international accounting standards, keeping in mind the cross-sectional comparability of financial statements in the facilitation of decision making (Krivogorsky, 2011). Perhaps with the same motivation, i.e. to ensure comparability between financial statement line items, Section 38 of the Bangladesh Banking Companies Act 1991 compels banking companies in Bangladesh to prepare financial statements in concurrence with the format laid down in the First Schedule of the same Act. The latest amendment of the First Schedule was issued in June 2003 by Bangladesh Bank, the central bank of the country. The Guidelines for Islamic Banking issued by Bangladesh Bank in 2009, accompanies specimen financial statements that aim to maintain uniformity of financial statements among the banks operating under Shari'ah. These specimen financial statements deal with the presentation of the statements in a particular manner, but do not restrict the reporting entities in disclosing additional information. In fact, the Bangladesh Bank circular (BRPD Circular No. 14, dated 25 June 2003) that announced the latest amendments to the First Schedule states that the changes are made 'with a view to bringing in more disclosure in the financial statements of the bank companies' and to 'help the users of the statements get adequate and transparent idea about the concerned bank company'.

The study is based on content analysis of the financial statements and the related disclosures of the 7 listed Islamic banks and 23 listed conventional banks in

Bangladesh. The audited financial statements for the year-ending 31 December 2014 have been used for the purpose of this study.

The first chapter of this study sets the direction and provides an overview of the study. The second chapter provides an overview of the banking industry in Bangladesh. The third chapter then explores previous researches and relevant literatures to establish importance of complying with IFRS and the importance of comparability in financial reporting. This chapter also looks into the findings of previous researches to gain an understanding of financial reporting environment and the state of IFRS observance in Bangladesh. The fourth chapter of the study discusses the research methodologies applied in conducting this study, and the fifth chapter discusses the findings of the research. The sixth chapter provides the conclusion, recommendation and scopes of future research.

## **1.2 STATEMENT OF THE PROBLEM**

In financial reporting, all listed banks (Islamic or conventional) in Bangladesh are required to comply with the IFRS requirements, however subject to some departures due to regulatory requirements. In general, the banks are required to comply with the Companies Act 1994, the Banking Companies Act 1991, the Securities and Exchange Rules 1987, requirements set by the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE) for listed companies, the IFRS as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) as Bangladesh Financial Reporting Standards (BFRS) and, in the case of the Islamic banks, the Guidelines for Islamic Banking. The Guidelines for Islamic Banking takes into account the requirements set by the Accounting and Auditing Organization for Islamic Financial Institutions

(AAOIFI), therefore some may claim that the Islamic banks in Bangladesh also need to comply with the AAOIFI standards.

More often than not the requirements set by the aforementioned local regulatory and supervisory authorities and international standard setters complement one another in strengthening the financial reporting and related disclosures, and aims to provide better information to the users of the financial statements. However, in instances, the authoritative order of the requirements set by these local authorities and international standard setters can be of conflicting nature. If the requirements differ, the plausible understanding is that the requirements set by the local authorities supersede the requirements set by the international standard. Hence, ensuring compliance with the requirements set by the Bangladesh Bank may necessitate departure from some of the requirements set by the IFRS.

The IFRS follows a principle based approach. Even though the IFRS stipulate possible accounting policies in given scenarios, the reporting entities enjoy the flexibility of interpreting these stipulations. Different interpretation leads to the adoption of different accounting policies with different consequences in reported figures, hence result variation of financial performance.

Levitt (1998), Healy and Wahlen (1999) recognise that earnings management occurs when managers use judgment in financial reporting. Deliberate misstatement can also be a consequence as it was the case in Waste Management, Inc (SEC, U.S., 2002; Harrison Jr. W., Horngren, Thomas, & Suwar, 2014). Determination of depreciation policy for tangible and intangible non-current assets is a classic example where management of individual entities applies their own judgment to determine the useful life, residual value, and pattern of use of the assets. The room for management's judgment in determining these factors may result reporting entities to

adopt depreciation policies that are in divergence and lacks comparability with other entities, even when the industry and the asset class is similar. The depreciation expense often comprises a significant portion of total operating expense; hence, have the potential to heavily influence profitability of the reporting entities.

The Conceptual Framework (2010) of the IASB identifies faithful representation as a fundamental qualitative characteristic of financial reporting (Conceptual Framework, 2010: Para QC4). The financial information is faithfully presented if information is neutral (Conceptual Framework: Para QC12), and information is neutral if it is presented without attempts to present in a particular direction (Conceptual Framework: Para QC14), i.e. without tempering performance and financial position of the entity. As identified in chapter two of this study, previous research found evidence of earning manipulation by the banks in Bangladesh as well as non-compliance with the mandatory disclosure requirements by the reporting entities in general.

The Conceptual Framework (2010): Para QC25 recognises that although a single economic phenomenon can be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability. The Conceptual Framework (2010) of the IASB establishes boundaries for the exercise of judgment in preparing financial statements. Preparers and the auditors of financial statements should use the Conceptual Framework (2010) as a point of reference to resolve an accounting question that is not being answered by an accounting standard or where accounting standards allow choices. Simmonds (1989) pointed out that while there are alternatives allowed, the entities tend to choose the practice with which they are familiar with. It may implicate that where alternatives are allowed, the reporting entities may select the accounting policy that appears to

comply with IFRS requirements, even though the policy do not reflect economic reality of the transaction. The issue is addressed in this study while analysing the depreciation policies of the banks.

