

The Impact of AAOIFI Accounting Standards on Earnings Quality: The Case of Islamic Banks in Bahrain

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The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

1991

48

26

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7

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88

AAOIFI standards

- AAOIFI standards are followed – as part of regulatory requirement or IFIs' internal guidelines – in:
 1. Middle East
 2. Asia Pacific
 3. South Asia
 4. Central Asia
 5. Africa
 6. Europe, and North America

Objectives of AAOIFI

- The objectives of AAOIFI are:
- **To develop accounting and auditing** thoughts relevant to Islamic financial institutions;
- **To disseminate accounting and auditing** thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
- **To prepare**, promulgate and interpret **accounting and auditing standards** for Islamic financial institutions; and
- **To review** and amend **accounting and auditing** standards for Islamic financial institutions.

Purpose

- The purpose of this paper is to examine **the change** in earnings quality* **after** the adoption of AAOIFI Accounting Standards in Islamic Banks of Bahrain.

**Earnings quality indicates continuity of earnings in the coming years is more than the continuity of accruals.*

Originality/value

- This paper provides an insight from the reality of Islamic financial institutions (IFIs) of Bahrain as a result of the adoption of AAOIFI accounting standards on earnings quality

Design/methodology/approach

- In this paper **we hypothesize** that, adoption of AAOIFI accounting standards **could lead to high level of earnings quality**.
- This paper uses the **Richardson Sloan model** in examining the change in earnings quality after the adoption of AAOIFI standards in Islamic Banks of Bahrain.
- Data were collected from the annual reports of 5 Islamic banks in Bahrain during **2002-2011**

Research model

$$ROI_{i,t+1} = \gamma_0 + \gamma_1(ROI_{i,t} - TACC_{i,t}) + \gamma_2 TACC_{i,t} + v_{i,t+1} \quad \dots\dots\dots(1)$$

$$ROI_{i,t+1} = \rho_0 + \rho_1 ROI_{i,t} + \rho_2 TACC_{i,t} + v_{i,t+1} \quad \dots\dots\dots(2)$$

$$ROI_{i,t+1} = \gamma_0 + \gamma_1(ROA_{i,t}) + (\gamma_2 - \gamma_1) TACC_{i,t} + v_{i,t+1} \quad \dots\dots\dots(3)$$

Where:

$ROI_{i,t+1}$: is return on investment for firm (i) in the next year (t+1).

γ_0 : is constant.

γ_1 : is continuity of cash flows.

γ_2 : is continuity of accruals.

$ROI_{i,t}$: is return on investment for firm (i) in year (t).

$TACC_{i,t}$: is total accruals for firm (i) in year (t).

Earnings quality indicates continuity of earnings in the coming years is more than the continuity of accruals as $\gamma_2 < \gamma_1$ known as earnings quality

Findings

- The findings indicate that the change in earnings quality after the adoption of AAOIFI in Islamic Banks of Bahrain is higher due to the improvement of the quality of financial reporting

Ind. Variables		t-statistics	Sig.	VIF
(Constant)		2.721	0.004	
ROE		2.523	0.008	5.86
LIQ		3.224	0.001	4.00
SIZE		2.321	0.009	4.68
AGE		1.987	0.010	1.073
Durban-Watson DW	1.138			
R	0.632			
R-Square	0.413			
No. of Observations	49			

independent sample t-test results

Mean of EQR (ρ_2) before adoption	T-test	Sig.	β	Df	T- Critical	Mean of EQR (ρ_2) After adoption
$\rho_2 = 0.00085$	2.318	0.03	- 4.820008	50-1=49	1.68	$\rho_2 = -0.00012$

Implication of the study

- Adoption of AAOIFI accounting standards are expected to lead to high level of earnings quality among Islamic Financial Institutions and play a significant role in attracting global investors' interest to the local markets, especially in developing country like Bahrain

Thank You

Q & A