

# REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Bangladesh

## ACCOUNTING AND AUDITING

May 16, 2003

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### Executive Summary

The Bangladesh Securities and Exchange Commission and the Institute of Chartered Accountants of Bangladesh have demonstrated a keen interest in implementing International Accounting Standards (IAS) and International Standards on Auditing (ISA) to upgrade the quality of corporate financial reporting. Various steps have already been taken, however, further results will require the design and implementation of a comprehensive action plan on accountancy reform. This report includes policy recommendations, which may be used as inputs for such an action plan.

This report provides an assessment of accounting and auditing practices within the broader context of the Bangladesh institutional framework and capacity needed to ensure the quality of corporate financial reporting. The accounting and auditing practices in Bangladesh suffer from institutional weaknesses in regulation, compliance, and enforcement of standards and rules. The preparation of financial statements and conduct of audits, in many cases, are not consistent with internationally acceptable standards and practices.

Better-qualified graduates generally do not join the accounting profession because it is not viewed as a stepping-stone to a rewarding and prestigious career. The out-of-date legal requirements, widespread noncompliance with accounting and auditing standards, ineffective enforcement mechanism, poor quality accounting education and training, and inadequate adherence to professional ethics have contributed to the weakness of the financial reporting regime.

The policy recommendations provided in this report focus on improving statutory framework, strengthening enforcement mechanisms, upgrading professional education and training, and enhancing capacity of regulatory and professional bodies. A major recommendation is that an independent oversight body—Financial Reporting Council—should be established. The Financial Reporting Council will be responsible for adoption, monitoring, and enforcement of IAS and ISA with respect to financial reporting by the public-interest entities. In addition, arrangements will need to be made to develop a simplified financial reporting framework for small- and medium-size enterprises.

This report was prepared by a team from the World Bank, based on findings from a diagnostic review carried out in Bangladesh in January–March 2003. The team comprised M. Zubaidur Rahman (OPCFM) and Suraiya Zannath (SARFM). The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

## I. INTRODUCTION

1. This report provides a systematic assessment of strengths and weaknesses of accounting and auditing practices in Bangladesh. The assessment was carried out as a part of the World Bank and the International Monetary Fund (IMF) joint initiative on Reports on the Observance of Standards and Codes (ROSC). This initiative appraised actual practices and analyzed the efficacy of the monitoring and enforcement mechanism for formal standards, rules, and regulations for accounting, auditing, and corporate financial reporting. National specialists used a diagnostic template developed by the World Bank to collect data for the assessment. This data was complemented by the findings of a due diligence exercise conducted by Bank staff, based on a series of meetings with key stakeholders.

2. Despite sustained domestic and international efforts to improve economic and demographic prospects, Bangladesh remains poor. The country has a population of about 133 million within a geographic boundary of 143,998 square kilometers (56,160 square miles). Although more than half of the gross domestic product (GDP) is generated through the service sector, nearly two-thirds of the population are employed in agriculture. Major impediments to growth include frequent natural disasters, inefficient state-owned enterprises, inadequate infrastructure, weak private and foreign investments, and slow implementation of economic reforms. Weak national financial architecture, inadequate transparency and accountability, and a dearth of appropriate policy interventions are among the impediments cited for the country's slow economic development.

## II. INSTITUTIONAL FRAMEWORK

### A. Statutory Framework

3. **The Companies Act 1994 provides basic requirements for accounting and reporting applicable to all companies incorporated in Bangladesh.** The Companies Act 1994, which replaced the Companies Act 1913, provides the requirements for preparation and publication of financial statements, disclosures, and auditing, among other provisions. However, in most cases, the Act lacks clarity with regard to statutory requirements on disclosures in the financial statements of the incorporated companies. The formats for presentation of financial statements and requirements on disclosures prescribed in the Act need updating or removing. Moreover, some accounting requirements prescribed by the Act are incompatible with International Accounting Standards (IAS).<sup>1</sup> For example, contrary to IAS, the Companies Act requires capitalization of gains and losses arising from changes in foreign exchange rates under all circumstances. Inconsistencies between IAS and the Companies Act need to be eliminated. The committee, which has been formed by the Government for updating the Companies Act, should take it into consideration.

4. **The Securities and Exchange Commission (SEC) regulates financial reporting practices of listed companies.** Listed companies are required to comply with SEC accounting

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<sup>1</sup> Within this report, IAS refers to all standards and related interpretations issued by the former International Accounting Standards Committee (IASC), and the International Financial Reporting Standards (IFRS) and related interpretations issued by IASC's successor body, International Accounting Standards Board (IASB).

and disclosure requirements, despite inconsistencies with the requirements of the Companies Act 1994. The SEC, in protecting investor interests, issues various rules that apply to listed companies, including accounting and auditing requirements that, according to SEC Ordinance 1969 (Provision 2CC), supersede requirements set by the Companies Act. The October 1997 SEC rule required listed companies to follow IAS and International Standards on Auditing (ISA) as adopted by the Institute of Chartered Accountants of Bangladesh (ICAB).<sup>2</sup> Since the October 1997 SEC rule did not mandate full compliance with all IAS and ISA, the SEC revised the requirements on accounting and auditing by listed companies. In February 2000, the SEC issued a new rule on the format of audit reports specifying that auditors will verify that the financial statements have been prepared in accordance with IAS and the audit has been carried out in accordance with ISA. The SEC claims that its February 2000 rule on audit reports has mandated full compliance with IAS, although this requirement does not appear to have the force of law. To ensure compliance and clarify its position, the SEC should issue a rule for mandatory observance of IAS in preparing statutory financial statements.

