

Positive Accounting Theory and Changes in Accounting Principles: An Exploratory Inquiry into Bangladeshi Listed Companies

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ABSTRACT

In this study the author endeavors to explore the idea of positive accounting theory and changes in accounting principles from the perspective of corporate Bangladesh. In practice, accounting principles and their variant idioms like accounting concepts, accounting methods, accounting estimates, accounting policies etc. are not practiced consistently, either vertically (year to year) or horizontally (organization to organization). The reasons behind this inconsistent practice are of two major types – one is the non-voluntary which derives from practical reality and the other is voluntary which is practiced by the managers for some private gains even jeopardizing the investors, lenders, tax/other regulatory authorities and all other stakeholders at large. This study makes an effort to explore the various changes in accounting principles as reported in the financial statements of Bangladeshi listed companies and the status of positive accounting in Bangladesh. Besides, this exploratory study attempts to explain the various changes in accounting policies which is itself a substratum of positive accounting. It is widely accepted that accounting studies is one of the most practical disciplines but there is a substantial difference between organizational practice of accounting and its pedagogic discourse which was also revealed in this study.

Key Words: Accounting Change, Positive Accounting, Creative Accounting, Political Costs, Earnings Management, Accounting Scandals, Political Economy of Smooth Earnings.

INTRODUCTION

The merchants in the ancient periods were and today's CEOs of complex business world are introduced to the solemnity and weight of performance system at the inception of their duty to sell their business at a good value. And particularly, today's extreme competition to outsmart the rivals and the corporate cannibalism are making the executives fanatical to perform superbly which induce them sometimes to run

cosmetic surgery on their financial reporting. The purpose of this discourse was to explore various changes made in the accounting principles to report the managers' desired performance. This study tried to open the Pandora's Box regarding positive accounting theory and changes in accounting principles in Bangladesh corporate sphere. The primary objective of the Sarbanes-Oxley Act of 2002 was to improve the accuracy and reliability of corporate reporting along with due disclosures. Managers may choose to exploit their privileged position for private gain by managing financial reporting in their own favor. Various research studies have examined the issue of management motivation towards creative accounting behavior. More than half a century ago, Hepworth (1953) finds smoothing as a reasonable and wise action by which managers smooth their income by using specific means. In this regard, it is noteworthy to mention that income smoothing exercised by the managers satisfied a portion of the all the stakeholders and the other portion would be maltreated. Like income would be reported such a way to set the tax burden as minimum as possible, whereas confidence of the shareholders would be intact by reporting steady growth of the income i.e. no abrupt changes and employees' feeling would be pleased by keeping their trend of entire remuneration package upward. Tax is a significant motivator behind creative accounting or earning management (Niskanen and Keloharju, 2000). Other motivations for creative accounting discussed by Healy and Wahlen (1999) include those provided when significant capital market transactions are anticipated, and when there is a gap between the actual performance of the firm and analysts' expectations; besides, managers try to maintain smooth earnings for making their position stronger in their companies. Dharan and Lev (1993) report on a study showing poor share price performance in the years following income increasing accounting changes. In a good performing year accountants will not be fooled to change their accounting policies without any special reasons. There is no such type of study on positive accounting along with changes in accounting policies is conducted yet on Corporate Bangladesh; so this exploratory study would open the avenue for further work in this regard.

PROBLEM STATEMENT

Applications of different accounting alternatives by a single company in different years or similar types of companies belong to the same industry in the same year diminish the essence of accounting standards of performance measurement. It also weakens the comparability of financial information between different periods for same company and even in the same period for different companies; they also obscure useful historical trend data. These altogether results sub-optimal decisions if anyone takes decision based on these inconsistent financial statements due to

changes made in the accounting principle along with adoption of various earnings management mechanisms.

The conceptual framework of both - Financial Accounting Standards Board (FASB) of the United States of America (USA) and the International Accounting Standards Committee (IASC) of the United Kingdom (UK) states comparability along with consistency as one of the most crucial characteristics that contributes to the usefulness of accounting information. By saying that FASB and IASC – both are prescribing various alternative methods for treating a single accounting transaction along with their benchmark treatment. The executives are taking the chance of these alternative methods as they choose their preferred accounting methods. The most obvious reason behind changing of accounting methods is earning management. On the contrary, a few companies find it difficult to maintain comparability and consistency in using their accounting methods due to some unavoidable reasons, as for example, due to the numerous changes in accounting principles mandated by the FASB or IASC though it is the least possible reason behind changing accounting principles. Whatever may be the case, the companies should provide adequate disclosure where they would inform all the stakeholders about the changes and their effects on the financial results; with such information, investors and analysts can compare current results with those of prior periods and can make a more informed assessment about the company's future prospects.

