

FINANCIAL REPORTING OF ISLAMIC BANKS IN BANGLADESH: BASIS OF REGULATORY COMPLIANCE

Mohammad Sahabuddin^{*1}, Md. Robiul Islam², Junaina Muhammad³, Mass Hareeza Ali⁴ and Md. Abdul Bashir⁵

^{1,3}Universiti Putra Malaysia, Dept. of Accounting and Finance, Faculty of Economics and Management, Seri Serdang, 43400, Selangor, Malaysia.

²International Islamic University Malaysia, Institute of Islamic Banking and Finance, Jalan Gombak, 53100 Kuala Lumpur, Selangor, Malaysia.

^{4,5}Universiti Putra Malaysia, Dept. of Management and Marketing, Faculty of Economics and Management, Seri Serdang, 43400, Selangor, Malaysia.

*For correspondence; Tel. (+6) 011-23834961, E-mail: sahabuddingme@gmail.com

ABSTRACT: There is a worldwide trend to adopt the international financial reporting standards (IFRS) but Islamic banking companies in Bangladesh are required to follow different rules and regulations. These banks should follow more regulatory formalities than the conventional ones. The Bangladesh Financial Reporting Standards (BFRS) adopted the International Financial Reporting Standards (IFRS) in 2000. Since then, the regulator in Bangladesh has initiated the Shariah governance framework from regulatory and non-regulatory aspects. This study considered the annual report of 8 Islamic banks in Bangladesh in 2015 and tried to identify the requirements in preparing the financial reports under Islamic Shariah and to show the compliance status of these banks. The average compliance rate with the requirements was found to be 88.11%. It is recommended that in complying the requirements of the financial reports, Bangladesh Bank may modify BRPD Circular No. 15/2009 that will be helpful for banks to prepare financial reports conveniently.

Keywords: Annual Reports, Islamic Bank, Disclosure, Financial Reports, Standards.

1. INTRODUCTION

According to the Annual Report [1] of Bangladesh Bank, there are 56 scheduled banks in Bangladesh who operate under full control and supervision of Bangladesh Bank, which is empowered to do so through Bangladesh Bank Order, 1972 and Bank Company Act, 1991. Scheduled Banks are classified into following types: state-owned commercial banks (SOCBs) (6) specialized banks development finance institutions (SBDFIs) (2) private commercial banks (PCBs) (39) foreign commercial banks (FCBs) (9).

Among these 56 scheduled banks, only eight banks are operated under Islamic Shariah (see Table 1). All of these Islamic banks are listed on stock market except newly introduced Union Bank Limited. Average market Deposits of Islamic Banks is more than 20% (see Table 2). It means that Islamic Banking has become a part of mainstream banking in Bangladesh [1]. The first Islamic bank was established in Bangladesh in 1983. At that time, there was no separate guideline to prepare financial reporting for Islamic Banks.

The nature of business of Islamic shariah based banking is different from the conventional banking. Besides these required specimen guidelines Islamic banks are to comply with provision of the Banking Companies Act 1991, International Financial Reporting Standard, the Companies Act 1994, the Securities and Exchange Rules 1987, Dhaka and Chittagong Stock Exchanges Listing Regulations, Accounting and Auditing Organization for Islamic Financial Institutions, Islamic Shariah and other laws and rules applicable in Bangladesh [2].

So, comparatively the Islamic shariah based banks abide by more rules and regulations than the interest-based banks. This study attempts to identify the regulatory requirements in preparing the Financial Reports of banks under Islamic Shariah. It also attempts to appearance the compliance position of these banks so far as statutory requirements are concerned.

Table 1: List of Islamic Banks in Bangladesh

Sl.	Name of Bank	Year of Incorporation	Listing Status	Year of Listing
1.	Islami Bank Bangladesh Limited (IBBL)	1983	Listed	1985
2.	ICB Islamic Bank Limited (ICBIBL)	1987	Listed	1990
3.	Al-Arafah Islami Bank Limited (AAIBL)	1995	Listed	1998
4.	Social Islami Bank Limited (SIBL)	1995	Listed	2000
5.	Export-Import Bank of Bangladesh Limited (EXIM)	1999	Listed	2004
6.	First Security Islami Bank Ltd. (FSIB)	1999	Listed	2008
7.	Shahjalal Islami Bank Limited (SJIBL)	2001	Listed	2007
8.	Union Bank Limited	2013	Listed	-

Source: Bangladesh Bank Annual Reports [1], Dhaka Stock Exchange [3], and Annual Reports of concern banks.