5. **The Bank Companies Act 1991 authorizes the Bangladesh Bank to regulate financial reporting by banks.**<sup>3</sup> The accounting and auditing requirements set by the Bank Companies Act 1991 are in addition to the requirements set by Companies Act 1994. The Bank Companies Act prescribes the format of balance sheet and income statement, including disclosure requirements that each bank must follow for regulatory reporting to the Banking Inspection Department of the Bangladesh Bank. The same accounting and financial reporting rules are required to be followed by banks in preparing financial statements for external users. The Bank Companies Act empowered the Bangladesh Bank to approve appointment of bank auditors. In practice, the Bangladesh Bank maintains a list of approved auditors. The list contains both large and small audit firms.

6. **The Chief Controller of Insurance under the Insurance Act 1938 regulates the financial reporting practices of insurance companies.** Financial statements must comply with formats provided in the Insurance Act, but the accounting and disclosure rules prescribed by the Act are, in most cases, not consistent with IAS accounting principles. The Insurance Act specifies that insurance companies' annual audited financial statements should be submitted to the Chief Controller of Insurance within six months from the balance sheet date.

7. **Tax laws influence presentation and disclosure in general-purpose financial statements.** Taxation authorities do not accept some IAS-compatible accounting treatments for determining taxable profit, for example, recognizing finance leases, prior period adjustments, and expensing of pre-operation costs. Although there is no legal requirement on observance of tax accounting rules in external financial reporting, those who prepare and audit financial statements generally ensure that the accounting treatments that are acceptable to the taxation authorities are used not only for tax reporting purposes but also for preparing the general-purpose financial statements.

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<sup>2</sup> The ICAB prepared Bangladesh Accounting Standards (BAS) and Bangladesh Standards on Auditing (BSA) on the basis of IAS and ISA, respectively.

<sup>3</sup> Bangladesh Bank is the central bank of Bangladesh.

8. **All companies registered under the Companies Act 1994 or its predecessor Companies Act 1913, must prepare and present annual audited financial statements.** The directors of limited companies—both private and public—are responsible for filing annual audited financial statements with the Registrar of Joint Stock Companies within 30 days of the annual general meeting. An annual general meeting should be held within 15 months of the previous annual general meeting. However, it is possible to get permission from the Registrar for a three-month extension. Listed companies' financial statements are required to be audited within 120 days of the end of accounting period. The Companies Act 1994 allows both sole practitioners and partnership firms to act as auditors. However, according to SEC rules, only partnership firms with seven-years experience in professional practice are allowed to audit listed companies. The SEC requires auditor rotation once every three years, except where the company declares dividends at a rate prescribed by the SEC, in which case the same auditor can continue in office. The practice of linking auditor rotation with the company's dividend declaration is highly unusual, and it is not clear what purpose it serves.

9. **Companies Act provisions are not fully in line with IAS requirements on preparing consolidated financial statements.** The Companies Act 1994 governs group accounting in Bangladesh, defining holding and subsidiary company relationships and providing requirements on financial reporting of holding companies by broadly prescribing certain disclosures regarding group activities and profit and loss status of subsidiaries. The Companies Act requires that a set of financial statements for each subsidiary, together with some additional statements be annexed to the holding company's balance sheet. This practice, which pre-dates the Companies Act 1994, is inconsistent with generally accepted accounting principles regarding preparation of consolidated financial statements and with IAS.

10. **The Companies Act supports long-term employment of an auditor.** The company auditor, according to the Companies Act 1994, is appointed through a resolution passed at the annual general meeting of the shareholders. Another provision in the Act appears to guarantee lifetime appointments for auditors, unless they are proven dishonest or unqualified, or if they resign. This provision is not in the interest of shareholders who should be able to change auditors freely.

## **B. The Profession**

11. **The accountancy profession is regulated by the Institute of Chartered Accountants of Bangladesh (ICAB).** The ICAB was established in 1973 by a Presidential Order, which links ICAB with the Ministry of Commerce from which ICAB receives annual grants. This professional body was modeled on the Institute of Chartered Accountants of England and Wales and acts as both an examining body for awarding chartered accountant certification and the licensing authority for members engaged in public auditing practice. The ICAB began with 78 members who had professional qualifications from the United Kingdom and Pakistan. In February 2003, membership reached 700, out of which 260 are in public practice in Bangladesh, with most of the remaining members working in industry and government. Some members work and live abroad. An elected Council, whose members hold a three-year term, is in charge of overall management of the Institute. The ICAB president, who is also the chief executive officer, is elected to a one-year term by the Council. The Council is assisted by various committees of volunteer members. The ICAB is a member of the International Federation of

Accountants (IFAC), South Asian Federation of Accountants (SAFA), and Confederation of Asian and Pacific Accountants (CAPA).

