

Divergence within IFRS adoption: the case of depreciation practices of listed banks in Bangladesh

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ABSTRACT

Comparability is one of the qualitative characteristics of financial statements prepared in compliance with the International Financial Reporting Standards (IFRS). This research attempts to identify whether this qualitative characteristic can be negated even when entities apply IFRS. The researcher analyzed the data using a content analysis of audited financial statements of the listed banks in Bangladesh. It was found that despite the increasing effort by accounting standard setters and pressure groups to achieve IFRS-compliance and harmonization in accounting practices, non-compliance and divergence still exists. This research also finds that the divergence in depreciation practices can be of enough significance to negate comparability. The findings of this research expected to assist the international and national standard setters as well as the regulators in understanding the practical issues in implementing accounting standards and developing clearer IFRS implementation guidelines.

ABSTRAK

Perbandingan adalah salah satu karakteristik kualitatif dari laporan keuangan yang disusun sesuai dengan Standar Pelaporan Keuangan Internasional (IFRS). Penelitian ini mencoba untuk mengidentifikasi apakah karakteristik kualitatif ini dapat dinegasi-kan meskipun entitas menerapkan IFRS. Peneliti menganalisis data menggunakan analisis isi laporan keuangan diaudit bank-bank yang terdaftar di Bangladesh. Dite-mukan bahwa meskipun ada peningkatan upaya oleh pembuat standar akuntansi dan kelompok penekan untuk mencapai kepatuhan IFRS dan harmonisasi dalam praktik akuntansi, ketidakpatuhan dan divergensi masih ada. Penelitian ini juga menemukan bahwa perbedaan dalam praktik depresiasi cukup signifikan untuk meniadakan kom-parabilitas. Temuan penelitian ini diharapkan dapat membantu para pembuat standar internasional dan nasional serta para regulator dalam memahami masalah-masalah praktis dalam penerapan standar akuntansi dan mengembangkan pedoman pelaksana-naan IFRS yang lebih jelas.

1. INTRODUCTION

The International Accounting Standards Board (IASB) has identified comparability as an enhancing qualitative characteristic of financial reporting. This can be attained if reporting entities adopt accounting policies that are not distant when transactions are similar. Comparability enhances usefulness of financial statements as it endows the users to identify and understand similarities in and dissimilarities among the reported amounts (Conceptual Framework, 2018).

In contrast, divergence in accounting practices increases the user's confusion and result misinterpretation of the reported amounts. This was the case during the Great

Crash of 1929, which ensued the formation of regulators and accounting standard setters who insists on comparability of financial statements (Zeff, 2005). The International Accounting Standards Committee (IASC), predecessor of the IASB, was established 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 the comparability between financial statement line items, Section 38 of Bangladesh Banks Act 1991 compels banks in Bangladesh to prepare financial statements in concurrence with the

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financial reporting format as laid down in the “first schedule” of the same Act.

To enhance comparability and credibility of the audited financial statements by overcoming divergences and by harmonizing accounting and auditing practices, the Institute of Chartered Accountants of Bangladesh (ICAB) has adopted the accounting standards as issued by the IASB (Chowdhury, 2013). Banks listed with any of the two stock exchanges in Bangladesh shall prepare their financial statements in accordance with IFRS as required by Rule 12(2) of Bangladesh Securities and Exchange Rules, 1987 (IFRS Foundation, 2016).

Nonetheless, despite developing and requiring IFRS standards to achieve comparability, the flexibility is given within the IFRS standards. For instance, depreciation is one of the key areas of financial reporting where IFRS allows management of the reporting entities to apply significant judgment. After initial recognition of a tangible or intangible non-current asset, estimation of three factors: asset’s pattern of use, useful life, and residual value determines the amount of depreciation to be charged over an asset’s useful life. Longer useful life and higher residual value estimation decrease the periodical amount of depreciation in comparison to shorter useful life and lower residual value estimation. Different estimations on pattern of use nominate different depreciation methods and, therefore, depreciate assets at different rates and patterns.

There is a risk of earnings management when managers use judgment in financial reporting (KPMG, 2016). The room for management’s judgment in determining asset’s useful life, residual value, and pattern of use may result reporting entities to adopt depreciation policies that are in divergence and lacks comparability, even when the industry and the asset type are similar. This may also give room for deliberate misstatement as it was the case in Waste Management, Inc (US Securities and Exchange Commission, 2002).

This research identifies and evaluates the depreciation policies adopted by the listed banks in Bangladesh—an emerging economy that mandatorily applies IFRS for financial reporting of listed entities. This research establishes whether the depreciation policies of these banks meet IFRS requirements, and whether the depreciation rates and useful lives of different classes of assets are in comparability across entities of the same industry.