Positive accounting established its wing as an academic school of thought by works of Ross Watts and Jerold Zimmerman (1990) in 1978 and 1986 at the William E. Simon School of Business Administration of the University of Rochester. They also founded the Journal of Accounting and Economics in 1979. Positive Accounting Theory endeavors to make a wise prediction of the real world events and translates them to accounting transactions; while normative theories tend to recommend what should or would be done. Positive accounting would be a well reflected form of contractual portrayal of a firm and the firm would be viewed as a nexus of contracts and accounting tools are the aids to facilitate the formation and performance of the contracts. This contractual attributes of a firm would be compared with the view of Yale University Professor Shyam Sunder(1997) as he also viewed each organization as a set of contracts among employees, customers, managers, shareholders, suppliers, auditors etc., where each party seeks its goals through exchange of resources with the organization and accounting helps implementing and enforcing this contract set by tracking resource inflows and outflows, furnishing information about fulfillment of contracts.

In Bangladesh, however, neither there have been any seminal discussions in the academic, policy and neither corporate levels nor any substantial works have carried out on positive accounting and change of accounting principles though a good work

on Creative Accounting in Bangladesh and Global Perspectives were carried out by Sen and Inanga (2008). This vacuum does suggest studies on this topic from the perspective of corporate Bangladesh are very much crucial to commission to reveal the financial reporting chemistry of companies of Bangladesh, the burgeoning economy.

BACKGROUND OF THE SUBJECT MATTER AND SIGNIFICANCE OF THE STUDY

Background and Significance of the Study for the World at large

Changes in Accounting Principles are allowed by any accounting board of the globe, like by the Financial Accounting Standard Board (FASB) of the United States of America (USA) and the International Accounting Standards Committee (IASC) of the United Kingdom (UK). This provision has been kept in the financial reporting standards of all the countries of the world as they are very crucial to adapt in case of any actual change of the organization and change of nature of any transactions and change of practical reality. But, accountants and managers from all countries are using them to realize their private gains even by putting the organizations in danger along with weakening the interest of other stakeholders like the investors, lenders and national revenue department. To mark a line of demarcation between the crooked accounting practice and ethical standard accounting behavior, the fields of creative accounting, positive accounting and a good number of their alternative terminologies are brought to table for discussion. Now-a-days, accounting scandals are everywhere and it has been threatening the sustainable survival of the corporate hegemony of the capitalist world.

Scandals and corruption in corporate business are not limited to inside the corporate houses; rather the wings of corruption extend up to the custodians of corporate business - the external, statutory and independent auditors and the following paragraphs entail a few of these instances.

All the stakeholders including investors are not safe at all as they are not sure whether they would protect their base investment due to not only the market volatility but also financial reporting risk; besides, the stand alone risk exposure from earnings management by the managers or accountants are very material. In this regard, no endorsement carries more weight than an investment by Warren Buffett. He became the world's second richest person by buying safe, reliable businesses and holding them forever. So when his company increased in stake in Tesco to 5% in 2012, it sent a strong message that the giant British grocer would rebound from its disastrous attempt to compete in America (The Economist, December 13, 2014) by cooking the accounting books of the company. Warren Buffett anticipated rightly

this matter because on December 9, 2014 Tesco was caught for its dodgy accounting and subsequently it reduced its profit forecast by 30% and Warren Buffett's firm lost US\$750 million.

It is not the managers, who are only liable for this corrupt accounting practice; the auditors are also crooked as they provide clean audit reports ignoring the material flaws in the financial statements. No sooner did the news break than the spotlight fell on PricewaterhouseCoopers (PWC), one of the "Big Four" global accounting firms/networks (the other big three are Deloitte, Ernst & Young/EY, and KPMG). Tesco had paid PWC UK Pound 10.4 million to sign off on its audited financial statements of 2013 and PWC gave a clean audit though there was massive accounting anomaly was there in the books of Tesco.

PWC's failure to detect the problem is not an isolated case; rather it has taken its rife since 2001 – 2002 when Enron scandal came into public and its corrupt audit firm, Arthur Andersen imploded. The situation is graver still in emerging markets. In 2009 Satyam, an Indian technology company admitted it had faked over US\$1 billion cash on its books. North American exchanges have delisted more than 100 Chinese firms in recent years because of accounting problems. In 2010 Jon Carnes, a short seller sent a cameraman to a biodiesel factory that China Integrated Energy (a KPMG client) said was producing at full blast, and found it had been dormant for months. The next year Muddy Waters, a research firm, discovered that much of the timber Sino-Forest (audited by Ernst & Young/EY) claimed to own did not exist. Both companies lost over 95% of their value. So, it is very clear that auditors are accomplices of the accountants in cooking books.