12. **The ICAB capacity needs to be strengthened.** ICAB does not have the capacity to adequately function as an effective professional accountancy body. It has not yet implemented adequate quality assurance arrangements with respect to performance of its members. The ICAB does not provide sufficient guidance to its members on how to improve the quality of audits. Its Investigation and Disciplinary Committee is not proactive with respect to disciplining errant public practitioners. Moreover, ICAB has no effective measures to ensure that its members maintain current professional standards through continuous professional development.

13. **Despite the presence of accounting firms associated with Big Four international networks, some local audit firms have significant market share.** There are 185 audit service providers—firms and sole practitioners—including the local associates of international network accounting firms. The Big Four internationally associated firms audit almost all the local subsidiaries/affiliates of foreign companies, most of the banks and other financial institutions, and large nongovernmental organizations. The clients of local firms and sole practitioners include a significant number of listed companies, many public sector enterprises, as well as small- and medium-size business entities.

14. **The professional accountants' code of ethics needs updating.** The ICAB has a code of professional conduct for both of its practicing and nonpracticing members. This code focuses on the characteristics of objectivity, neutrality, knowledge, and skills. The code as adopted by the ICAB needs updating in line with the IFAC Code of Ethics for Professional Accountants issued in November 2001.

15. **The Institute of Cost and Management Accountants of Bangladesh (ICMAB) is actively involved in training and related activities.** The ICMAB was established under the Cost and Management Accountants Ordinance (1977) and is attached to the Ministry of Commerce. The main focus of ICMAB activities is to educate and train qualified and student members to develop their knowledge, skills, and competence in cost and management accounting. The total number of members of the ICMAB was 700 in mid-June 2003. The ICMAB training curriculum includes topics relating to IAS, but capacity is constrained by the shortage of well-trained instructors and resources, leaving ICMAB unable to deliver high-quality training programs on the practical application of international standards.

### **C. Professional Education and Training.**

16. **Generally, the best students are not attracted to the accountancy profession.** A bachelor's degree in any discipline is the prerequisite for entering a professional accountancy training program prior to taking the qualification examinations. The curriculum at higher education institutions does not include all necessary building blocks for students entering the accountancy profession. Also, there is a lack of adequate number of teachers to teach practical application of IAS and ISA. The better-educated students are not attracted to the profession, which suffers from a poor image, largely because of the inadequate quality of professional training. Also, without sufficient command of the English language, students are handicapped

since the training materials are in English. The ICAB needs to develop a strategy for attracting high-quality students to the profession.

17. **Professional education and training are not adequate for future accountants' skills development.** The quality of higher education suffers from the lack of modern curriculum and skilled instruction. Accounting courses in the bachelor's degree program do not include practical application of national and/or international accounting and auditing standards. Many accounting teachers lack the experience and adequate knowledge to teach either the theoretical or practical aspects of IAS and ISA. Undergraduate-level teaching in accounting and auditing mainly focuses on elementary topics and application of some basic standards. The outdated curriculum and lack of appropriate literature leaves students without an applicable background for modern accounting and auditing. The academic programs do not challenge students to improve critical thinking.

18. **The training programs offered by the ICAB during students' prequalification period appear to be inadequate.** The ICAB lacks capacity for providing training in line with the IFAC-proposed International Education Standards for Professional Accountants. Students are not receiving adequate development in technical and functional skills, organizational and business management skills, interpersonal and communication skills, and skills in forming professional judgments. In addition to lacking detailed knowledge in the practical aspects of IAS and ISA, many instructors in ICAB-administered prequalification classes lack adequate knowledge of the IFAC Code of Ethics for Professional Accountants. In fact, professional ethics for accountants is not taught in prequalification educational programs, as required by the proposed International Education Standards. The ICAB-developed training manuals for the qualifying examinations do not include recent developments in the many areas of accounting and auditing. Out-of-date materials are not useful to students.

19. **There is a large supply of unqualified accountants.** A very low passing rate in the professional qualification examinations conducted by the ICAB has created a type of accountant that is known as "CA Course Complete" (CC accountant). Because of the limited supply of well-skilled, qualified accountants (chartered accountant), corporations often hire the lesser-qualified CC accountants for their accounting departments. There are estimated to be more than 9,000 CC accountants and about 700 qualified chartered accountants in Bangladesh. Between 1972 and end-June 2003, 11,026 students enrolled with the ICAB as trainee accountants (articleship). In December 2002, 4 out of 56 trainee accountants passed the final examination and qualified as chartered accountants. The trainee students often complain of inconsistencies between the contents of the pre-examination training programs offered by the ICAB and the examination questions. The Examination Committee of the Council of ICAB carries out all activities connected with the qualification examinations.