Islamic banking in Bangladesh already reached the level of systematic importance by securing more than 20 per cent of the banking industry. The market share set to grow further. While the present market share and growth may seem impressive, the attention shall be given in developing a strong and comprehensive regulatory framework that includes financial reporting as well. Complying with the IFRS requirements and achieving the qualitative characteristics of the Conceptual Framework (2010) will further contribute in developing a positive outlook of the industry. It is hence the high time to look into the financial reporting of the Islamic banks to conclude if they are complying with the applicable IFRS requirements. Having a comparative analysis with the conventional banks will allow the industry players, the academicians, and the researchers to determine the qualitative position of the Islamic banks in terms of financial reporting. This will also allow the industry regulators and supervisors to devise appropriate strategies in developing the industry further.

### **1.3 RESEARCH OBJECTIVES**

The study aims to fulfil the following research objectives.

1. Determine the extent of compliance with IFRS presentation and disclosure requirements (IAS 1) by the listed Islamic and conventional banks in Bangladesh.
2. Determine whether the listed Islamic and conventional banks in Bangladesh comply with recognition and measurement requirements (IAS

16 and IAS 28) in depreciating their tangible and intangible non-current assets.

3. Taking depreciation policy as a sample, determine whether the differences in accounting policies of the listed Islamic and conventional banks in Bangladesh are of significance to risk comparability of the reported figures.

#### **1.4 RESEARCH QUESTIONS**

The study seeks to answer the following research questions.

1. Do the listed Islamic and conventional banks in Bangladesh comply with mandatory IFRS presentation and disclosure requirements?
2. Do the listed Islamic and conventional banks in Bangladesh comply with IFRS recognition and measurement requirements while adopting its accounting policies?
3. Do the financial statements prepared by the listed Islamic and conventional banks assert comparability?

The study seeks the answers whether the Islamic banks are any better than the conventional banks in terms of compliance with the IFRS and whether their accounting policies achieves greater comparability in reported figures than the conventional banks. The study examines the disclosures accompanying the financial statements of the listed Islamic and conventional banks in seeking the answers. This study is one of the few that examine these important issues covering the banking industry in Bangladesh. This study concludes with recommendations to improve IFRS adoption and to achieve greater comparability in financial reporting.

## **1.5 SIGNIFICANCE OF THE STUDY**

The study aims to set a ground for improving the financial reporting environment in Bangladesh by identifying a few of the financial reporting issues. The findings expected to assist the international and national standard setters and the regulators in understanding the practical issues in implementing the accounting standards, which in turn will contribute towards developing clearer IFRS implementation guidelines, especially where alternatives are allowed. Furthermore, this study will be beneficial to the academicians involved in teaching of financial reporting as this study highlights the importance of IFRS adoption and identifies the practical issues involved in implementing IFRS for financial reporting.

## **1.6 LIMITATIONS OF THE STUDY**

This study has several limitations. The study covered listed banks of only one country. Comparing with Islamic and conventional banks in other countries could lead to a better understanding of whether the level of compliance is driven primarily by the country factor or by the mode of banking factor. The data used in this research are extracted from the annual reports of the individual banks, not from any tailored database. Hence, considering the time and resource required in extracting data from individual annual reports, extending the sample universe to more than one country would detriment the feasibility of the study. Due to the same reason, the study only looked at the financial statements of one year. Comparing the level of IFRS compliance with the previous years could allow us to understand whether the banks in Bangladesh are improving in terms of compliance and comparability, and whether the Islamic banks are progressing faster towards compliance and comparability than the

conventional banks. The study also has not explored whether the new generation banks complies more with the IFRS requirements than the older banks.

The study looked into the depreciation recognition and measurement requirements of IAS 16 and IAS 38, but did not look into the requirements of other IFRS due to lack of information provided in the annual reports.

The disclosures made in the annual reports are not always indicative enough to reasonably determine whether a particular non-disclosure is due to the non-applicability of the disclosure requirement or due to compliance failure of the bank. Hence, the study selected only the requirements of IAS 1 applicability of which can be assumed as reasonably certain.

In evaluating the level of compliance with the presentation and disclosure requirements, all items are equally weighted based on the assumption that all items are equally important to the users of the financial statements. However, in reality this may not be true as different users likely to have different information need, hence leverage more on some information than others. Nevertheless, the study is based on general purpose financial statements that are aimed at a wide range of users; therefore, equal weightage avoids placing judgement in determining the importance of any disclosure.

## **1.7 CHAPTER SUMMARY**

This first chapter provided the direction of the study. This part briefly discussed the importance of complying with IFRS requirements and the importance of comparability in financial reporting. While discussing the statement of problem, the chapter identified the regulatory authorities, pronouncements of whom may require certain departures from the IFRS requirements. This chapter also provided the purpose of the study by identifying the research objectives and the research questions. This