2. RESEARCH METHOD

This research is based on content analysis of audited financial statements of thirty listed banks in Bangladesh. The research first summarizes IFRS requirements for depreciating tangible and intangible non-current assets. Then, it reflects those requirements on depreciation policies adopted by the banks. Audited financial statements for the year-ending 31 December 2018 are used to excerpt the depreciation policies.

The limitation of this research is that it could not quantify the monetary mismatch resulting from the differences in depreciation policies due to the absence of sufficient information in the financial statements.

3. DATA ANALYSIS AND DISCUSSION ANALYSIS OF ACCOUNTING STANDARDS

Depreciation Concept

Depreciation is a non-cash expense that is recognized by the reporting entities in their Statement of Profit or Loss for assets that are expected to be used for more than one period and have a finite useful life (IAS 16: 6, 58; IAS 38: 8, 89). In accrual accounting, when the economic benefits of an outlay are expected to arise over a number of periods, the outlay amount is allocated in the Statement of Profit or Loss over those periods on a systematic and rational basis (Conceptual Framework: Para 4.51, 2018). Depreciation designates this systematic and rational basis of cost allocation that reflects the pattern of economic benefits consumed from the asset (Kieso, Weygandt, & Warfield, 2013).

Depreciation is a cost allocation process, not an asset valuation process. Depreciation is not a technique that measures decline in the market value of a tangible or intangible non-current asset. It is also not a process that periodically sets aside an amount of cash to replace assets as they wear out.

Depreciation does, however, reduce the carrying value of assets, but not to reflect their market values. This is justified in financial reporting because depreciation is required for those assets which are primarily held not for sale but for entity’s own use (IFRS 5: 1, 6). Revaluation, not depreciation, is the technique that allows reporting entities to adjust carrying value of assets to reflect to their fair value, if they materially differ (IAS 16: 34, IAS 38:75).

Relevant Accounting Standards

IAS 16 Property, plant and equipment prescribe the accounting treatment of tangible non-current assets that are held for use by a reporting entity in the production or supply of goods or services, or for rental to others, or for administrative purposes (IAS 16: 6). Determining the depreciation charges after the initial recognition of within scope assets is one of the principal issues covered by this standard.

The current version of IAS 16 was revised in December 2003 as part of the IASB's project on Improvements to International Accounting Standards. The improvement project was undertaken due to queries and criticisms raised by securities regulators, professional accountants, and other international parties. One of the objectives of the project was to reduce or eliminate alternatives, redundancies and conflicts within the standards (IAS 16: IN2). The revision resulted clarification in requirements related to depreciable amount calculation (IAS 16: IN11), and depreciation period identification (IAS 16: IN12). IFRS-based reporting entities are required to apply the requirements of the revised IAS 16 from period beginning or after 1 January 2005 (IAS 16: IN1). ICAB adopted this standard as BAS 16 with effective date on or after 1 January 2007 (Hussain Farhad & Co., 2013).

IAS 38 Intangible assets prescribe accounting for identifiable non-monetary assets that do not have physical substance (IAS 38: 8). Financial assets and assets that are within scope of another standard are not covered by this standard (IAS 38: 2). Assets that contain both tangible and intangible elements need to be depreciated together or separately either based on IAS 16 or based on IAS 38 depending on management's judgment of which element is more significant and if the two elements are separable. For example, operating software of an ATM machine is more appropriately depreciated in conjunction with the tangible element and following IAS 16 requirements as, in the complete asset, the tangible element is more significant than the intangible element, and the former cannot be operated without the latter. If software is not an integral part of related hardware, for example: enterprise resource management software, then the software is more appropriately depreciated as a separate intangible asset following IAS 38 requirements (IAS 38: 4).

The current version of IAS 38 includes a number of changes from the previous, including

requirements related to determination of intangible asset's useful life (IAS 38: IN9, IN10). The revised version is compulsory for IFRS based reporting entities from period beginning or after 31 March 2004 (IAS 38: IN1). ICAB adopted IAS 38 as BAS 38 with effective date on or after 1 January 2005 (Hussain Farhad & Co., 2013).

Determining the Useful Life

The useful life of an asset is the period over which the asset is expected to be available for use by the entity (IAS 16: 6, IAS 38: 8). It is not compulsory for a reporting entity to hold an asset until the end of its usable economic life. Management may adopt a policy to use only relatively new assets and replace assets after using only a portion of their economic usable lives. In such a case, where the useful life is shorter than the usable life (IAS 16: 57), reporting entities are required to depreciate assets in terms of their usefulness to the entity, not in terms of total usable lives.

