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The adoption of international accounting standards by small and closely held companies: evidence from Bahrain

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Abstract

This study examines the accounting practices and the degree of adoption of international accounting standards (IASs) by small and closely held companies in Bahrain. It finds that 86% (31) of the 36 companies responding to the questionnaire applied IASs and they considered IASs to be very relevant for them. All firms prepare balance sheets, and the majority prepares income statements and cash flow statements. They also duly audit these statements. The data collected also revealed that the quotient influence on whether or not a firm adopted IAS was exerted by their external auditors. External auditors exerted the greatest influence on getting firms to adopt IASs. Banks and company partners were the primary users of company financial statements; inventories, depreciation, disclosure on financial statements, and the presentation of current assets and liabilities. The main IASs followed by a majority of firms are those pertaining so. Some of the standards were considered totally irrelevant, contrary to the prevailing idea that adoption of IASs creates an information overload for small and closely held companies. The results of this study indicate that a majority of our respondents did not find that it was costly to adopt or interpret IASs. Those few firms that experienced some difficulties sought clarification from their external auditors. About 84% of those who adopted IASs strongly agreed that using IASs improves their organization's ability to financial assistance from the banking sector. Also, about 90% of the respondents fully agreed that IASs help to achieve the objectives and improve the effectiveness of financial reporting.

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1. Introduction

In recent years, corporate financial reporting practices have undergone radical changes all over the world. These changes in developing countries are particularly significant. Although there is no agreement about the type of accounting system developing countries should use (Wallace, 1990), the adoption of international accounting standards (IASs) has been suggested as an appropriate accounting system to facilitate economic growth (Belkaoui, 1988). Belkaoui (1994, p.75) suggests that

The best strategy available to the developing countries is either of joining the International Accounting Standards Committee (IASC) or some of the other international standards setting bodies, and adopting their complete set of pronouncements. The rationale, behind such a strategy, is to reduce the setup and production costs of accounting standards, joining the international harmonization desire, facilitating the growth of foreign investment that may be needed, enable the profession to emulate well established professional standards of behavior, conduct and legitimize its status as a full-fledged member of the international community. Some of the developing countries give more credibility to IASs, and other standards than do the developed countries that have a dominant influence in the preparation of such standards.

Choi, Frost, and Meek (1999, p.262) state that IASs are used as a result of either international or political agreements, or voluntary (professionally encouraged) compliance. Al-Bastaki (1996) found that the adoption of IASs is one of the most effective strategies for enhancing the accounting profession in Bahrain. The application of the European Union's (EU) accounting-related directives in developing nations generally results from an international political agreement. When international and national accounting standards are the same, there is no problem; but when they differ, national standards come first. Choi et al. cite the following four main reasons for the wider acceptance of IASs. First, many countries use them as the basis for national accounting requirements. Second, they are used as an international benchmark. Third, the EU and other supranational bodies recognize them. And, fourth, many stock exchanges (e.g., London, Frankfurt, Luxembourg, Zurich, Thailand, Hong Kong, Rome, and Amsterdam) and regulators accept financial statements that are prepared in accordance with IASs. Research also shows that more than 56 out of 67 countries surveyed by the IASC (1996) either used IASs as their national standards or based their national standards on IASs.

Many developing nations are trying to achieve harmonization in reporting practices in conformity with that of developed countries. Bahrain is not lagging behind. It adopted IASs in 1994 in the absence of other local standards.¹ There is evidence that listed companies in Bahrain are using IASs (Al-Bastaki, 1996; Joshi & Al-Bastaki, 1999). Also, nonlisted banks and other business enterprises have started using IASs in the preparation of financial statements. Previous research on Bahrain examined the adoption of IASs by large-sized listed companies (i.e., the adoption of IASs is related to large-sized or listed companies only). However, since the majority of firms in Bahrain are small, closely held unlisted firms contribute about 40% of the Gross Domestic Product (GDP) and provide employment to a

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