Especial significance of this study particularly for Bangladesh

Bangladesh Corporate Sector has been suffering from extreme dehydration of financial liquidity, capital markets are hovering around the rock bottom, the erstwhile skyrocketing stock and real estate price as well reached at its all-time low, interest on deposit fall down from 14% to 9%, and all the banks are on the banks of credit crunch.

Corporate Bangladesh is in a too fix to fix the problem. Stock market, real estate and employment are in dire situation. Banks are sitting idle on their money that are procured at a high price as no significant response from the borrowers, rather the few are on the cue to take the loans. Because, they do not feel confident to borrow money at rate which is not affordable at all to the borrowers (as for an instance, about five years ago, banks typically provided an amount of loan which was equivalent to 70% to 80% of the real estate value at a single-digit rate of interest, but at present the scenario has changed drastically, because now at best 40% - 50% of property value is given as property loan at an interest rate of 16% to 18%; whereas the property

value does plunge down and as the market looks gloomy, lenders demand more collateral setting off an overall credit crunch. A good number of banks are overly stressed with their liquidity and solvency as well.

Is it like the implosion of the giant subprime mortgage lenders in 2007 or like the collapse of Lehman Brothers in 2008? Or is this like the crisis hit Amsterdam in 1772, after a respected Dutch investment syndicate made a disastrous bet on shares of the British East India Company, which was operating in Kolkata (erstwhile Calcutta), Bengal Presidency of British India (Koudijs and Voth, 2014)?

The present financial scandal contagion engulfs all the corporate skyline of Bangladesh and a glimpse is as follows:

Scandals are ubiquitous - from corporate IPO (initial public offering) and stock exchange crash in 1996 and 2010 to banking scandal like Oriental Bank, BASIC Bank, Sonali Bank, and multilevel marketing scam like Destiny 2000.

In May 2012, a report from the Bangladesh Bank (the central bank of Bangladesh) revealed that the Ruposhi Bangla Hotel Branch of the state run Sonali Bank, Bangladesh's largest commercial bank, illegally distributed (as loans) Taka 36.48 billion (US\$460 million) during 2010 – 2012 and all of them were fake loans. The largest share of Taka 26.86 billion (US\$340 million) went to the notorious Hall-Mark Group. Other companies that benefited include: (1) T and Brothers, Taka 6.10 billion; (2) Paragon Group, Taka 1.47 billion; (3) Nakshi Knit, Taka 660 million; (4) DN Sports, Taka 330 million; (5) Khanjahan Ali, Taka 50 million

This is considered to be the country's largest banking scandal. It dwarfs previous fraud cases, such as a Taka 6.2 billion Letter of Credit fraud in Chittagong in 2007, a Taka 5.96 billion fraudulent withdrawal from Oriental Bank in 2006, and a Taka 3 billion forgery scandal in 2002: although it is still smaller than the recent Destiny Group multilevel marketing scam, which is estimated at Taka 45 billion (Farashuddin, 2012).

Besides, a good number of accounting scandals are happening everywhere in Bangladesh as managers are preparing the financial statements reflecting their private gains and use them to prepare the prospects required during the time of going public or initial public offer (IPO), to prepare the proposals for taking loans from banks and merger & acquisition deals, even in the time of giving the financial statements to the auditors to get them audited. Here, sometimes, auditors do not scrutinize the whole stuff and the managers pass through the auditors with their cooked books. The proofs of these cooked books are antecedents of the above corporate scandals.

This corporate abysmal performance and fake accounting practice envisage a period of mayhem for earnings management via exploitation of various alternative and creative accounting treatments to smoothen the performance. So, it would be a

novel idea to explore about positive accounting and changes of accounting principles in Bangladesh.

OBJECTIVE

No accounting hegemony (like either IASC or FASB) provides holistic and comprehensive accounting standards which derives a unidirectional approach to process entire financial transactions. Besides, lack of comprehensive congruity of accounting standards means different treatments are allowed for transactions. Any changes or modification in the accounting principles of a corporation can have a significant impact in the decision making process of its stakeholders. Therefore, the purpose of this study is to describe about the parameters of accounting policy changes along with the status of the industry practice in real life where accounting policies are changed to show better financial position and performance resulting private gain of the managers.