Management of the reporting entities needs to apply careful judgment when estimating the useful life of an asset. However, they cannot apply the prudence concept as an excuse to depreciate assets over a shorter useful life even though they intend to use the asset for a longer period. Prudence concept does not allow deliberate overstatement of expense or loss and understatement of profit (Conceptual Framework: Para 37, 2018).

Tangible non-current assets normally have a finite useful life, except land. The factors which limit their useful lives include: physical wear and tear, deterioration and decay, damage or destruction, and obsolescence (Benedict & Elliott, 2008; Subramanyam, 2014; and Kimmel, Weygandt, & Kieso, 2015). Wearing and tearing result from continuing use of the tangible assets while deterioration and decay occurs because of aging even when they are not in use. A tangible asset can become obsolete because of altered business requirements or technological progress which limits the asset from producing sufficient returns to justify its continued use. An intangible asset can also become obsolete.

Terms of contract may limit the useful life of an asset. A license may have a limited useful life because it is granted only for a number of years. Previously IAS 38 required reporting entities to assume a finite useful life for intangible assets of not more than twenty years from the date of the asset is available

for use. However, in the revised standard this requirement has been lifted (IAS 38: IN9).

Terms of contract may cap useful life of finance lease assets (Fargher et al., 2008 and Benedict & Elliott, 2008). IAS 17 Leases require finance lease assets to be depreciated by the lessee over the shorter of the lease term and its useful life if there is no reasonable certainty that the lessee will obtain ownership of the asset at the end of the lease term. If the reasonable certainty of ownership exists, the lessee is required to depreciate its finance leased assets, applying the same policy as for its owned assets (IAS 17: 27).

In case of land, usefulness does not decline instead increases as good sites become scarce over time (Kimmel, Weygandt, & Kieso, 2015). Thus, other than a few exceptions (where the fertility of the land diminishes over time), land is classified as non-depreciable asset even when acquired in conjunction with a building. If land and building acquired together, building is depreciated separately (IAS 16: 58). An increase in value of land does not excuse depreciation charges for building (IAS 16: 58).

Depreciation Commencement and Cessation

The previous version of IAS 16 did not specify when an entity shall begin depreciating its assets (IAS 16: IN12); however, the revised IAS 16 clarifies the issue by specifying that depreciation begins when an asset is in the location and condition necessary for it to be capable of operating in the manner intended by management, i.e., when the asset is ready to use (IAS 16: 55; IAS 38: 97). Recognition of depreciation expense continues even if the asset's fair value exceeds the carrying amount (IAS 16: 58).

Repairs and maintenance are necessary to maintain tangible asset's expected performance, but this does not exempt an asset from being depreciated (IAS 16: 52). Depreciation ceases when the asset is disposed of or sold by the entity, or when the entity decides to recover asset's carrying value principally through a sale and classifies the asset as held for sale as per the criteria set by IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations (IAS 16: 55, IAS 38: 97).

Assets are to be depreciated based on their service potential, not actual use (IAS 16 BC: 31). Thus, depreciation does not cease if the entity puts the asset into idle or retires it from active use, unless the asset already been fully depreciated (IAS 16: 55, IAS 38: 117).

Residual Value

Residual value is the amount that the reporting entity currently would obtain from the disposal of the asset, after deducting the estimated costs of disposal, as if the asset already were of the age at the end of its useful life (IAS 16: 6). Thus, the residual value estimation reflects current market condition, not future.

The residual value depends on the asset retirement policy of the reporting entities. If an entity uses an asset until the end of its useful economic life, i.e. until the asset is physically exhausted, then the residual value can be insignificant or nil. If, however, the entity disposes its assets after using only a portion of its useful economic life, then the asset will have a higher residual value.

At the end of asset's useful life, i.e. at the point when the asset is fully depreciated, the net book value of the asset will be equal to its residual value.

Depreciation Methods

The two most common depreciation methods applied by reporting entities are: (1) the straight-line method, and (2) the reducing (diminishing) balance method. Different methods allow reporting entities to depreciate assets at different rates even when asset's useful life and the depreciable amount are same.

IAS 16 or IAS 38 do not restrict reporting entities to adopt any specific depreciation method for any particular class of assets. The standards also do not require a reporting entity to apply a single depreciation method for all of the depreciable assets. However, IFRSs require reporting entities to apply depreciation method that reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity (IAS 16: 62; IAS 38: 97). If an entity cannot reliably determine the expected pattern of economic benefits that to be consumed from a depreciable intangible asset, IAS 38 dictates the use of straight-line method for that asset (IAS 38: 97).