Table 2: the Comparative position of the Islamic Banking Sector (as of December 2014) (billion Taka)

Particulars	Islamic banks	Dual banking@ (Conventional+ Islamic)	Islamic banking sector	All banking sector
<i>1</i>	<i>2</i>	<i>3</i>	<i>4 (2+3)</i>	<i>5</i>
Number of banks	8	16	24	56
Deposits	1349.7	67.6	1417.3	6965.1
Credits	1137.6	57.7	1195.4	5147.2
Credit deposit ratio	84.3	85.4	84.3	73.9
Liquidity: excess(+)/shortfall(-)	127.5	0.1	128.2	1142.2

Source: Bangladesh Bank Annual Report [1], Page-39

Financial Reporting Framework for Islamic Financial Institutions

Bangladesh Bank issued separate Guidelines for Conducting Islamic Banking in November 2009. Paragraph 3.4 in Appendix II states that: The reporting institutions are required to comply with the disclosure requirements of the Securities and Exchange Rules 1987, Dhaka and Chittagong Stock Exchange Listing Regulations and other laws and rules applicable in Bangladesh. Rule 12(2) of the cited Securities and Exchange Rules prescribes compliance with International Accounting Standards (IAS): The financial statements of an issuer of a listed security shall be prepared in accordance with the requirements laid down in the Schedule and the International Accounting Standards as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB). ICAB has adopted IAS and IFRS as Bangladesh Financial Reporting Standards (BFRS). However, some aspects of IAS 39 have not been adopted. Shahjahal Islami Banks note on the basis of preparation read as the Financial Statements have been prepared in accordance with the First Schedule of the Bank Companies Act 1991 and Bangladesh Accounting Standards and Bangladesh Financial Reporting Standard, Standards issued by the Accounting & Auditing Organization for Islamic Financial Institutions [2] and other related laws and rules applicable in Bangladesh.

2. LITERATURE REVIEW

Hafij Ullah [4] attempted to investigate that Shariah compliance status of the Islamic banks in Bangladesh is in a vulnerable condition, Shariah compliance status highly varies among the Islamic banks, and Shariah violation is high in investing activities because of lack of knowledge, lack of sincerity in complying Shariah, poor attention in Shariah audit and Shariah research and lack of strong Shariah supervisory board comprising full-time skillful members. Peni Nugraheni, Hairul Azlan Anuar [5] opined, the result revealed that there is a statistically significant difference in the quantity and quality of voluntary disclosure value of Shariah- and non-Shariah-compliant companies. For regression results, the company size significantly influences the quantity of voluntary disclosure while the quality of voluntary disclosure is affected by company size and type of industry. Adel Mohammed Sarea, Mustafa Mohd Hanefah [6] says, financial statements for Islamic financial institutions (IFIs) are now considered more important to Shariah scholars, researchers and users of financial statements.

However, the first study conducted by Abdel-Magid [7] on the need of accounting for IFIs found that there is an increasing demand among researchers to ensuring the accounting practice is based on Shariah principles. The study has proposed a framework to prepare financial statements based on a unique model of accounting standards for IFIs that makes financial statements more comparable, transparent and reliable for users. Similarly, Akhtaruddin [8] states that the disclosure levels of Bangladeshi listed companies are generally poor which ultimately raises the question on accounting transparency in Bangladesh. Reaz and Arun [9] think that full compliance of disclosure with the proper and effective audit is very important to maintain accountability and bring about the transparency of firms. Pandit, Hossain and Khatun [10] conducted a study covering twenty-five conventional and Islamic banks of Bangladesh and showed that the average regulatory disclosure compliance was 67.34%. Thus, it is important to identify the regulatory requirements in preparing the financial statements of the bank which is registered with the Registrar of Joint Stock Companies and Firms (RJSC) as a company, scheduled bank in Bangladesh, listed the company on the stock exchange and Islamic bank follows Shariah principles simultaneously. prescribes compliance with International Accounting Standards (IAS): The financial statements of an issuer of a listed security shall be prepared in accordance with the requirements laid down in the Schedule and the International Accounting Standards as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB). ICAB has adopted IAS and IFRS as Bangladesh Financial Reporting Standards (BFRS). However, some aspects of IAS 39 have

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Regulatory Compliance Status of Banks under Islamic Shariah for Preparing their FRs

The study found that 46% of the IFIs asserted compliance with either IFRS or IFRS as adopted by a specific jurisdiction, while 18% asserted compliance with AAOIFI FAS. Significantly, 34% asserted compliance with local GAAP. In summary:

- 48 or 36% asserted compliance with IFRS,
- 13 or 10% asserted compliance with IFRS as adopted by a specific jurisdiction,
- 19 or 14% asserted compliance with local GAAP without differential requirements for Islamic transactions,
- 26 or 20% asserted compliance with local GAAP with differential requirements for Islamic transactions, and
- 24 or 18% asserted compliance with AAOIFI FAS.

- Two IFIs, about 2%, did not specify the accounting standards or law complied with in the preparation of their financial statements.