REVIEW OF RELEVANT LITERATURE

Creative Accounting

Creative Accounting is an accounting practice which recognizes the revenue in a way that makes a company look better than what it would actually be and one of the prime motives behind creative accounting is to inflate stock prices, for example, it strives for reporting as much profit as possible by changing the accounting methods to its favor. There are some variations in defining the term, creative accounting. Creative accounting refers to the use of accounting knowledge to influence the reporting figures, while remaining within jurisdiction of accounting rules and laws, so that instead of showing the actual performance and position of the company, they reflect what the management wants to tell the stakeholders". (Birjes Yadav 2013). "Creative accounting is a process whereby accountants use their use of accounting rules to manipulate the figures reported in the accounts of a business" (Oriol Amat ; John Blake; Jack Dowds, 2000).

Change in accounting principles

By definition, a change in accounting principles involves a change from one generally accepted accounting principle to another. As for example, change of method of revenue recognition for long-term construction contracts from the completed-contract to the percentage-of-completion method. But, adoption of a new principle in recognition of events that have occurred for the first time or that were previously

immaterial is not an accounting change.

It is important to make a distinction between change in accounting principle and correction of an error. As for an example, what if a company previously followed an accounting principle that was not acceptable (or if the company applied a principle incorrectly)? And, this unacceptable one is nothing else but an error! In such cases, the accounting profession considers a change to a generally accepted accounting principle from the earlier unacceptable one is called a correction of error.

Positive Accounting Theory

Contemporary financial accounting research began flourishing in the 1960s when Ball and Brown (1968), Beaver (1968), and others introduced empirical finance methods to financial accounting. The subsequent literature adopted the assumption that accounting numbers “information perspective” to investigate the relation between accounting numbers supply information for security market investment decisions and used this information perspective to investigate the relation between accounting numbers and stock prices. Besides, accounting numbers have a good number of other usages along with the trending security market analysis as stated in the paragraphs beneath.

Accounting numbers are also used to measure the performance of the executive and the other workforce including the labor of the organization. Managers’ compensation and the pertinent increment of compensation depend on accounting numbers. The usage of accounting numbers in bonus plans suggested the possibility of accounting choice which would affect the financial wealth of the organization, so would be the interest of the researchers to employ various accounting choices to know reasons behind choosing a particular accounting method to influence the executive compensation. In this respect, Watts and Zimmerman (1978) would be given the extraordinary credit to examine this first.

Positive accounting is very much different from conservative accounting approach because it assumes that conservative accounting yields sub-optimal results. Conservative accounting requires lower magnitude of verifiability to recognize losses whereas it requires very high degree of verifiability to recognize gains (Basu, 2009). The contractual view of positive accounting puts it in tension with value relevance studies in accounting. Positive accounting considers that accounting’s primary role is to value the firm which indicates that positive accounting favors efficiency perspective which emphasizes how various managers choose accounting methods that show a true representation of the firm’s performance.

This efficiency perspective of positive accounting can be explained alternatively through the opportunistic perspective which hold the view that managers, who are agents to the owners (shareholders, represented by the board of directors), act to their

self-interests. They only adopt accounting policies that allow them to benefit and they think what is good for them is also good for the firms. In this regard, different types of hypothesis exist such as political cost, bonus plan, and debt hypothesis that reveal the motives of the managers in choosing one accounting method over another.

Bonus scheme or compensation hypothesis

The management compensation hypothesis affirms that managers who have accounting incentives, or their remuneration that is attached with the firm's accounting performance will tend to maneuver accounting method in a way which will reflect better accounting figures that they would be; in this regard, methods of depreciation, uncollectible allowance and research & development costs would be treated in a way which will incentivize the managers.

Debt-equity hypothesis

The debt-equity hypothesis states that managers will tend to cook the financial statements which show better profits as similar to the bonus plan with the anticipation of having a better performance and liquidity position which will exhibit better condition to pay the interest and principal of the debt owners.

Political cost hypothesis

The political cost hypothesis presumes that firms will tend to decorate their financial statements in a way which does not attract the attention of the politicians, policy makers so that no adverse or extra regulations in respect of tax or compliances are imposed.

