

# The regulatory conundrum: achieving effective corporate governance and auditing reforms in Bangladesh

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# Introduction: two papers

- Corporate social reporting in Bangladesh (Khan, Muttakin, Siddiqui, 2014)
- The state of the audit market in Bangladesh (Khan, Muttakin, Siddiqui, 2015)

# **Session 1: Corporate governance and corporate social reporting disclosures: the case of an emerging economy**

Khan, A.R., Muttakin, M.B. and Siddiqui, J. (2013), Journal of Business Ethics

# Introduction

- We examine the relationship between corporate governance and the extent of corporate social responsibility (CSR) disclosures in the annual reports of Bangladeshi companies.
- A legitimacy theory framework is adopted to understand the extent to which corporate governance characteristics, such as managerial ownership, public ownership, foreign ownership, board independence, CEO duality and presence of audit committee influence organisational response to various stakeholder groups.

# Prior literature

- Previous studies investigating CSR disclosure in Bangladesh have found such disclosure levels to be significantly low (for example, Belal 2000) and of rather descriptive nature, mostly reporting positive news (Imam 2000).
- Belal (2001) reported that a significant portion of the CSR-related disclosure involved information regarding employee-related information.
- The paper also questioned the credibility of such information, as the disclosures were mostly descriptive in nature.
- Azim et al. (2009), in a recent study of CSR disclosures by listed public companies in Bangladesh in 2007, revealed that only around 16 % companies made such voluntary disclosures

# Prior literature

- Belal and Owen (2007) conducted an interview-based study to capture the views of corporate managers regarding the current state and future prospects of CSR reporting in Bangladesh.
  - the desire to satisfy key stakeholder groups to be the principal motivation for CSR reporting in Bangladesh.
  - Managers working both in private and public entities identified government as a major stakeholder as it had the power to regulate the companies.
- Instructions from parent companies and concerns raised by buyer groups were also recognised as significant sources of pressure, especially for multinational companies and export-oriented industries.

# Prior literature

- Other stakeholders mentioned by the respondents included **media and influential lobby groups**, and stakeholder groups such as the community, environment and wider society were either ignored or virtually unheard of.
- The role of ‘powerful’ stakeholder groups was also mentioned by Islam and Deegan (2008) as the principal driving force for CSR disclosures in Bangladesh.
- Uddin, Siddiqui and Islam (2015) provide evidence of potential (political) abuse of CSR practices due to the influence of the state.

# Methodology

- The sample consists of all 135 manufacturing companies listed with Dhaka Stock Exchange (DSE) in Bangladesh from 2005 to 2009.
- We exclude 19 companies due to missing or incomplete information.
- The final sample comprises the remaining companies (116) with a total of 580 firm-years observations. The sample consists of various sectors such as: cement (7), ceramics (4), engineering (19), food (21), jute (3), paper and printing (2), miscellaneous (11), pharmaceuticals (21), tannery (5), paper and printing (2) and textile (23).
- OLS regression model, using CSR disclosure as the dependent variable

# Findings

- Our results suggest that CSR disclosures generally have a negative association with managerial ownership
- However, such relationship becomes significant and positive for export-oriented industries.
- We also find public ownership, foreign ownership, board independence and presence of audit committee to have positive significant impacts on CSR disclosures.
- However, we fail to find any significant impact of CEO duality.

# Implications

- Thus, our results suggest that pressures exerted by external stakeholder groups and corporate governance mechanisms involving independent outsiders may allay some concerns relating to family influence on CSR disclosure practices.
- Overall, our study implies that corporate governance attributes play a vital role in ensuring organisational legitimacy through CSR disclosures.

# Issues with corporate governance

Issues...

- What type of corporate governance model may be suitable for an emerging economy such as Bangladesh?
- What type of model has Bangladesh adopted?
- What has prompted such adoption?