Straight line method

The straight-line method spreads an equal amount of depreciation expense over asset's useful life. The asset is equally useful during the periods of its useful life is the simple rationale for selecting this method. Kieso, Weygandt, & Warfield (2013) and Hoggett et al. (2012) identified the straight-line method as the most commonly used depreciation method. Kimmel, Weygandt, & Kieso (2015) stated,

for 83% of the 600 US largest companies this method is the primary method of depreciation. Revsine et al (2012) referred to the 2009 AICPA survey that found 99% of US companies use the straight-line method at least for some of the assets. Wild (2013) stated, 87% of companies use this method for plant assets. Subramanyam (2014) stated, 85% of publicly traded companies applies the straight line method. Weetman (2011) stated, most UK companies use straight-line method.

Management of a reporting entity may prefer straight line method as it allows recognition of a stable depreciation expense over the asset's useful life, therefore avoids causing any overwhelming fluctuations in reported profits. Depreciation applying using this method is also easier to calculate and administer. A newly established company or the one which recently invested heavily in non-current assets may prefer straight-line method as this helps to avoid high depreciation charges, i.e. a profit dip, in the beginning years of asset's useful life.

In the straight-line method, the depreciation charge for the year calculated as: depreciable amount (D) of an asset divided by its estimated useful life (n). Depreciable amount (D) is calculated by deducting the residual value (R) from the capitalized amount (C) (IAS 16: 6). The following is the calculation of periodic depreciation charge applying the straight-line method.

Periodic depreciation charge (amount),

$$d = D/n = C-R/n$$

Periodic depreciation charge (rate), $r = d/C$

Where,

D = Depreciable amount

R = Residual value

C = Capitalized amount

n = Useful life

Reducing balance method

In reducing balance method, depreciation expense reduces as asset gets older. This method is appropriate for those assets from which the economic benefits expected to be consumed gradually reduces as the asset advances to latter years. This is largely based on the assumption that asset's efficiency, output, or other benefits reduce over the periods, i.e., the asset suffers its greater loss of service in the earlier years (Fargher et al., 2008).

In the early years of an asset, reducing balance basis depreciation will be higher than straight-line basis depreciation, but in later

years, it will be lesser than straight-line (Kieso, Weygandt, & Warfield, 2013 and Kimmel, Weygandt, & Kieso, 2015). This method is sometimes referred to as a conservative accounting policy as it results lower net profit in the early years of asset use (Robinson et al., 2009).

Expenses following a downward trend and profit following an upward trend are generally favored by management as this indicates a progressing business performance (Carruth, 2011). As this is the case in reducing balance method, this may influence the management of the reporting entities to prefer reducing balance method over the straight-line method. However, only 4% of the US largest 600 companies apply reducing balance method as the primary method of depreciation (Kimmel, Weygandt, & Kieso, 2015). A 2009 AICPA survey shows that 7% of US companies use reducing balance methods at least for some of the assets (Revsine et al., 2012). According to Wild (2013), 4% of the companies use this method for plant assets. Subramanyam (2014) stated that 10% of the publicly traded companies apply reducing balance method.

In some tax jurisdictions reporting entities could be required to recognize same amount of depreciation for both accounting profit and tax profit calculations. This may encourage the management of the reporting entities in such jurisdictions to adopt reducing balance basis as this allows recognition of higher deductible expense and lower tax at the beginning years of an asset's useful life. However, National Board of Revenue (NBR) or any other regulatory body in Bangladesh does not require such uniformity in tax and financial reporting. The following is the calculation of periodic depreciation charge in reducing balance method.

Periodic depreciation charge (amount),

$$d = V_0 \times r$$

Periodic depreciation charge (rate),

$$r = 1 - \left(\frac{R}{C} \right)^{\frac{1}{n}}$$

Useful life, $n = \log(R/C) / \log(1-r)$

Where,

V0 = Opening net book value

C = Capitalized amount

R = Residual value (R > 0)

Depreciation charge using reducing balance method is calculated by multiplying the depreciation rate (r) with opening net book value (V0) of an asset. Opening net book value

(V0) calculated as: capitalized amount (C) of asset less accumulated depreciation to the current period beginning. Figure 2 illustrates calculation of periodic depreciation charge applying the reducing balance method.