What are the other factors that motivate companies to change accounting methods? First and foremost generalized answer to this question is managers have self-interest in how the financial statements make the company look. They naturally wish to show their financial performance in the best light. A favorable profit picture can influence investors, and a strong liquidity position can influence creditors. Too favorable a profit picture, however, can provide union negotiators and government regulators with ammunition during bargaining talks. Watts and Zimmerman (1990) paved the foundation stone of positive accounting theory and they epitomized the phenomenon of positive accounting theory. Hence, managers might have varying motives for reporting income numbers. Research has provided additional insights into why companies may prefer certain accounting methods over others and the reasons behind them are as follows:

Political Costs

As companies become larger and more politically visible, politicians and regulators devote more attention to them. The larger the firm, the more likely it is to become subject to regulation such as antitrust, and the more likely it is to be required to pay higher taxes. Therefore, companies that are politically visible may seek to report low income numbers, to avoid the scrutiny of regulators. In addition, other constituents, such as labor unions, may be less willing to ask for wage increases if reported income is low. Researchers have found that the larger the company, the more likely it is to adopt income-decreasing approaches in selecting accounting methods.

Capital structure

A number of studies have indicated that the capital structure of the company can affect the selection of accounting methods. For example, a company with high debt to equity ratio is more likely to be constrained by debt covenants. The debt covenant may indicate that the company cannot pay dividends if retained earnings fall below a certain level. As a result, such a company is more likely to select accounting methods that will increase net income.

Bonus payments

Studies have found that if compensation plans tie managers' bonus payments to income, management will select accounting methods that maximize their bonus payments.

Manage or smooth earnings

Substantial earnings increase attract the attention of politicians, regulators, and competitors,. In addition, a large increase in income is difficult to achieve in following years. Further, executive compensation plans would use these higher numbers as a baseline and make it difficult for managers to earn bonuses in subsequent years. Conversely, investors and competitors might view large decreases in earnings as a signal that they company is in financial trouble. Also, substantial decreases in income raise concerns on the part of stockholders, lenders, and other interested parties about the competency of management. For all these reasons, companies have an incentive to "manage" or "smooth" earnings. In general, management tends to believe that a steady (say 10% for an example) growth per year is much better than a 30% growth one year and a 10% decline next *year*.

LIMITATION OF THE STUDY

This study is an exploratory one as there is no substantial work on the area is a common place in Bangladesh. The author was not able to get any established *modus operandi* to conduct this study; rather the methodology was developed by the author

which would not be embedded on the rigor of analytics.

DEVELOPMENT OF CONCEPT FRAMEWORK

After reviewing the relevant literature, the author has set the scope of this study as follows:

The avenues for creative accounting along with changing of accounting principles

There are a good number of means where creative accounting and change of accounting principles would take place and a few of them are stated below.

Tangible assets

“Subjective depreciation” of assets creates proper field of creative accounting where accountants hold ample opportunity to estimate the salvage value of the assets which will incentivize more. Because, there are a good number of wild guessing points like recoverable amount and useful life of the assets along with the estimation of impairment if there is any.

Goodwill

Goodwill provides the substantial silo where a huge shadowy heap would be stored and would be utilized as per the requirement of the accountants to make the financial statements to their turn. In this day of frequent merger and acquisition (selling and buying of business) goodwill is a very good recipe for creative accounting. Besides, goodwill is derived through purchasing is a very infrequent even, rather it is created very now and then by underestimation of assets purchased. The story does not stop here, various methods of capitalization and depreciation of goodwill during its useful life adopted by the managers influence the financial performance of the firm in the way they want to have.

Depreciation (and amortization)

Various options for depreciation methods have significant impact on the financial statements over the entire period of useful economic life of an asset. Thus, each different method of depreciation has different impact on outcome. Besides, there is no strict requisite to comply with a specific method of depreciation; rather the accountants use their own favorable method(s).

Inventories

The inventory provides sufficient opportunities for creative accounting and subjectivism. The under estimation or over estimation of stock finally has an impact not only on the financial statements of current year but also on the following year.

Provisions for uncollectible (bad debt), liabilities and charges

This provision is an effective tool for “leveling outcome”. Accountants become excessively liberal or extremely conservative as per their requirement of cooking the

accounting books.

Construction contracts

Choosing between the two methods of accounting for construction contracts has the following impact on the profit and loss: - Under the completed contracts, the result will be recognized after the completion of contract; while in method based on percentage of definitive result will be staggered over time, throughout the progress of the contract. Besides, switching from one method to another method also impact on profit and loss account.

The potential conduit for creative accounting is found in six principal areas stated beneath

Regulatory flexibility, a dearth of active regulation, a scope for managerial discretion or judgment in respect of assumptions, the timing of some transactions, the use of artificial transactions and finally the reclassification and presentation of financial numbers in a desired (not objective) manner. Even in a highly regulated accounting environment such as the USA, a great deal of flexibility is available (Largay, 2002; Mulford and Comiskey, 2002).