# Two theories of corporate governance

- Shareholder model
  - views that the purpose of the corporation is to maximise shareholders' wealth
  - Like the agency theory, the shareholder model of CG is also a rational actor model, where human beings are expected to be maximising their own interest.
  - As the model is based on assumptions of strong market efficiency, a voluntary code of CG is deemed to be sufficient, as managers in a strong market would have enough incentives to install CG mechanisms in their firms

# Two theories of corporate governance

- Stakeholder model
  - rejects the agency relationship as the principal problem of CG. Rather, absence of stakeholders' involvement is viewed as the main obstacle for ensuring efficient controls.
  - Contrary to the shareholder model, this model emphasises a trust-based long-term relationship between firm and stakeholders, protection of the rights of different stakeholders, employee participation and business ethics (Letza et al., 2004).

# Two theories of corporate governance

- The market-based system of governance is considered to be more appropriate where company shares are generally owned by dispersed owners, and the managers are relatively free from close scrutiny and control.
- Such systems are characterised by one-tier board leadership structure.

# Two theories of corporate governance

- The institutionally based system, on the other hand, relies on closer contact between shareholders, managers, workers and suppliers.
- This system of CG is more applicable to countries where banks are the primary sources of finance for the companies.
- Such models are characterised by the presence of a two-tier board structure: bankers and other non-executive directors are members of the supervisory or oversight board, whereas the managers are members of the management board.

# Two theories of corporate governance

‘The market-based system presupposes a **low degree of concentration of ownership, limited bank holdings...**as well as **free flowing reliable and timely information** about the business and financial affairs of the company. A number of these characteristics are not readily realisable in Africa, at least for the time being’.(Rwegasira, 2000, p. 265)

# The political economy of corporate governance in Bangladesh

- Ownership concentration
- Shareholder activism
- The capital market
- Presence of second-order institutions
- Legal structure
- Economic dependence on donor agencies
- Political patronage in the banking sector
- State of CSR and labour rights

# Ownership concentration

- Like many other developing countries, most companies in Bangladesh are either family owned or controlled by substantial shareholders (corporate group or government).
- Company managements are effectively just extensions of the dominant owners (Farooque et al., 2007).
- They are closely held small and medium-sized firms where corporate boards are owner driven.
- Consequently, most of the companies have executive directors, CEO and chairman from the controlling family.
- Farooque et al. report that, on average, the top five stockholders hold more than 50% of a firm's outstanding stocks.

# Shareholder involvement

‘The perception of AGMs amongst the non-banking listed companies surveyed seems to be a combination of a necessary evil and a statutory requirement. Generally, **shareholder demands concentrate either on higher dividends or trivial concerns like better quality food and gifts at the AGM and transportation allowances. The main incentive for attendance is the meal served at an attractive hotel and, surprisingly, trading activity increases prior to AGMs to reflect that interest.** There are, in reality, a very limited number of people going to AGMs who actually understand the financial statements being presented and, consequently, have little to contribute in terms of relevant inputs’ (BEI, 2003, p. 33)

# The capital market

- Capital market still not developed enough, despite a reasonably long history
- Weak or at best, semi-strong form of market efficiency
- Market fundamentals are mostly ignored
- Large corporations are reluctant to come to the capital market:
  - Bank financing is easier
  - Policy inconsistency
  - Bureaucratic procedures

# Presence of second-order institutions

- Despite having a very large population, the number of qualified accountants in Bangladesh is surprisingly low, even compared with its neighbours
- Bangladesh lacks the presence of any second-tier accountancy bodies to cater to the needs of the corporate world (for example, accounting technicians).
  - This means that a vast majority of accountants working in the corporate sector do not possess any accounting qualifications.
- Missing links: financial analysts, fund managers, skilled corporate lawyers

# Legal structure

- When will the Companies Act (1994) be updated????
- Who is responsible for effective implementation?

‘Responsibility for enforcement is shared among the Registrar of Joint Stock Companies, the Securities and Exchange Commission, the professional accountancy bodies, and the judiciary. The involvement of several bodies in corporate accountability complicates enforcement and reduces overall effectiveness’. (World Bank, 2002, p. 83).

