( ) Expensive
( ) Inefficient
( ) Difficult to apply
( ) Time consuming
( ) Unsuitable to working environment
( ) Other (Pls. Specify) ....

6- Please do give your comments relating to this issue (this will help us in understanding the concept of judgment in accounting used by the professionals in a better way).

3- In your opinion , indicate the factor/s that aid the accountants in making a judgmental based decision.

( ) Experience
( ) Awareness
( ) Law
( ) Standards
( ) Accounting Education
( ) Company Policies
( ) Industry
( ) Time
( ) Accounting Area
( ) Any other (please specify) ....

4- Tick the processes that you go through to make a judgmental decision, and rank them in order.

Decision Making Processes	Tick	Rank
Gathering Data		
Structure Problem		
Assign Risks to Alternatives		
Choose Among Alternatives		
Diagnose Problem		
Quantify Objectives		
Simulate Results of Alternatives		
Identify Objectives		
Manipulate Data		
Generate Statistics on Alternatives		
Explain Choice		
Validate Data		
Generate Alternative		
Explain Alternatives		

5- Do you use judgment and decision making models(e.g. Brunswik Lens and Simon's models, Probabilistic models) to assist in you decision making process :

( ) Yes, because they are:

( ) Effective
( ) Cost efficient
( ) User friendly
( ) Timely
( ) Other (Pls. Specify)

( ) No, because they are:

2- For the following IASs, specify the degree of judgment you used in their implementation, understanding and interpretation:

(Low =1 High =5)

Accounting Area	Degree of Judgment				
IAS 1: Disclosure of Accounting policies	1	2	3	4	5
IAS 2: Inventories	1	2	3	4	5
IAS 3: Consolidated financial statement	1	2	3	4	5
IAS 4: Depreciation accounting	1	2	3	4	5
IAS 5: Information to be disclosed in the Financial Statement	1	2	3	4	5
IAS 6: Accounting responses to changing prices	1	2	3	4	5
IAS 7: Cash Flow Statements	1	2	3	4	5
IAS 8: Net Profit or Loss for the period, fundamental errors and changes in accounting policies	1	2	3	4	5
IAS 9: Research and development costs	1	2	3	4	5
IAS 10: Contingencies and event accounting after the balance sheet date	1	2	3	4	5
IAS 11: Construction contracts	1	2	3	4	5
IAS 12: Accounting for taxes on income	1	2	3	4	5
IAS 13: Presentation of current assets and liabilities	1	2	3	4	5
IAS 14: Reporting financial information by segment	1	2	3	4	5
IAS 15: Information reflecting the effects of changing prices	1	2	3	4	5
IAS 16: Property, plant and equipment	1	2	3	4	5
IAS 17: Accounting for leases	1	2	3	4	5
IAS 18: Revenue	1	2	3	4	5
IAS 19: Retirement benefits costs	1	2	3	4	5
IAS 20:Accounting for government grants and disclosure of government assistance	1	2	3	4	5
IAS 21: The effect changes in foreign exchange rates	1	2	3	4	5
IAS 22: Business combination	1	2	3	4	5
IAS 23: Borrowing costs	1	2	3	4	5
IAS 24: Related party disclosure	1	2	3	4	5
IAS 25: Accounting for investments	1	2	3	4	5
IAS 26: Accounting and reporting by retirement benefit plans	1	2	3	4	5
IAS 27:Consolidated Financial Statements and accounting for investments in subsidiaries	1	2	3	4	5
IAS 28: Accounting for investments in associates	1	2	3	4	5
IAS 29: Financial reporting in hyperinflationary economics	1	2	3	4	5
IAS 30: Disclosure in the Financial Statements of banks and similar financial institution	1	2	3	4	5
IAS 31: Financial reporting of interests in joint ventures	1	2	3	4	5

5- Total years of experience ....

How long you have been with the present company...

Part 2:

1- For the following financial accounting areas, specify the degree of judgment you used:
(Low = 1 High = 5)

Accounting Area	Degree of Judgment				
Bad Debt Expense	1	2	3	4	5
Expensing vs. Capitalizing	1	2	3	4	5
Fixed Assets Depreciation	1	2	3	4	5
Fixed Assets Useful Life	1	2	3	4	5
Fixed Assets Valuation	1	2	3	4	5
Intangibles Valuation	1	2	3	4	5
Inventory valuation	1	2	3	4	5
Research and Development	1	2	3	4	5
Revenue Recognition	1	2	3	4	5
Footnote Disclosure, if any	1	2	3	4	5
Financial Instruments	1	2	3	4	5
Impairment of Assets	1	2	3	4	5
Valuation of Mergers and Acquisitions	1	2	3	4	5
Accounting for Non Controlled Subsidiaries	1	2	3	4	5
Contingencies	1	2	3	4	5
Intangible valuation	1	2	3	4	5
Any other (please specify)	1	2	3	4	5

Survey: Judgment –Based Accounting

Questionnaire

Part 1:

A. Company background

1- Company Name: ....

2- Size Indicators:

Turnover (1997-1998): ....
Number of Employees: ....
Total Assets:...

2- Company Classification:

( ) Commercial Bank Sector.
( ) Investments Banks.
( ) Insurance Sector.
( ) Service Sector.
( ) Industrial Sector.
( ) Hotel and Tourism Sector.

B. Respondent Background

1- Job Position: ....