20. **Continuing professional education and development need to be strengthened, monitored, and enforced.** The ICAB annual requirement for continuing professional education is 12 hours for practicing members and 10 hours for nonpracticing members, but there is no effective monitoring or enforcement mechanism. Weak arrangements for continuing professional education and development mean that many qualified accountants lack up-to-date knowledge on international developments for financial reporting, auditing, and other related subjects. According to international best practice, every practicing auditor should keep pace

with new developments in auditing and accounting; this requires at least 30 hours of continuing professional education per year.

#### **D. Setting Accounting and Auditing Standards**

21. **The ICAB issues Bangladesh Accounting Standards (BAS).** As the professional body of accountants, ICAB regulates its members; however, it has no legal mandate for setting accounting standards. Despite that, ICAB develops and issues BAS, which are not legally binding by corporate management. The ICAB expects its members, who prepare and audit financial statements, to observe the local standards. The ICAB has a standard-setting committee that selects particular IAS as the basis for drafting BAS. The BAS is prepared by adapting IAS to reflect specific local requirements under Bangladesh laws and regulations. The draft BAS is submitted to the Council of the ICAB for discussion, finalization, and adoption.

22. **The ICAB issues Bangladesh Standards on Auditing (BSA) to be observed by its members.** An ICAB committee sets and issues local auditing standards following the same process as for setting accounting standards. Although BSAs are based on ISAs, no attempt is made to update the local standards when the international standards are revised. Thus, many new ISAs are not yet reflected in BSAs. No implementation guidelines on BSA or ISA exist from ICAB or any other authority, so the approach of interpretation and implementation may differ from auditor to auditor.

#### **E. Ensuring Compliance with Accounting and Auditing Standards**

23. **No effective mechanism exists to enforce requirements for accounting and financial reporting provided in the Companies Act 1994.** The Office of the Registrar of Joint Stock Companies (RJSC) has legal authority to enforce the provisions of Companies Act 1994. The RJSC has no technical capacity to identify accounting and auditing violations; in most cases it does not even enforce timely filing of annual audited financial statements. The RJSC records lack up-to-date information to verify the number of companies that have not submitted the required annual audited financial statements and returns.

24. **The SEC is the only regulatory body working to improve the quality of financial reporting.** The SEC lacks sufficiently trained staff to conduct detailed analyses to monitor compliance with accounting and financial reporting requirements. In a preliminary quick review of financial statements up to end-February 2003, SEC staff identified 16 listed companies that appeared to have disclosure deficiencies and/or indications of accounting manipulations. However, all these financial statements received unqualified audit opinion. Using its regulatory powers, the SEC made arrangements for second audits of these companies, selecting specific partners in five audit firms to do so, using SEC-specified terms of reference. Three of the company management groups challenged the SEC decision to conduct a second audit, and then obtained court orders prohibiting auditors from entering their premises. The inability to conduct these special audits has undermined SEC's regulatory authority to protect public interest. In the case of the other 13 SEC second audits, various infractions were discovered in the annual financial statements.

25. **The banking regulator has no mechanism to monitor and enforce accounting and financial reporting requirements.** The Bangladesh Bank, as the regulator of banking and nonbanking financial institutions, conducts routine supervision exercises to monitor and enforce prudential regulations. Bangladesh Bank inspectors examine whether financial statements have been prepared in accordance with established regulations. In this inspection process, no attempt is made to assess the degree of compliance with requirements on preparing general-purpose financial statements.<sup>4</sup> Also, no attempt is made to determine the reliability of the auditor's opinion on a set of financial statements.

26. **Financial statements prepared by insurance companies are not subjected to monitoring and enforcement actions.** The Insurance Act 1938 vested adequate power in the Chief Controller of Insurance to regulate the financial reporting of insurance companies. In practice, these powers are rarely exercised to ensure compliance with financial reporting requirements. Every year the Chief Controller appoints external auditors to conduct special audits in order to prepare reports on compliance with various prudential requirements. To conduct these special audits, the Chief Controller normally appoints small audit firms and sole practitioners, who in many cases lack knowledge of the insurance industry.

27. **No effective and efficient institutional arrangement exists to ensure compliance with auditing standards and code of ethics.** The ICAB has not established an effective and efficient mechanism to ensure member compliance with established auditing standards and the professional code of ethics. The ICAB has not made an effective effort to review the practices of the auditors and audit firms to evaluate the degree of compliance with the auditing requirements.

### III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

28. **Gaps exist between Bangladesh Accounting Standards and International Accounting Standards.** The ICAB has developed 16 BAS on the basis of IAS. However, as revised IASs are issued, the BASs are not updated. Moreover, 18 IASs have no counterparts in BAS. For nonlisted companies, financial reporting formats and disclosure requirements set by the Companies Act 1994 are mandatory; these requirements are not consistent with IAS. For listed companies, the SEC requires full compliance with IAS.