The potential for Creative Accounting may be found in six principal areas, regulatory flexibility, dearth of regulation, and managerial judgment of assumptions about the future, the timing of some transactions, the use of artificial transactions, and the reclassification and presentation of financial numbers.

- Regulatory flexibility - Accounting regulation often permits a choice between or among the available alternative treatments; for example, in respect of asset valuation (International Accounting Standards permit a choice between carrying non-current assets at either revalued amounts or cost less accumulated depreciation). Business managers, quite validly, change their accounting policies from one to another not with the view of meeting the substance of reality, rather they use for their private gain.

- Dearth of regulation – Some of the financial reporting areas are simply not fully regulated. For example, in the developing countries, particularly in Bangladesh there are sheer dearth of mandatory requirements in respect of accounting for stock options, pension scheme, and a good number of others like the specific accounting procedures for various financial instruments are yet developed in Bangladesh.

- Management has considerable scope for estimation in discretionary areas - McNichols and Wilson (1988), for example, examine the discretionary and non- discretionary elements of the bad debts provision and found there plenty scope for cooking the books.

- Genuine transactions can also be timed in a purposeful to give the desired

(not objective) impression of the managers in the accounts. As for an example, suppose a business has an investment at historical cost which can easily be sold for a higher sales price, being the current value. The managers of the business are free to choose between buying price and market price to record in the financial statements.

- Artificial transactions can be entered into the financial statements: By incorporating artificial transactions both the balance sheet and income statement can be manipulated. This is achieved by entering into two or more related transactions with an obliging external party, normally a bank. For an example, supposing an arrangement is made to sell an asset to a bank then lease that asset back for the rest of its useful life. The sale price under such a 'sale and leaseback' can be pitched above or below the current value of the asset, because the difference can be compensated for by increased or reduced rentals.

- Reclassification and presentation of financial numbers are relatively under-explored in the literature. However, the study by Gramlich et al. (2001) suggests that firms may engage in balance sheet manipulation to reclassify liabilities in order to smooth reported liquidity and leverage ratios.

- Some other reasons behind practicing change in accounting have been discussed widely and they are-

- To Meet Internal Targets: The managers want to cook the books for meeting internal targets set by higher management with respect to sales, profitability and share prices.

- Meet External Expectations Company has to face many expectations from its stakeholders. The Employees and customers want long term survival of the company for their interests. Suppliers want assurance about the payment and long term relationships with the company. Company also wants to meet analyst's forecasts and dividend payout pattern.

- Provide Income Smoothing Companies want to show steady income stream to impress the investors and to keep the share prices stable. Advocates of this approach favor it on account of measure against the 'short-termism' of evaluating an investment on the basis of the immediate yields. It also avoids raising expectations too high to be met by the management.

- Window Dressing for an IPO or a Loan The window dressing can be done before corporate events like IPO, acquisition or before taking a loan. Reports the tendency of companies nearing violation of debt covenants is twice or thrice to make income increasing accounting policy changes than other companies.

- Taxation The creative accounting may also be a result of desire for some

tax benefit especially when taxable income is measured through accounting numbers.

- Change in Management There is another important tendency of new managers to show losses due to poor management of old management by some provisions. Found this tendency in US bank.

METHODOLOGY

This part of the report illustrates the methodology employed to conduct this study. As this is an explorative study no rigorous empirical investigation.

Sampling frame

As this study was focused on listed companies in Bangladesh listed with Dhaka and Chittagong Stock Exchanges of Bangladesh, so the sampling frame includes all Bangladeshi listed companies.

Sampling unit

Annual Reports of the Bangladeshi listed companies constitute the sampling units for this study

Parameters of interest

As the topic of this study is about the changes of accounting principles, the key accounting policies which are subject to frequent changes are the parameters of interest and they are basis of preparation of financial statements, recognition of property, plant and equipment and their depreciation, , measurement basis, revenue recognition, valuation of inventories, account receivables & the respective uncollectible accounts. Besides, for Banking companies and Non-Bank Financial Institutions, the provisions for various loan products with the classifications of unclassified and classified groupings are also added as the parameters of interest.

Sampling method

Convenience sampling was chosen for this study so that data would be available for the same reporting time horizon for all the chosen companies.

Sample size

This study focused on the three sectors - Pharmaceuticals, Banking and Non-

Banking Financial Institutions and leasing companies. Ten companies from each sector were taken and the time periods cover 2009-2013 resulting 30 different companies and five annual reports for each company under study. Besides, the names of the companies are not disclosed here to maintain the professional confidentiality but the author has all the required data which is already published in their financial statements and disclosed as well in the public domain.