# Other factors

- Economic dependence on donor agencies
- Political patronage in the banking sector
- State of CSR and labour conditions

# Which CG model is appropriate for Bangladesh?

- The corporate sector is characterised by high ownership concentration, lack of shareholder involvement, the reluctance of firms to raise capital through the stock markets, high degree of bank borrowing and eventual nonpayment of such loans, and lack of quality manpower for operating the second-order institutions.
- The socio-economic environment is affected by unsatisfactory legal enforcement and poor working conditions.
- In addition, the Bangladesh corporate and economic environment also suffers from lack of timely information (Imam et al., 2001), and political instability (CPD, 2003)

# Which CG model is appropriate for Bangladesh?

- Paredes (2005) mentioned that the prerequisites for efficient functioning of the shareholders model include an **efficient capital market, competent manpower working in the second-order institutions, sound legal structure and long-term political stability**. Also, **shareholder involvement** and timeliness of financial reporting were considered important prerequisites for success of the shareholder model (Letza et al., 2004; Rwegasira, 2000).
- The political economy of the corporate sector in Bangladesh, justify the non-adoption of the shareholder model of CG.
- Rather, the poor working conditions and unsatisfactory levels of loan recovery make a case for representatives of workers and banks to be present on the board of directors.
- Therefore, it seems that the corporate environment in Bangladesh is more conducive for the adoption of a stakeholder-based model.

# What have we adopted: the SEC corporate governance order (2006, revised in 2012)

- One tier board of directors: the number of the board members of the company shall not be less than 5 (five) and more than 20 (twenty)
- At least one fifth (1/5) of the total number of directors in the company's board shall be independent directors
- The ID (or family) cannot hold more than one percent (1%) shares of the total paid-up shares of the company;
  - Qualification: The person should be a Business Leader/Corporate leader/bureaucrat/university teacher with economics or business studies or law background/professionals like CA, CMA, CS. The independent director must have at least 12 (twelve) years of corporate management/professional experiences.
  - Western definition of a 'family': spouse, son, daughter, father, mother, brother, sister, son-in-law and daughter-in-law shall be considered as family members

# What have we adopted: the SEC corporate governance order (2006, revised in 2012)

- The positions of the Chairman of the Board and the Chief Executive Officer of the companies shall be filled by different individuals
- Audit committee shall comprise of three members with the ID as the chair
  - Oversee the financial reporting process.
  - Monitor choice of accounting policies and principles.
  - Oversee hiring and performance of external auditors
  - Qualifications

# What have we adopted: the SEC corporate governance order (2006, revised in 2012)

- Mandatory auditor rotation (not required in the EU/UK!)
- External auditors not allowed to provide the following services-
  - Appraisal or valuation services or fairness opinions.
  - Financial information systems design and implementation.
  - Book-keeping or other services related to the accounting records or financial statements.
  - Broker-dealer services.
  - Actuarial services.
  - Internal audit services.
  - Any other service that the Audit Committee determines

# In practice.....

- ‘The Bangladeshi Corporate world is managing the ‘independent director’ well. For example, the central bank had stringent provision for the rotation of bank directors. The owners are running the show with their nominees even better. Also there could be the issue of ‘scratching each other’s back’. Thus, independent directors cannot serve its purpose. Independent directors should not be the Chairman of the Board’ (President, International Chamber of Commerce in Bangladesh, DSE, 2006)
- ‘Chair and CEO separation has resulted in the father being the chair, and the son being the CEO’ (BEI, 2003)

# In practice....

- ‘Do we have a large enough pool of independent directors who are qualified to sit in the audit committees? Most of the independent directors are ex-bureaucrats, as we need them for networking purposes with the government’ (Siddiqui and Humphrey, 2015)
- ‘I have my *bhatija* sitting in the board as independent director, and also chairing the audit committee- he is a commerce graduate and has experience in working in other businesses (owned by me!)...its not illegal...’ (Chairman of a bank)
- ‘How would audit firm rotation work when you only have a handful of audit firms that are capable of auditing large companies? In practice, it doesn’t happen’ (Siddiqui and Humphrey, 2015)