Repair and maintenance costs of tangible non-current assets generally increase as they age. Kieso, Weygandt, & Warfield (2013) and Hoggett et al (2012) presented an argument that reducing balance method allows entities to report an approximate straight line of total ownership costs for holding an asset in combination of decreasing depreciation expense and increasing repair and maintenance cost, therefore, equalizing total periodical expense for the asset. But, as Figure 1 illustrates, in reducing balance method an approximate straight line of total ownership cost is only likely if there is a drastic increase in repair and maintenance cost from the early stage of asset's useful life. Such increase in repair and maintenance costs can challenge the viability of continuation of an asset and thus nullifies the equalizing total ownership costs argument. This argument also misses the point that the cost of repair and maintenance is part of the recurrent expense while the depreciation is an allocation of the capitalized amount of an asset. IFRSs nowhere referred application of this assumption.

RESEARCH FINDINGS

The findings of this research are primarily of twofold: (i) divergence in the determination

of assets' useful lives, and (i) divergence in depreciation commence and cessation policies. The following discussion covers the findings in detail.

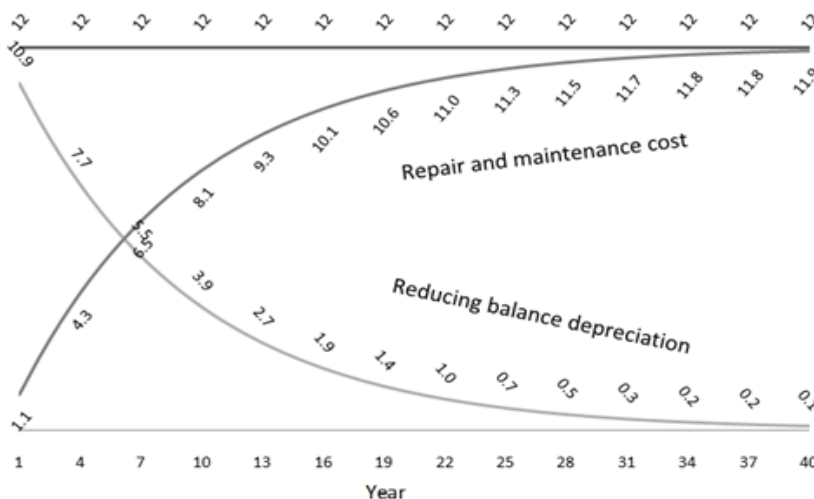
Useful Life of Assets

Based on disclosures made in the financial statements by the banks in Bangladesh, depreciable freehold non-current assets can be classified into six categories: (i) Buildings; (ii) Furniture and fixtures; (iii) IT and office equipment; (iv) Intangible assets; (v) Motor vehicles; (vi) Book and publications.

Buildings

As highlighted in Table 1, out of the thirty banks, 29 disclosed depreciation rates for buildings. The disclosed rates range from 2.25% in reducing balance method to 20% in straight-line method, which results in five years to 200+ years of useful life. This research excludes leasehold properties as the useful life of these assets might be capped by their lease period.

One of the banks has not disclosed any depreciation rate for buildings. Two of the banks have not recognized any depreciation expense for buildings. In the absence of any clarification, it is not clear if those banks do not own any building or do not depreciate buildings even after owning them. Benedict & Elliott (2008) identified several excuses that can be given by entities in resisting depreciation charges for buildings. These include difficulty



It is assumed that cost of the asset is CU 100, residual value is CU 1, useful life is 40 years, depreciation rate is 10.87% and total ownership cost is CU 12.

Figure 1
Total Ownership Cost

Source: Data processed

Table 1
Depreciation of Buildings

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	2.50%	40	10
	5%	20	1
	5% - 20%	5 - 20	1
Reducing balance*	2.25%	202	1
	2.50%	182	14
	4%	113	1
	5%	90	1
No mention	-	-	1

*For reducing balance rates, residual value assumed to be 1% of the asset's capitalized amount.

Source: Financial statements of the banks.

Table 2
Depreciation of Furniture and Fixtures

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	10.00%	10	8
	10 / 15%	10 / 6.67	1
	20%	5	1
	6.67 - 33.33%	3 - 15	1
Reducing balance*	10.00%	44	13
	10 / 12%	44 / 36	1
	10 / 20%	44 / 21	2
	10 / 40%	44 / 9	1
	Straight + Reducing*	10 / 10%	10 / 44
20 / 10%		5 / 44	1

Source: Financial statements of the banks.

of identifying the cost of building as it acquired in a combination of land, useful life of buildings is too long to estimate, and market price of buildings appreciates. These issues are dealt in IAS 16 in sufficient clarity, which establishes that the excuses of not depreciating buildings are invalid.

Furniture and fixtures

Furniture and fixture assets include movable assets that are not integral part of the structure of buildings and premises. This class of assets generally excludes mechanical equipment and IT equipment.