Data source

The data for the study were collected from the annual reports of the chosen available at the Dhaka Stock Exchange Library.

Study type

This study is mere an exploratory one, so no established method of research has followed here as there is none like that particularly from the perspective of Bangladeshi listed companies. This study entails a review of relevant literature and relies on published secondary data derived from the annual reports of the sample companies.

DATA ANALYSIS, FINDINGS AND INTERPRETATION

Change of Accounting Policies and Methods

As the study is conducted to examine the change of accounting policies reported in the financial statements of the companies listed in Dhaka Stock Exchange (DSE), financial statements were analyzed for 30 companies (as stated in the methodology section) for the time period of 2009 to 2013 through collection of 150 annual reports from DSE Library. Changes were found from the analysis, and change of accounting policies, particularly on the following 10 attributes is stated in the table below.

Table I: Change of Accounting Policies and Methods:

Items Type	Frequency	%
Depreciation - Rate	23	25.84
Depreciation - Method	9	10.11
Revenue recognition	11	12.36
Measurement basis	7	7.87
Impairment of Assets	4	4.45
Recognition & disposal of property, plant & equipment	12	13.48
Employee benefit	3	3.3
Basis of preparation	2	2.25
Receivables and Provisions	13	14.61
Inventories	5	5.73
Total	89	100%

Interpretations

It is very obvious from the Table I that the changes of accounting policies and methods are not infrequent events; rather they are substantial in nature and quantum as well. Besides, the changes of both rate and method of depreciation, recognition and disposal of property, plant & equipment and accounts receivables & provisions are of special mention because through these changes managers manage the earnings as per their desires and few of the cases, the changes are made to meet the reality.

Data on Depreciation of various Assets of Pharmaceutical Companies

Table II—Annual Depreciation Rates on different assets of 10 Pharmaceutical Companies

Items	Pharma 1	Pharma 2	Pharma 3	Pharma 4	Pharma 5	Pharma 6	Pharma 7	Pharma 8	Pharma 9	Pharma 10	Average	Variance	Standard Deviation	Median	Range
Depreciation on											Deviation				
Building	10%	6%	2.50%	2.50%	10%	25%	2.50%	3%	5%	5%	7%	0.043	0.2068	5%	22.50%
Plant & Machinery	15%	10%	7%	10%	10%	12%	7%	10%	15%	7%	10%	0.008	0.0895	10%	8%
Equipment	10%	12%	15%	10%	15%	9%	10%	20%	10%	20%	13%	0.016	0.1261	11%	11%
Computer	10%	12%	30%	10%	15%	9%	10%	20%	10%	20%	15%	0.042	0.2045	11%	21%
Furniture & fixture	10%	10%	10%	10%	15%	10%	10%	10%	10%	10%	11%	0.002	0.0474	10%	5%
Motor Vehicle	20%	20%	25%	20%	20%	25%	20%	10%	20%	20%	20%	0.015	0.1225	20%	15%

Interpretations

Table II provides a very clear idea regarding how the companies exercise the earnings management. As for an instance, where the average rate of depreciation on building is 7% along with median value of 5% which is quite justifiable, but the range is 22.5% with the maximum value and minimum value are 25% and 2.5% respectively. This is a very extreme situation because 70% of the sample companies are using less than 5% rate where a big pharmaceutical company is using 25% rate of depreciation which means 4-year useful life of the buildings. Besides, two companies are using 10% rate of depreciation which means 10-year useful life of the buildings. If this are required for practical and real causes, it has to be disclosed in details describing the due reasons otherwise this is a serious earnings management case for some specific private gain. Similar critics would be made for another Pharmaceutical Company⁷ here which is applying entire the rates of depreciation for all assets at a very low rate to reduce their expense and increase their profit and they have curtailed the rates of depreciations of all assets by about 50% in 2013 from 2012.