# Why such adoption?

- The impetus for this shift (towards adoption of the Anglo-Saxon model) has been a combination of global political economy pressures and problems arising out of the previous business house model of governance. (Mukherjee-Reed, 2002, p. 266)
- **As a condition of renegotiating loans**, international finance bodies imposed structural adjustment programmes on developing countries. These programmes included a variety of features that induced a move to an Anglo-Saxon model of governance. (Reed, 2002, p. 230)

# Why such adoption?

- In 1999, the Asian Development Bank (ADB) initiated a US \$1.07 million project to strengthen the capacity of SEC so that it can perform its regulatory functions.
- The purpose of the ADB technical assistance was to “develop a CG structure needed to build confidence and trust of the public and shareholders” (ADB, 2000).
- Under the project, the ADB aimed to develop a CG manual that would be distributed at the workshops and training sessions conducted by the SEC. Also, members of the SEC, DSE, CSE, and ICAB would be provided training regarding CG.

# Conclusion

- the process of development of CG regulations in Bangladesh is characterised by the absence of self-regulation by the professional bodies, a dominant presence of donor-driven private-sector regulations and the adoption of private-sector regulations by government-funded regulators.
- The apparent ineffectiveness of the ICAB to self-regulate its members, and its lack of initiative to develop any CG regulations, has led to the development of such regulations by private-sector think-tanks.
- These private-sector think-tanks do not have any regulatory or statutory authority. However, their projects are funded by donor agencies, and as a result, they enjoy significant influence on the regulators.
- The SEC, being a government-funded regulatory body, has to promote government agenda to legitimise its actions to the donor agencies and ensure continued flow of support towards the Bangladesh government.

Issues with  
CSR: Shall  
we take the  
Indian route?



# Indian Companies Act (2013): CSR requirements

- Company spends at least 2% of the average net profits (past three years) every financial year
- Provide a strategy to the Board regarding the CSR policy for the company which will clearly indicate the activities they'll perform from the list given by the new act.
- CSR policy is displayed on their website and duly informed to their shareholders

# Indian Companies Act (2013): CSR requirements

- Company spends at least 2% of the average net profits (past three years) every financial year
- Provide a strategy to the Board regarding the CSR policy for the company which will clearly indicate the activities they'll perform from the list given by the new act.
- Section VII of the Companies Act defines the activities which can be considered as CSR:
  - Eradicating extreme hunger and poverty
  - Promotion of education
  - Promoting gender equality and empowering women
  - Reducing child mortality and improving maternal health

# Indian Companies Act (2013): CSR requirements

- Combating human immunodeficiency virus, acquired
  - Immune deficiency syndrome, malaria and other diseases
  - Ensuring environmental sustainability
  - Employment enhancing vocational skills
  - Social business projects
- Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and such other matters as may be prescribed.  
(Parliament of India 2013)

# Indian Companies Act (2013): CSR requirements

- Initial results (based on 150 largest companies in India) suggest-
  - Most companies are complying with the 2% rule, which means voluntary CSR activities might have decreased significantly
  - There is no provision for an audit: are these merely claims?
  - No change in gender bias in corporate boards
  - Contribution to the Prime Minister's National Relief Fund is the most common CSR activity!

# Conclusion

- CG and CSR has improved in Bangladesh, mostly due to regulatory interventions by BSEC and BB
- However, the socio-political environment continues to affect the effectiveness of such mechanisms
- Reliance on 'imported' regulations may not be the solution

## **Session 2: Audit fees, auditor choice, and stakeholder influence: the case of a family-firm dominated economy**

Khan, A.R., Muttakin, M.B., and Siddiqui, J. (2015). The British Accounting Review

# Introduction: the audit market in Bangladesh

- The audit market in Bangladesh is characterised by poor demand for audited financial statements (Karim & Moizer, 1996; Ahmed & Goyal, 2005), poor perceptions regarding audit quality (Sobhan & Werner, 2003), and the presence of only one Big 4 audit firm (Siddiqui et al, 2013).
- Audit fees in Bangladesh are significantly lower than its neighbouring India and Pakistan (Ahmed and Goyal (2005) .
- Approximately 78 percent of CEOs are shareholders of a firm, either as founder shareholders or as descendants of founding families (Farooque, Ziji, Dunstan, and Karim (2007)).