29. **Accounting and reporting requirements for banks and insurance companies are not consistent with IAS.** Recognizing the shortcomings of financial reporting requirements under the Bank Companies Act, the Bangladesh Bank has recently issued a rule requiring compliance with prescribed reporting formats and some bank-specific disclosure requirements. Although this rule is based on IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, it does not require observance of all other IAS.<sup>5</sup> Under the Insurance Act, insurance companies in Bangladesh are required to prepare financial statements in accordance with formats that are not consistent with the requirements of IAS. Moreover, the

<sup>4</sup> General-purpose financial statements are primarily addressed to external users. They may or may not be same as the regulatory reports submitted by banks for meeting the requirements of regulators. There is limited capacity in Bangladesh Bank with respect to the concepts of general-purpose financial statements and IAS.

<sup>5</sup> Paragraph 4 of IAS 30 reads, "This Standard supplements other International Accounting Standards, which also apply to banks unless they are specifically exempted in a Standard."



accounting and disclosure requirements under the Insurance Act lead to significant deviations from IAS requirements.

30. **No organization in Bangladesh, including ICAB, issues implementation guidelines on either the BAS or the IAS.** Without guidelines, these standards are applied inconsistently. The lack of detailed knowledge about IAS and the absence of implementation guidelines often give rise to misunderstandings, creating a gap between IAS requirements and actual practices. Moreover, due to provisions of the Companies Act 1994, a general belief is that IAS requirements on finance leases and preparing consolidated financial statements are not applicable in Bangladesh.

31. **Information on “compliance gaps”<sup>6</sup> demonstrates serious weaknesses of corporate financial reporting.** The review of published financial statements, conducted by World Bank consultants for the preparation of this assessment revealed compliance gaps. The review involved an examination of 46 sets of financial statements of major listed companies, including 8 banks and 3 insurance companies; and interviews with experienced corporate accountants, practicing auditors, academics, professional bodies, and regulators. The financial statements of these companies make claims to have been prepared in accordance with both BAS and IAS. Since the SEC of Bangladesh mandated the use of IAS by listed companies, the checklist used for determining compliance included selected IAS requirements as benchmarks. In general, actual accounting and disclosure practices in Bangladesh fall far short of the applicable requirements. Some examples follow:

- **Consolidated financial statements.** It is common practice not to comply with the IAS requirements on consolidation.
- **Statement of changes in equity.** Many companies’ financial statements did not include this.
- **Segment reporting.** Few companies reported segment sales and only one company disclosed segment assets and liabilities in addition to segment income and expenditure. Most companies that apparently had business segments and geographical segments did not comply with the segment reporting requirements.
- **Effects of changes in foreign exchange rates.** Some companies that had exchange difference arising on outstanding foreign currency loans on the balance sheet date adopted a capitalization method instead of expensing. Although this is permitted under Companies Act 1994, it is a violation of IAS. In other cases, export receivables were disclosed at the exchange rate prevailing on transaction date instead of balance sheet date as required by IAS.
- **Related party transactions.** Detailed disclosures in accordance with IAS requirements were not found in any sets of financial statements. For instance, the ownership structure<sup>7</sup> of many companies suggested that related parties and related party transactions existed, but in most cases there were limited or no disclosures.
- **Revenue recognition.** Many companies did not properly disclose the accounting policy on revenue recognition. It is common practice for installment sale business in Bangladesh to recognize sales on cash rather than accrual basis as required by IAS.

<sup>6</sup> “Compliance gap” refers to the difference between applicable accounting standard and actual practice.

<sup>7</sup> Family ownership of more than one company; members of a group of companies, etc.

- ***Property, plant, and equipment.*** In cases where fixed assets were revalued, detailed disclosures required under the IAS were not available. Moreover, none of the companies addressed the IAS requirements on impairment of assets.
- ***Employee benefits.*** Many companies disclosed the existence of employee pension benefits but failed to disclose information required by the relevant IAS. In many cases, the liability for employee benefit expenses was not recognized on an accrual basis. No disclosure was made as to whether actuarial or any other forms of valuations had been made to quantify outstanding liabilities for employees' post-employment benefits. One of the major listed companies in Bangladesh was discovered to have appropriated loans from the employee provident fund and the workers' profit participation fund. The loans outstanding are several times the annual contributions made to these funds. Details of the terms and conditions of these loans and reconciliation of the movements of these funds were not disclosed.
- ***Dividends.*** Many companies did not disclose the amount of dividend per share; some merely stated the rate of dividend.
- ***Earnings per share (EPS).*** Many companies did not disclose EPS. Companies that showed EPS did not disclose the numerator or denominator, or both.
- ***Pre-operating expenses.*** Bangladesh accounting practice generally treats pre-operational expenses as assets on the face of the balance sheet, and then writes off these expenses over several years. These assets are not intangible and should have been expensed.
- ***Taxation.*** The general practice in Bangladesh is not to account for deferred taxes.
- ***Contingencies.*** Many reviewed companies do not disclose contingent liabilities for obligations that may arise from past events.
- ***Leases.*** There are a number of leasing companies operating in Bangladesh. The principal business operations are in the nature of finance leases, but very attractive fiscal incentives encourage lessors and lessees to treat them as operating leases, contrary to IAS requirements.
- ***Interim financial reporting.*** While presenting half-yearly reports, all companies failed to present the Statement of Changes in Equity and Notes to the Financial Statements.
- ***Additional disclosure by banks.*** Banks did not disclose aggregate amounts included in the balance sheet for loans and advances on which interest is not being accrued. Banks provided no information or commentary on the risk management policy. For financial instruments, terms and conditions, particularly the rate of interest and security for financial assets and liabilities, were not disclosed. Several banks included as assets in their financial statements large amounts as "suspense accounts" and "inter-branch balances" (unreconciled differences), and no explanation was provided for such treatment.
- ***Disclosures by insurance companies.*** The Insurance Act 1938 in Bangladesh prohibits the issuance of insurance policies without receipt of the premium except under certain prescribed conditions. The assessment revealed that some companies disclosed as assets substantial amounts as "Premiums Outstanding" and the circumstances and reasons for such outstanding amounts were not disclosed.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