As highlighted in Table 2, the research reveals that banks apply a wide range of rates for depreciating furniture and fixture assets that give useful lives ranging from 3 years to 44+ years.

Some of the furniture and fixtures are exposed to significant usage, for example:

furniture used in customer service centers or in ATM booths, so subject to faster depreciation than the furniture and fixtures used for administrative purposes. However, the research reveals that twenty-two banks did not differentiate in types or usage of the assets in this board class and applied a single rate of depreciation.

IT and office equipment

IT and office equipment assets include electrical appliances, IT equipment, and ATM machines. Reporting entities may also capitalize and depreciate operating software with related tangible asset in this class.

These classes of assets probably include the most diverse range of assets that do not have a uniform useful life. However, as shown in Table 3, twenty-one banks applied a single rate to depreciate all of their assets in this class. The rates used by the banks ranged from 33.33% in straight-line, which gives useful life

of 3 years, to 20% in reducing balance basis, which gives useful life of 21+ years.

Intangible assets

Software is the primary form of intangible assets as capitalized by banks. This class normally represents a minor share of the assets.

Fifteen banks did not disclose any depreciation rate for software. These banks either do not capitalize expenditure for software, i.e. recognizes the amount as an expense in the Statement of Profit or Loss as incurred, or they recognize and depreciate the amount as part of IT equipment.

As shown Table 4, the banks that disclosed depreciation rates for software, they have adopted rates that give a useful life ranging from 3 years at 33% straight-line to 21 years at 20% reducing balance.

It is arguable if reducing balance, as adopted by two banks, is the appropriate method for depreciating software as these assets typically provides equal economic

benefits over their useful lives.

Vehicles

Assets in this class are far more straightforward than assets in previous four classes. As shown in Table 5, twenty-six banks applied a uniform rate for depreciating vehicles that is 20% in straight-line which gives five years of useful life. Three banks applied 20% in reducing balance that results 21 years of useful life.

Books

Only thirteen banks depreciate books as a separate class of assets even though the amount represents an insignificant portion of the total of tangible and intangible non-current assets. The depreciation rates adopted by the banks do not show any uniformity in rates or useful lives. As shown in Table 6, The rates adopted by the banks give useful life of the books ranging from 5 years to 44 years.

Table 3
Depreciation of IT and Office Equipment

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	15%	6.67	1
	20.00%	5	9
	12.5 / 15 / 20%	8 / 6.67 / 5	1
	20 / 30%	5 / 3.33	1
	20 / 33.33%	5 / 3	3
Reducing balance*	18.00%	23	1
	20%	21	10
Straight / Reducing*	20 / 20%	5 / 21	3
	25 / 20%	4 / 21	1

Source: Financial statements of the banks.

Table 4
Depreciation of Intangible Assets

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	5%	20	1
	10%	10	1
	20%	5	9
	20 - 33%	5 / 3	1
	25%	4	1
Reducing balance*	20%	21	2
Do not depreciate as separate asset or No mention of rate	-	-	15

Source: Financial statements of the banks.

Table 5
Depreciation of Vehicles

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	20%	5	26
	20 / 25%	5 / 4	1
Reducing balance*	20%	21	3

Source: Financial statements of the banks

Table 6
Depreciation of Books

Depreciation method	Depreciation rate	Years to fully depreciate	No. of banks
Straight line	10%	10	2
	20%	5	3
Reducing balance*	10%	44	2
	20%	21	4
	30%	13	2

Source: Financial statements of the banks.

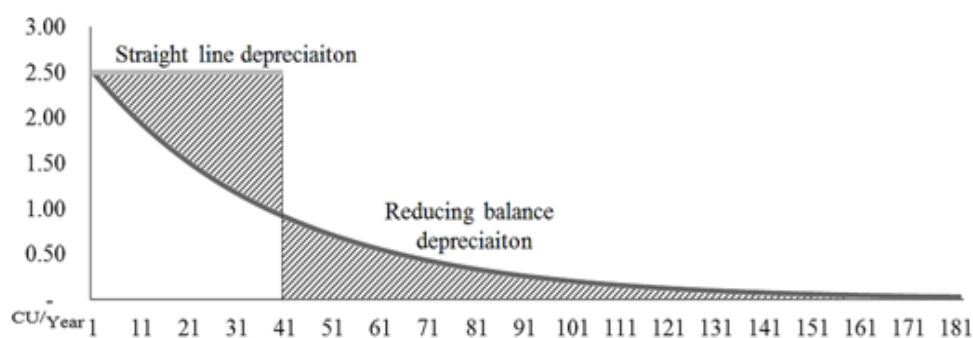


Figure 2
Difference in Depreciation if Rate is Same

Source: Data processed

Discussion of the Findings

A common observation is that the majority of the banks applied a uniform rate for depreciating their assets, however applying two different methods, thus giving greatly different useful lives and depreciation expenses.