Considering provisions of different laws and regulations the requirements have been classified into four categories, i.e., (i) refereeing the legislation as compiled, (ii) disclosure in the face of financial statements, (iii) disclosure of information in the notes as a part of financial statements and (iv) other requirements. The summary of regulatory of the banks is presented in Table 3. Banks should disclose the name of the legislations which have been followed for preparing their financial statements. Average compliance of this category is 85.71% where highest compliance is 100% (IBBL) and lowest compliance is 71.43% (AAIBL). Some banks did not refer the Companies Act 1994, the Listing Regulations" of DSE/CSE and/or AAOIFI/IFSB. But they have to comply with the requirements of those legislations. Out of seven Islamic banks, three banks have prepared their financial statements complying fully with the regulatory requirements whereas minimum compliance rate is 86.67% (FSIB). It may be because of the non-existence of the particular items. But it will be more informative if the bank shows zero value for the not-existence item. Banks are to provide some information in the notes to the financial statements. These notes form an integral part of the financial statements. The average score in this category is 94.831% with highest 100% and lowest 87.88%. Some banks did not make a disclosure regarding risk managements, risk exposure and risk mitigation in qualitatively and quantitatively. The industry's average compliance of others category is 75.71% where maximum compliance is 100% and minimum compliance is 60%. Some banks are not complying with Pillar 3 of Basel-II. Some of them do not present IAS/BAS/IFRS/BFRS compliance checklist which is a part of governance disclosure. It is mentionable here that the banks are presenting the corporate governance checklist with or without complying with the requirements. In case of general/Shariah governance disclosure, banks are not complying in full. They do not make qualitative and quantitative disclosure as prescribed in IFSB 4. So, they should be careful about general/Shariah governance disclosure to ensure full compliance with all Shariah principles. The overall maximum compliance rate is 100% which is obtained by IBBL whereas overall minimum compliance rate is 80.06% which is obtained by FSIB. EXIM Bank Limited obtained 90.60% score which is the second highest considering all requirements. The overall compliance rates of ICIBL, AAIBL, SIBL and SJIBL are 83.25%, 91.34%, 84.91% and 86.58% respectively. The industry's average compliance rate is 88.11% considering refereeing the legislation as compiled, disclosure in the face of financial statements, the disclosure of information in the notes as a part of financial statements and other requirements.

Table 3: Regulatory compliance status of Islamic Banks in preparing FSs

Requirements/ Name of Bank		Refereeing legislation	Financial Statements	Notes to the FS	Others	Total Score
IBBL	Score	7	15	31	6	59
	%	100	100	100.00	100	100.00
ICBIBL	Score	6	14	31	3	54
	%	85.71	93.33	93.94	60	83.25
AAIBL	Score	5	15	31	6	57
	%	71.43	100	93.94	100	91.34
SIBL	Score	6	15	31	3	55
	%	85.71	100	93.94	60	84.91
EXIM	Score	6	14	33	5	58
	%	85.71	93.33	100.00	83.33	90.60
FSIB	Score	6	13	29	3	51
	%	85.71	86.67	87.88	60	80.06
SJIBL	Score	6	15	31	4	56
	%	85.71	100	93.94	66.67	86.58
Industry Average	%	85.71	96.19	94.81	75.71	88.11

Source: Researchers' own analysis

3. CONCLUSIONS

The problems that are prevalent in the financial reporting seems to stem in the directives and regulations that central banks and regulators usually issue. As an example, it is may be required in a national standard to comply with IFRS but the central bank or the regulator issues a new directive that brings about the conflict with IFRS requirements. Therefore, it is required that central banks, regulators, preparers and those who set the standards play an effective role in improving the comparability of the financial statements. To bring greater transparency and accountability and to ensure good governance in the banking industry, different regulatory authorities impose different regulations. Banks need to comply with all of the requirements in a highly leveraged industry.

The heart of the banking business is the trust and confidence of the customer. Therefore, it should be the prime concern of banks to maintain customer loyalty. In the countries with Muslim population such as Bangladesh, the customers follow the Shariah and they want their banks to observe Shariah laws beside the laws and regulations. Consequently, it is important for the banks to ensure the proper disclosures in their reporting. The findings of the present study showed that there is an average compliance rate of 88.11% in Bangladeshi Islamic banking companies and it is relatively higher than previous study (67.34%) by Pandit [10]. It will also be appreciable if the stakeholders see the full compliance with disclosure requirements. In a case study on AB Bank Limited, Hossain [11] shows that this bank is complying with all disclosure requirements set by Bangladesh Banks. Hossain [14] and Arif & Tuhin [15] concluded that it would be very easy for banks to comply with these requirements if the Bank Companies Act 1991 makes it mandatory as well as voluntary to comply with all of the disclosure requirements. As per the guidelines of IFSB 4, Bangladesh Bank should come forward to find ways of harmonizing the differences among different

legislations. Complying with all the requirements regarding financial statements of banks under Islamic Shariah Bangladesh Bank may require modifications in the BRPD Circular No. 15/2009. Though the current study does not provide any model, the concerned banks and regulators may consider the findings of this study for their future course of actions.

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