32. **The Bangladesh Standards on Auditing are based on the International Standards on Auditing.** The ICAB has issued many BSAs that need updating to reflect revisions of ISAs. For example, major changes in ISA relating to “Going Concern” and “The Auditor’s Report on Financial Statements” need immediate consideration. Moreover, many ISAs do not exist in Bangladesh.<sup>8</sup> And none of the 13 International Auditing Practice Statements issued by IFAC have been adopted.

33. **The lack of methodological guidelines hinders application of auditing standards.** With the exception of audit firms associated with the international network of accounting firms, most audit firms have no access to quality audit-practice manuals. Lacking practice-oriented methodological guidelines, auditors generally find it difficult to handle important concepts, such as audit risks, audit planning, internal control, materiality, documentation, and going concern. It is difficult to apply normal audit procedures regarding related-party transactions due to the lack of legal requirements concerning group accounting and consolidation.

34. **In general, actual practices diverge from ISA.** To assess actual auditing practices, the ROSC team interviewed practicing auditors and senior leaders of the auditing profession. Facilitated discussions were conducted with a group of partners representing ten large- and medium-size audit firms, from which the following points were made on auditing practice in Bangladesh:

- The knowledge gap regarding practical application of ISA and IFAC Code of Ethics, coupled with the absence of any enforcement mechanism, adversely affect audit quality.
- It is difficult to find audit firms that comply fully with the ISA on quality control.
- Intense work pressures force many large audit firms to comply more in form than in substance.
- Small firms find it difficult to bear the cost of implementing proper quality control arrangements.
- The shortage of audit staff with industry-specific knowledge and expertise in information technology erodes quality.
- Auditors seldom note any material irregularities in their audit reports. If a set of financial statements deserved audit qualification(s) due to material deviations, the auditors usually bring the situation to the attention of management through the Management Letter rather than acting on the problem.

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<sup>8</sup> These include ISA240, *The Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statements*; ISA250, *Consideration of Laws and regulations in an Audit of Financial Statements*; ISA260, *Communications of Audit Matters with Those Charged with Governance*; ISA402, *Audit Considerations Relating to Entities using Service Organizations*; ISA501, *Audit Evidence—Additional Considerations for Specific Items*; ISA505, *External Confirmations*; ISA510, *Initial engagements—Opening Balances*; ISA550, *Related Parties*; ISA560, *Subsequent Events*; ISA580, *Management Representations*; ISA710, *Comparatives*; ISA800, *The Auditor’s Report on Special Purpose Audit Engagements*; ISA910, *Engagements to Review Financial Statements*; ISA920, *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*; and ISA930, *Engagements to Compile Financial Information*.

- Poorly supervised trainee students who work for audit firms carry out most audits. With rare exceptions, audit firm partners seldom visit clients. Furthermore, professional interaction between the trainee students and experienced senior manager/partner is very limited.

35. **Of the 46 sets of financial statements of listed companies reviewed by World Bank consultants, the audit report rarely complied with the SEC-prescribed format.** Most of the reviewed financial statements had material noncompliance with one or more requirements of the applicable IASs. Despite these irregularities, the auditors issued an unqualified audit report on the financial statements.

## V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

36. **The quality of audited financial statements is a concern to investors and other users of financial statements.** Interviews and discussions with various stakeholders, including foreign and local investors, investment bankers, financial analysts, and regulators revealed serious concerns about the quality of financial reporting, as well as the competence and integrity of most professional auditors. There was a widespread view that the low-level skills among accounting professionals and the lack of enforcement mechanisms contribute to noncompliance with established accounting requirements and auditing standards. There is consensus that lack of transparency in audited financial statements discourages foreign investors. From discussions, leaders of the foreign banking community sent a strong message—“If you want investment, you need to produce decent sets of financial statements.” Representatives of the investment community generally agree that audited financial statements are rarely reliable and free from material misstatement. The investment analysts and various accounting and finance experts commented that actual accounting practices in Bangladesh need to improve in all areas covered by IAS. Most interviewees shared the opinion that improving the quality of financial reporting requires a robust regulatory regime and effective enforcement mechanisms for ensuring compliance with accounting and auditing standards and an auditors’ professional code of ethics.