- 2.5% applied by 25 banks for buildings, but 11 banks applied the rate in straight-line and 14 banks applied in reducing balance.
- 10% is the most popular rate for furniture and fixture assets as disclosed by the banks. This rate is applied by 28 banks. However, 10 banks apply the rate in straight-line method and 19 banks apply the rate in reducing balance method. One of the banks apply the rate in both methods.
- For IT and office equipment assets, 20% is used by almost all of the banks. Twenty-nine banks apply this rate; where 17 banks use straight-line and 14 banks use reducing balance method (3 banks use both methods).

This may indicate management of the banks has a silent intention to be comparable with other banks, but they differ in policies either due to misunderstanding of the effect or as part of deliberate earnings management.

Divergent in depreciation rates and asset's useful life results disparity in periodical depreciation expenses in the Statement of Profit or Loss and in carrying value of the assets in the Statement of Financial Position. For instance, at 2.5% in straight-line will allow an entity to fully depreciate an asset in 40 years' time, whereas at 2.5% in reducing balance an asset will be depreciated only 59.76% at the end of 40 years. At 2.5% reducing balance method, it will take 91 years for an asset's net book value to be equal to 10% of the capitalized amount, and 182 years to be equal to 1% the capitalized amount. The disparity is of similar extreme at other rates and methods.

The marked area in Figure 2 shows the difference in depreciation expense if different

methods applied even if the rate is same (2.5%). In this instance, the gap between depreciation expenses in two methods will continue to be widening till end of year-40. In year-40, depreciation expense in straight-line method will be 2.69 times of the depreciation expense in reducing balance method $\left(\frac{((2.5-0.93)/0.93)+1}{1}\right)$.

Uniform useful life but different method will not solve the issue of divergence. As Figure 3 illustrates, an asset if depreciated over 40 years but in two different methods, the depreciation expense will still be different.

Depreciation Commencement and Cessation Policy

Depreciation commencement policy

Depreciation commencement policies disclosed by the listed banks in Bangladesh represent a wide array of practices. None but one disclosed policy that is in exactitude of IFRS provisos; that is, commencement of depreciation from the day asset is available for use.

Six banks stated that they depreciate assets from the day of asset's acquisition. Five other banks disclosed that they depreciate assets from the day of asset's "addition" which may imply they too depreciate assets from the day of asset's acquisition. In practice, entities may require a lead time to bring an asset into available for use condition after its acquisition. Thus, the day an asset becomes available for use can be a later day than the day asset is acquired. Early commencement of depreciation charges may result in higher depreciation expense in the first year.

Depreciation from the day assets are put into use is the policy disclosed by one bank. In this instance, the predicament is, an asset doesn't necessarily put into use on the same day it becomes available for use. The former may happen on a later day. This policy may allow a reporting entity to defer depreciation commencement of an asset.

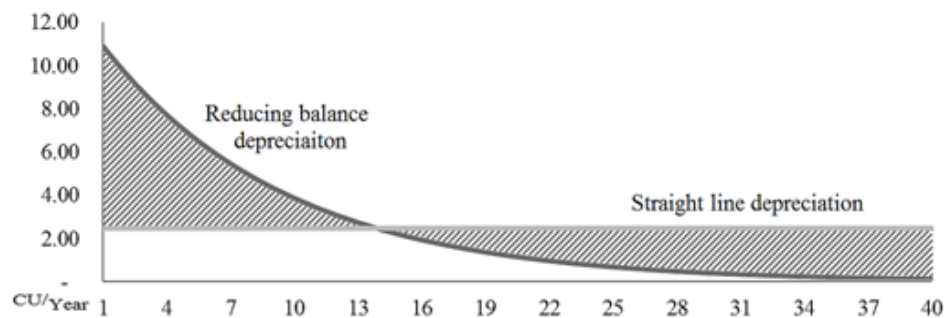


Figure 3
Difference in Depreciation if Life is Same
Source: Data processed

Table 7
Policies on commencement of depreciation

Depreciation begins:	No. of banks
From the date available for use	1
From the date of acquisition	6
From the date of addition	5
From the date put into use	1
Full month's depreciation	5
From the month of acquisition	3
From the following month of acquisition	2
Full year's depreciation	3
From the year of acquisition	2
From the following year of acquisition	1
No disclosure	2

Source: Financial statements of the banks.