# The audit market in Bangladesh

- At present, only one Big 4 audit firm (KPMG) has an office in Bangladesh, whereas the other internationally linked audit firms (B4A) operate through their affiliated firms.
- Karim (2010) reports that although B4A firms are considered large firms in the context of Bangladesh, in the global context these are not very large firms, with the number of partners ranging from 3 (for the affiliated firm of Ernst and Young) to 7 (for the affiliated firm of Deloitte).
- In Bangladesh, the Big 4 and B4A firms command only 17 percent of listed audit clients and account for only 34 percent of client assets and 45 percent of client revenue (Karim, 2010).
  - By contrast, Big 4 audit firms have a 41 percent market share in India (International Accounting Bulletin, 2011).
  - The lack of market power may be due to the direct absence of most Big 4 firms in the audit market in Bangladesh.

# Objective of the paper

- As of December 31, 2011, more than 70 percent of the top performing companies on the Dhaka Stock Exchange (DSE), the country's premier stock exchange, were family-owned firms, making this the dominant form of listed companies in Bangladesh
- Do family firms prefer lower quality audit?
  - Do family firms pay lower audit fees?
  - Do family firms hire lower quality auditors?

# Methodology and results

- Using a sample of 1,058 firm-year observations of public limited companies listed on the Dhaka Stock Exchange (DSE) in Bangladesh from 2005 to 2013, we investigate auditor choice and audit fees in family firms.
- OLS regression models, range of ownership, corporate governance and control variables (please see the paper for further info)

# Major findings.....

- The mean audit fee of the sample companies is Tk. 116,726 (US \$ 1,496). Earlier, Karim and Moizer (1996) reported that mean audit fees in Bangladesh were Tk. 55,791 in 1992, whereas Khan et al. (2011), using data from 2003 to 2005, found mean audit fees to be Tk. 67,480.
- The mean family ownership is approximately 30 percent. The mean ownership by non-family insiders is 9.5 percent and institutional investors and government are 15 percent and 5 percent, respectively. The mean firm size is Tk. 2,450 million.

# Major findings.....

- Among family firms 92 percent of the CEOs are family members.
- Board independence is statistically indistinguishable between family and non-family firms.
- On average, non-family firms pay higher audit fees than family firms. Institutional ownership is more prevalent in non-family firms than in family firms although the difference is statistically insignificant.
- Average government ownership of non-family firms is significantly higher than family firms.
- On average, 18.4 percent of family firms and 23.2 percent of non-family firms recruit industry specialist auditors.

	Model 1		Model 3	
	Audit fees			
Variable	Coefficient	Prob.	Coefficient	Prob.
Intercept	4.951 <sup>a</sup>	0.000	4.277 <sup>a</sup>	0.000
FAMILYCON	-0.168 <sup>a</sup>	0.009	-0.035	0.604
INSIDEOWN	-0.609 <sup>a</sup>	0.001	-0.581 <sup>a</sup>	0.002
INSTOWN	0.014	0.939	0.040	0.814
GOVOWN	0.001	0.997	0.011	0.948
AUDCOMPLX	0.325 <sup>a</sup>	0.002	0.382 <sup>a</sup>	0.000
SIZE	0.288 <sup>a</sup>	0.000	0.318 <sup>a</sup>	0.000
BOARDIND	0.238 <sup>b</sup>	0.041	0.664 <sup>b</sup>	0.025
PROF	1.283 <sup>a</sup>	0.000	0.991 <sup>a</sup>	0.000
SUBD	0.165 <sup>a</sup>	0.003	0.103 <sup>c</sup>	0.056
MNC	0.406 <sup>a</sup>	0.002	0.460 <sup>a</sup>	0.000
EXPORT			0.121 <sup>b</sup>	0.047
FAIMILYCON*EXPORT			0.252 <sup>a</sup>	0.001