## VI. POLICY RECOMMENDATIONS

37. The policy recommendations outlined in this section benefited from valuable inputs from the country stakeholders. These recommendations will be useful as inputs for preparing and implementing a country action plan for accounting and auditing reforms in Bangladesh.

38. **Improve the statutory framework of accounting and auditing.** Steps should be taken to ensure that the legal and regulatory requirements on accounting, auditing, and financial reporting fully protect the public interest. This recommendation might necessitate the enactment of a new Financial Reporting Act and the repeal of the provisions on accounting, auditing, and financial reporting in Companies Act 1994, Bank Companies Act 1991, Insurance Act 1938, and other related regulations. It will be easy to update accounting, auditing, and financial reporting requirements from time to time by simply amending the single Financial Reporting Act. The new Act should focus on making legal arrangements for the following:

- **Fully adopt IAS/IFRS and ISA** without modifications and ensure mandatory observance of these standards. Adopt IAS/IFRS and related interpretations issued by

the IASB as legally enforceable standards applicable to the preparation of the legal entity and consolidated financial statements of all public interest entities.<sup>9</sup> The audit of financial statements prepared by public interest entities should be carried out in accordance with ISA and other related pronouncements issued by IFAC. Also mandate the IFAC Code of Ethics for Professional Accountants for all practicing accountants and auditors.

- ***Develop a simplified financial reporting framework for small and medium enterprises.*** All but the smallest enterprises may be subjected to the simplified financial reporting framework.<sup>10</sup> Until finalization of the IASB project, Accounting by Small and Medium Entities and in Emerging Economies, the national accounting standardsetter should set standards for small- and medium-size enterprises in conformity with the IAS. However, if the national accounting standardsetter deems it necessary to derogate from IAS, it should have the authority to do so provided it clearly explains and justifies the reasons for the derogation.

39. **Establish an independent oversight body to monitor and enforce accounting and auditing standards and codes.** Empower the oversight body to monitor and enforce accounting and auditing requirements with respect to general-purpose financial statements. These activities related to general-purpose financial statements are different from the banking and insurance supervisors' actions that deal with regulatory reporting in compliance with prudential regulations. The proposed Financial Reporting Act should establish a new independent oversight body, which may be called Financial Reporting Council. The accountants in public practice should not dominate the operations and management of this Council, nor should professional accountants dominate the Governing Body. The members of the Governing Body of the Council may be drawn from the SEC, Bangladesh Bank, Bangladesh Bar Council, Federation of Bangladesh Chambers of Commerce and Industry, Dhaka Stock Exchange, Chittagong Stock Exchange, ICAB, ICMAB, Department of Accounting of Dhaka University, and Institute of Business Administration of Dhaka University. The secretariat of the Governing Body may be housed at the SEC. The main focus of Financial Reporting Council's activities would be as follows:

- ***Setting accounting and auditing standards.*** The Financial Reporting Council will adopt, without modification, all IASs, ISAs, and IFAC-issued Code of Ethics for Professional Accountants, for observance by the public interest companies with respect to financial reporting. In addition, it will develop implementation guidelines on practical application of IAS/IFRS and ISA in Bangladesh. The Financial Reporting Council should also be entrusted with the responsibility of developing

<sup>9</sup> Public interest entities may be defined by the nature of their business, their size, and their number of employees; or by their corporate status by virtue of their range of stakeholders. Examples of public interest entities might include banks, insurance companies, investment funds, pension funds, listed companies, and large enterprises. The large enterprises may be defined as follows: individual enterprises and groups of enterprises that meet two of three following thresholds should be considered as public interest entities—(a) total number of employees exceeding [a number to be decided in consultation with various stakeholders]; (b) total assets on the balance sheet exceeding [amount to be decided in consultation with various stakeholders]; and (c) total turnover exceeding [amount to be decided in consultation with various stakeholders].

<sup>10</sup> The definition of micro-enterprise in the context of financial reporting will need to be developed.

accounting and auditing requirements for small- and medium-size enterprises. A unit of the Financial Reporting Council may be entrusted with the task of preparing and disseminating standards and related implementation guidelines.