Table 8
Policies on cessation of depreciation

Depreciation ceases:	No. of banks
On disposal	8
In the month of disposal	1
At end of previous month of disposal	8
In the previous year of disposal	5
No disclosure	8

Source: Financial statements of the banks.

Four banks stated that they charge full months depreciation in the month of asset's acquisition irrespective of the acquisition day in the month. One charges full month's depreciation if the asset is acquired within the first half of the month, otherwise do not charge any depreciation in that month. Three others stated their policy is to depreciate assets from the month of asset's acquisition, which may also imply that they charge full month's depreciation in the month of acquisition. These policies were acceptable prior to revision of IAS 16 and IAS 38, but do not reflect the clarification made in the revised IFRSs. These non-compliances may result over/understatement of depreciation expense in the first year.

Two banks disclosed that they depreciate assets from the following month of asset's acquisition. Among them, one bank applies this policy only for its building, and furniture and fixture assets. This can be a simplified and generalized approach of those banks to consider the lead time between asset acquisitions and available for use days. However, this may result an early or delayed commencement of depreciation expense.

Full year's depreciation charged by three banks in the year of asset's acquisition, as disclosed in their financial statements. Two among them apply this policy only if an asset is acquired within first nine months of the accounting year, otherwise do not charge any depreciation in that year. Two other banks disclosed that they depreciate assets from the year of asset's acquisition. In absence of further clarification, this may indicate that they also charge full year's depreciation in the year of asset's acquisition irrespective of the acquisition day in the year. One other bank's stated policy is to depreciate mechanical, and vehicle assets from the following year of their acquisition. These policies are farthest from that the revised IFRSs entails and likely to distort depreciation expense calculation in

severity. Table 7 lists the different policies on commencement of depreciation charge by the banks.

Depreciation cessation policy

Depreciation cessation policies are not as diverse or as ambiguous as it is in depreciation commencement policies. The scope of financial statement distortion is also limited in this case as consequences of departures from IFRS stipulations normally are smoothed out by the recognition of disposal gain/loss in the same period. However, any departures from IFRS stipulations may distort depreciation expense, and disposal gain/loss line amounts reported in the financial statements.

IFRS based reporting entities are required to cease depreciation at the point of asset's disposal. This is the stated policy of eight banks. One other bank's stated policy is to cease depreciation in the month of asset's disposal. This may hint that they too cease depreciation on disposal.

Eight banks do not depreciate assets from/in the month of asset's disposal, as per their disclosure. No depreciation in the year of asset disposal is the policy adopted by five other banks. These policies are in the departure of precise IFRS requisites, which may result understatement of depreciation expense, but overstatement of disposal gain, in the year of asset disposal. Table 8 lists the different policies on cessation of depreciation charge by the banks.

Discussion of the findings

Prior to revised IAS 16, issued in 2003, IFRS based reporting entities were flexible in commencing depreciation of an asset. However, the revised IAS 16 made it clear that entities shall commence depreciation when an asset is available for use. Departure from this requirement represents that management of the listed banks either are not aware of the clarification made in the revised IAS 16 or they

choose to continue what they have been doing previously.

4. CONCLUSION, IMPLICATION, SUGGESTION AND LIMITATION

This research finds that despite increasing effort by accounting standard setters and pressure groups to achieve IFRS-compliance and harmonization in accounting practices, non-compliance and divergence still exists. This research also finds that the divergence in depreciation practices can be of enough significance to negate comparability.

While adopting a depreciation policy for an asset, banks cannot ignore the reality of an asset's use pattern just because it might make a dent in the bank's reported profit or will not help to report desired financial performance. The concept of prudence does not either justify deliberate understatement of asset values by making prompt depreciation.

The IASB has adopted principles-based approach rather than rules-based approach in establishing its accounting standards. Hence, in IFRS based reporting environment a greater degree of professional judgment is required. It may not be practical for the IASB to suggest any specific useful life or depreciation method for a particular class of asset as it can greatly vary based on geographical location and economic condition of a jurisdiction. The national accounting standard setters or the regulators can assume this responsibility as they are more aware of the business model in their jurisdiction. However, the IASB can include financial reporting consequences of available alternatives to clarify the effect of each alternative.

Banking sector in Bangladesh can be considered as lot younger than many of the established economies. This indicates accounting policies of many yet to be shaped into proper, and efforts to be made towards standardization of the accounting policies. For individual banks it may not be possible to coordinate or influence other banks to come up with uniform or relatively similar depreciation policies in depreciating similar class of assets. The Central Bank as the primary regulator of the banks can advise banks what shall be the ideal depreciation rate and useful life for a particular type of asset.

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