# Auditor choice

	Auditor choice	
	Model 2	
Variable	Coefficient	Prob.
Intercept	8.631	0.000
FAMILYCON	-0.436 <sup>a</sup>	0.003
INSIDEOWN	0.006	0.957
INSTOWN	1.170	0.329
GOVOWN	0.895	0.313
AUDCOMPLX	0.367	0.256
LEV	0.412 <sup>a</sup>	0.000
SIZE	0.424 <sup>a</sup>	0.000
BOARDIND	0.901 <sup>b</sup>	0.030
PROF	4.817 <sup>a</sup>	0.000
MNC	1.613 <sup>a</sup>	0.000
EXPORT	0.434 <sup>b</sup>	0.070
FAMILYCON*EXPORT	0.857	0.001

# Findings...

- We find that in comparison with non-family firms, our sample family firms pay significantly lower audit fees and tend to choose lower quality auditors
- However, for export-oriented industries, family firms seem to pay significantly higher audit fees and recruit better quality auditors compared to non-family firms, indicating stakeholder power.

# Reforming the audit profession in Bangladesh

- **Issue 1: Audit fees**

*'The auditing function would seem to represent a vicious circle; auditors are not perceived as independent and do not provide quality audits, therefore companies and shareholders are not willing to pay high fees for an audit. The low fee structure, in turn, does not provide an incentive for auditors to provide quality personnel and audits' (BEI 2003, pg 62).*

*'The AGM is dominated by the management...so it is the management who do not want the AF to increase...shareholders do not have much say about this. If management has a concrete proposal regarding AF increase, I'm sure that would have been passed in the AGM. If the management is not convinced that AF needs to be increased, it is not going to happen' (Former president, ICAB, interview taken in 2014).*

# Reforming the audit profession in Bangladesh

- Company management did not see the value of audit, as audit did not offer any 'tangible' benefits, as opposed to services such as tax consultancy.
- One senior auditor pointed out that, for services such as tax consultancy, the market had no problems paying high fees, whereas, *'we find it difficult even to negotiate an increase of Tk 5,000 audit fees'* (interview taken in 2014)

# Reforming the audit profession in Bangladesh

- **Issue 2: skill and competence**

'The profession remains dependent on entrants from the **Department of Accounting and Information Systems, Faculty of Business Studies, University of Dhaka** for increasing its members. The majority of students who recently passed in ICAB exams are business graduates from the University of Dhaka and the proportion is as high as 90%. This university, considered the best in general education provider in the country, **does not however rank within the top 200 in Asia and 2,000 in the world**. An inadequate number of good quality commerce graduates is a major bottleneck behind increasing the memberships' (World Bank ROSC, 2015)

# Reforming the audit profession in Bangladesh

*'We seem to be attracting a particular class of students who are very good with the maths. But they lack communication skills. Auditing requires a lot more than just computational skills. You will have to communicate with the clients on a regular basis, and some of our articled students seem to be intimidated by the client management, which is sometimes run by smart MBAs from western schools' (Senior audit partner, interviewed in 2014)*

# Reforming the audit profession in Bangladesh

- World Bank (2002) reports that between 1972 and end-June 2003, 11,026 students enrolled with the ICAB as trainee accountants. However, the current number of members in the ICAB is just over a thousand, indicating the poor passing rate, and high percentage of drop outs.