- ***Monitoring compliance with accounting standards.*** A monitoring unit of the Financial Reporting Council will be responsible for identifying and forwarding findings on noncompliance to the Enforcement Unit along with recommendations on the nature of sanctions to be imposed on the parties responsible for infractions. Adequate legal backing will be necessary for effective conduct of monitoring activities. The Monitoring Unit should have experienced staff— full-time or part-time—with capacity to conduct an in-depth review of financial statements. The policies and procedures for carrying out monitoring activities will be developed by the Unit and approved by the Governing Body of the Financial Reporting Council.
- ***Reviewing auditors’ practice.*** A review team would be responsible for reviewing the practices of independent auditors and audit firms that audit the financial statements of public interest entities. This Financial Reporting Council will maintain a register of auditors and audit firms approved to audit public interest entities. A unit of the Financial Reporting Council will be responsible for carrying out practice review of auditors and audit firms. The practice review will evaluate an audit firm’s quality assurance arrangements, its audit approach, and the working papers with regard to selected audit engagements. In addition, valid complaints against auditors and audit firms will be investigated. In the case of material infractions, the responsible unit of the Financial Reporting Council will recommend appropriate actions against the auditor and forward them to the enforcement unit for implementation. In addition, this unit will oversee public interest activities undertaken by the ICAB and assess whether the auditing profession is properly serving the interests of stakeholders, including the public. .
- ***Enforcing sanctions for violations.*** The enforcement unit of the Financial Reporting Council will determine appropriate actions against the violators of accounting and auditing standards and codes. In addition to resorting to the national legal system, the unit should be empowered to impose enhanced administrative sanctions against management of enterprises, auditors, and audit firms for their roles in violating accounting, auditing, and financial reporting requirements. The enhanced administrative sanctions would facilitate enforcement without depending fully on the lengthy legal process. The administrative sanctions recommended by the Enforcement Unit will be discussed and approved by the Governing Body of the Financial Reporting Council.

40. **Strengthen capacity of the regulatory bodies.** Take necessary steps to strengthen capacity of the Securities and Exchange Commission, Bangladesh Bank, and Controller of Insurance for enabling these regulatory bodies to effectively deal with accounting and financial reporting practices of the regulated entities.

41. **Take preventive measures to improve the degree of compliance with accounting requirements by the publicly traded companies.** The SEC should raise awareness among top

management of listed companies on the importance of compliance with accounting and auditing requirements. Through outreach programs, top management would be briefed on their responsibility for compliance with standards and on enforcement policies. These programs should also present case studies that demonstrate the strengths and weaknesses of financial reporting in the country. Efforts should also be made to present international developments on improving transparency of corporate financial reporting, new dimensions of regulatory regimes affecting accounting and auditing, and the role of transparent financial reporting in attracting both strategic and portfolio foreign investments.

42. **Upgrade the procedure of licensing accountants and auditors in public practice.** To obtain professional accounting qualifications, practitioners should meet minimum requirements based on IFAC standards. The curriculum and system of qualification examinations should be improved to conform to IFAC-proposed International Education Standard for Professional Accountants. Moreover, arrangements should be made for regular ICAB monitoring of the quality of practical training provided by authorized providers (audit firms) to trainee accountants and auditors.

43. **Improve the professional education and training arrangement of ICAB.** The ICAB should revamp instruction manuals to make them compatible with internationally comparable learning materials for trainee accountants and auditors. Current global developments in accounting and auditing education and training must be reflected in the training curriculum of ICAB. Business ethics should be taught extensively as a separate subject. The ICAB should employ trained instructors with adequate knowledge of the practical dimensions of IAS and ISA. Arrangements should be made to facilitate the development of in-house training facilities in audit firms.

44. **Ensure effective continuing professional education and development of the accountants and auditors in public practice.** The requirements on continuing professional education and development of qualified members should be improved in line with the IFAC-issued continuing professional education and development—Proposed International Education Guideline for Professional Accountants. According to the Code of Ethics for Professional Accountants, each qualified accountant/auditor is obliged not only to maintain competence, but also to continually seek personal improvement. Therefore, the professional body should arrange delivery of high-quality training programs and facilitate access to programs offered by universities and other training providers. The ICAB should develop a mechanism for monitoring and enforcement of the requirements on continuing professional education of the practicing members.

45. **Strengthen the capacity of ICAB by establishing twinning arrangements with a developed professional accountancy body.** For this purpose, a professional body should be identified in Europe, North America, Australia, or New Zealand. Through a long-term twinning arrangement, best practices of the twinning partner would be transferred to the ICAB. In view of recent developments around the world in regulation of the accountancy profession and reform of the role of professional bodies, ICAB governance requires restructuring and strengthening. For example, the Council of the ICAB should include nonmembers.

46. **Strengthen ICMAB capacity to deliver high-quality training programs on practical implementation of IAS.** The ICMAB can play a vital role in the implementation of IAS since it provides training to existing and potential corporate accountants. To ensure IAS compliance when preparing corporate financial statements, corporate accountants should have access to effective and high-quality training programs. ICMAB capacity should be strengthened to provide effective training on practical application of IAS.

47. **Improve curriculum and teaching in accounting programs of universities and colleges.** Ensuring that a minimum quality standard is maintained in teaching accounting and auditing courses in all Bangladesh universities and colleges, a centrally coordinated initiative is necessary for curriculum development and training-the-trainers activities. Review and update the accounting curriculum to include international accounting and auditing standards and practical-oriented teaching at the undergraduate level. Supported by case studies, the ethical dimensions of business management, corporate finance, accounting, and auditing should be taught in undergraduate business/commerce programs. The reform of accounting curriculum and teaching methodology should raise English communication skills and increase critical-thinking ability of students. A train-the-trainers program is required to enhance the capacity of higher educational institutions for teaching accounting and auditing courses with international components.