Data on Depreciation of various Assets of Banking Companies

Table III – Annual Depreciation Rates on different assets of 10 Banking Companies

Items	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8	Bank 9	Bank 10	Average	Variance	Standard Deviation	Median	Range
Depreciation on															
Building	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	5%	2.50%	3%	2.50%	2.80%	0.0006	0.0237	2.50%	2.50%
Furniture & Fixture	10%	10%	10%	10%	15%	10%	20%	10%	12%	10%	11.70%	0.01	0.1	10.00%	10%
Machine & Equipment	20%	20%	20%	20%	20%	15%	20%	20%	17%	20%	19.20%	0.0028	0.0525	20.00%	5%
Software	20%	0	5%	0	20%	20%	20%	20%	33%	0	13.80%	0.121	0.3478	20.00%	28%
Vehicle	20%	20%	20%	20%	20%	20%	20%	20%	20%	20%	20.00%	0	0	20.00%	0%
Computer	33%	20%	20%	20%	20%	20%	20%	20%	20%	33%	22.60%	0.027	0.1644	20.00%	13%

Interpretations

Most of the banks use similar rates of depreciation for depreciating the assets over their useful lives though a few use very extreme rates to managing the income as per their requirement. The extreme range exists for software which is 28% as one bank uses 33% and the other bank uses 5% rate for depreciating software though all other banks use 20% rate of depreciation for software. In case of depreciating building, every bank except one bank uses 2.5% rate of depreciation and the other bank uses the double rate which is 5%. On the contrary, in case of computer, two banks use

33% rate for depreciation while all other banks use the rate, 20%. Likewise, for the rate of depreciation of furniture and fixture, both the median and mean value are about to 10%, but two banks use 15% and 20% respectively.

Data on Depreciation of various Assets of Leasing Companies

Table IV – Annual Depreciation Rates on different assets of 10 Leasing Companies

Items	Lease 1	Lease 2	Lease 3	Lease 4	Lease 5	Lease 6	Lease 7	Lease 8	Lease 9	Lease 10	Average	Variance	Standard Deviation	Median	Range
Depreciation															
Building	2.50%		10%		10%	10%	5%				7.50%	0.0331	0.182	10%	7.50%
Furniture & Fixture	12.50%	12.50%	10%	15%	10%	5%	12.50%	12.50%	10%	18%	11.80%	0.0107	0.103	12.50%	13%
Equipment	20%	20%	20%	20%	20%	20%	20%	17%	15%	20%	19.20%	0.0028	0.053	20%	5%
Computer	20%	20%	20%			20%	20%			10%	18.33%	0.1428	0.378	20%	10%
Motor Vehicle	25%	25%	20%	25%	20%	20%	25%	20%	20%	20%	22.00%	0.006	0.077	20%	5%
Software	25%	20%							15%	10%	17.50%	0.1963	0.443	17.50%	15%

Interpretations

Most of the leasing companies use 20% rate of depreciation for depreciating computer over their useful lives of 5-year but one leasing company uses only half of 20% i.e. 10% rate of depreciation which is too low to provide a justifiable amount of depreciation, rather here the company reduces the expenses to increase profit and they also use 10% rate of depreciation for depreciating software. Besides, one leasing company uses 5% rate of depreciation for furniture which is also too low. These altogether shows the existence of earning management attitude of the managers.

Data on Provisions on various Classes of Loan Products of Leasing Companies

Table V – Equal Rates for providing provisions on various loan-products for both banking and leasing companies

Classification of loans	Unclassified General Loan	Unclassified SME loan	Unclassified Loan for housing finance & professionals	Unclassified Consumer Loan	Short term agree and micro credit	Special Mention Account	Sub-standard general loans and advances	Doubtful Loan	Bad or Loss Loan
Rate of Provision	1%	0.25%	2%	5%	5%	5%	20%	50%	100%

Interpretations

All the rates for providing provisions on various loan-products for both banking and leasing companies are exactly same and the reason behind this is that these two sectors – banking and leasing are under the strict regulatory regime of central

bank. And, these are the minimum rates prescribed by Bangladesh Bank, Central Bank of the country and they are under the intensive monitoring and scrutiny of Bangladesh Bank and all the companies of these two sectors are to report monthly and compulsorily to Bangladesh Bank.

CONCLUSION AND FORWARD

The objective of this paper is to provide an exploratory perspective on positive accounting and change of accounting policies in Bangladeshi listed companies. There is a debate over the accounting terminologies (like creative accounting, earnings management etc, but there is no debate on the anomaly of accounting practice which distorts decision makers while they make decisions based on company's financial statement. A plausible accounting framework is required which would not force the managers to choose a single set of policies, rather there would be reasonable options with prudent considerations which would protect the accounting information from murky and tarnishing slag-heap that induces accounting scandals and frauds to the stakeholders of the organizations.

This study endeavors to reflect an explanatory view, so a lot more to advance with – like developing an empirical framework on positive accounting theory along with change of accounting policies from the perspective of Bangladesh is an utter necessity of the day. Besides, the establishment of a linkage between the theory and empirical test by examining inter-industry and intra-industry variations in accounting methods would be another way forward as a follow through of this exploratory study.

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