*‘Our job is to make the boys pass not fail. Higher pass rate means that the students are better prepared and not that the standards have gone down. I don’t see any problem in more students passing. Unfortunately, many of my colleagues within this profession do not share this view, probably to avoid competition’ (Member, ICAB council, interviewed in 2014).*

# Reforming the audit profession in Bangladesh

- **Issue 3: self-regulation and discipline**

- self-regulations have been largely ineffective, and disciplinary actions against members have been very few and far between (World Bank, 2001)

*'The disciplinary members all work on an ad-hoc basis. We are not being paid for this job. But this (the disciplinary procedures) take a lot of our time, and you know, we auditors are busy people (QA)*

# Reforming the audit profession in Bangladesh

*'The institute's disciplinary procedures are wrong. For example, sometimes members are suspended for two years. As a result, this member probably is working for some other audit firm and his/her ethical level remains the same. If the institute had mentioned that this member would have to attend a certain number of hours of CPE, then it would have made some sense. It is like you are sending a person to jail but not rehabilitating him properly' (ICAB council member)*

*'Complaints would be lodged only if there is an aggrieved party. **Shareholders in our country do not understand the financial statements and are not aware of the duties and responsibilities of the auditors.** Therefore, they are not aggrieved against an auditor even if a material misstatement is detected in an audited financial statement' (Senior partner of an audit firm)*

# Reforming the audit profession in Bangladesh

*'We ask ICAB to take actions against the auditors, but they never do that. This has forced us to take actions against auditors (such as imposing penalties) which are within our jurisdiction' (Executive director, BSEC)*

*'SEC lacks qualified personnel. Most of the allegations against audit firms are baseless. This is because they don't know their job. For example, two members of the SEC are former district judges. How can you expect accounting competence from them?' (Council member, ICAB)*

*'Why would a qualified accountant work for us? When I joined, I found a competent young officer. So I tried to groom him and he became sort of an expert regarding surveillance. However, as soon as he qualified as a professional accountant, the private sector offered him huge salaries, and he left us. I don't blame him, what incentive could we offer him?' (Former chairman, BSEC)*

# The solution (!): the Financial Reporting Council

- Originally proposed by the World Bank ROSC report in 2002
- The council
  - Chair nominated by the government
  - Additional secretaries from MoF and MoC
  - One nominated representative from CAG and NBR each
  - One BSEC commissioner
  - One nominated candidate each from ICAB, ICMAB and FBCCI, one professor of accounting
  - CEO of the council
  - How many of them are qualified auditors???
- This is grossly different from what was proposed by the WB ROSC report (2002)! (and from FRC elsewhere, eg FRC UK)

# The solution (!): the Financial Reporting Council

- Functions:
  - Standards setting division
  - Financial reporting monitoring division
  - Audit practice review division
  - Enforcement division

# Standard setting

- IFRS and ISAs are set internationally.
  - Most developing countries tend to go for wholesale adoption, due to capacity and resource limitations, as well as institutional pressures
- As part of the IFAC SMO framework, the ICAB is obliged to adopt such standards
- ICAB's response to IFAC compliance programme indicates that the IFRS and ISAs have been adopted
  - Also for SMEs!!!
- Would the members of FRC have enough expertise to set accounting and auditing standards?

# Financial reporting

- To analyze and identify companies that do not comply with IFRS and IAS
- To recommend actions against companies that violate such standards
- Issues
  - How many registered companies do we have?
  - Would FRC have the capacity to do this?

# Audit practice review

- Audit inspection
- Once in every three years, the FRC will-
  - Review the quality control system of audit firms
  - Monitor the steps taken for the development of the profession
  - Promote public interest

How would quality be reviewed? What about ICAB's quality review? Would the FRC have the capacity to do this? (example, BSEC!)

# Enforcement

- The enforcement division will recommend actions against violating companies and audit firms
- Maximum punishment: 5 years imprisonment or/and Tk 500,000 fine
  - Can we rule out scope for corruption?
  - Is FRC going to be another dysfunctional bureaucratic mess, resulting in higher cost of doing business?

# Other issues...

- The FRC will issue various codes for professional accountants
- Registration of auditors
  - Existing audit fees are already poor due to a buyer driven market
  - Would the clients be willing to pay for this?
  - Would it eventually lead to decreased audit quality?
- **The performance gap: does the FRC really address the problems with the profession?**
  - Education standards
  - Audit fees
  - Institutional aspects

- Discussion/ questions

- For any queries, please contact:

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