2- Age:

( ) 0-35
( ) 36-50
( ) Above 50

3- Educational Background:

Degree	Major
Diploma	
Bachelors	
Masters	
Doctorate	

4- Professional courses:

( ) CPA
( ) ACCA
( ) CFA
( ) Others

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considerably in various situations, however, it is always a part of the decision making process.

Accounting standards provide a general frame of reference by which accountants abide. Wherever a choice is given regarding the alternative courses of action, judgment is used. The use of judgment in solving accounting problems, is a part of professional practice, and its importance has been recognized by professional organizations, e.g. the AICPA has viewed judgment as the most important factor in an audit. Through a balance of rules and judgment, the accounting profession will be able to achieve highest quality of performance in financial reporting and restore public confidence in the financial reporting system.

The agenda for future research may include whether the way in which judgment is exercised is consistent with the concept of professionalism in accounting or whether the exercise of judgment is distorted by mere legalism. Furthermore, comparative studies on accounting systems which are comprehensively rule based and those which are judgment based, would be of interest in exploring the accounting impact on the information contents of accounting statements and their usefulness to the users. Last but not least, the extent and areas in which accountants and auditors use their judgment in managerial accounting and auditing, should also be surveyed.

Notes

1. The American Heritage Dictionary defines judgment as " the formation of an opinion after consideration or deliberation."

2. Warnock (1997) explores the nature of rules in accounting, based on some ideas from legal, academic literature; the examination suggests that the rules embodied in the Statement of Standard Accounting Practice (SSAP) leave, and will continue to leave, ample scope for the exercise of professional judgment. Controversies on accounting standard rarely seem to focus on the many determinate rules, which are often found to follow naturally from some indeterminate rule.

3. It has been argued that there is a problem of bias in professional judgment used by accountants. Then it is the bias that should be attacked, not necessarily the exercise of judgment. Skinner(1995) gives three main arguments for overly flexible financial reporting in today's accounting environment: (I) accounting theory or conceptual framework is not specific enough to provide a proper grounding for professional judgment; (ii) accounting standards, which are intended to provide assistance and direction to practice, are incomplete, sometimes allow alternatives, and sometimes are unclear, and (iii) professional judgment may be suspended or applied improperly.

4. One respondent in this survey commented that in real accounting practices, we have to use judgment in various areas like depreciation, stock valuation, provisions, and contingencies, etc. This survey, in my opinion, will bring out a majority opinion on the application of judgment accounting. The results will definitely be a guide to the accounting community".

because of their effectiveness in solving the problems. On the other hand, those (65%) against the use of such decision models, rejected them due to their unsuitability to the working environment and their relative cumbersome application. The remaining (14%) were silent on the use of those models.

SUMMARY AND CONCLUSIONS

Accounting is a mixture of both art and science. Accounting standards provide the necessary theoretical background that sets boundaries for the professionals to select and apply accounting techniques for the measurement, organization, interpretation and communication of economic events. However, in today's fast changing working environment, the use of judgment is very essential in defining and outlining the issues to be addressed and in designing the methodologies for handling and manipulating them. Thus the art of judgment is a necessary complement for the science of accounting standards.
The following conclusions emerged from findings of this study:

- A high degree of judgment is applied in respect of estimation of contingencies, footnote disclosure and a moderate degree of judgment is applied for other areas of financial accounting, such as financial instrument, intangible amortization, impairment of assets, bad debt expenses, expensing versus capitalizing etc4.

- Professional accountants in Bahrain also use judgment in the implementation of IASs. IASs 1, 2, 3, 4, 5, 7, 8,, 23, 27, and 28, all require above average or relatively high level of judgment in their interpretation and applications. The policy implication for this could be that Bahrain needs to modify these accounting standards to suit its local conditions.

- Respondents ranked the experience the most important factor in influencing an accountant's judgment based decisions. Company policies, accounting standards, personal awareness, law and education are other important factors in influencing their judgment.

- Professionals were divided on the use of systematically developed models. Some favored their use because of their effectiveness while others rejected them because of their unsuitability in a specific environment. Only 21% of accountants stated that they used these models in their decision making process.

Judgment is usually applied in situations where the actual proof is missing, and reliance on one's prudence is inevitable. In such situations, the use of judgment gives flexibility and freedom to form an opinion based on particular circumstances. The extent to which judgment is applicable, is a function of the benefits derived from such application to the company and its constituents, and a reflection of the controls in place.

To arrive at a viable decision, judgment should be applied in proportion to the facts and figures available. Judgment is greatly influenced by experience, education and training, knowledge of accounting standards, laws and company policies. People with identical backgrounds in the same situations, do not have to make the same decisions; they may differ greatly in the way they look at the issues. The extent to which judgment is applied, varies

> "If the regulations permit us a certain course of treatment for a given situation, event or item of reporting but, at the same time allows us to be more prudent in our reporting, then we use our judgment. Our judgment is influenced by many things, like.. experience, training or education, age, company policies etc. But, people with identical background and age don't have to make the same judgment, they may differ in the way they look at the issue".

Similarly, the Finance Manager from BATELCO stated that

> "Judgment accounting is largely based on prudence, materiality, and experience of the accountant. It depends on a particular situation".

And, a Finance Manager from Bahrain Duty Free company also made a similar statement

> " Accountant use his judgment in the cases where actual proof or evidence is missing. His judgment should be based on reasonableness, past experience, history, market, consistency and going concern".

Furthermore, five audit managers from the BIG 5 (now BIG4) audit firms were contacted to ascertain the extent to which they tolerate the judgment exercised by accountants. All of them commented that they do not count on accountants' judgment. The audit manager from one of the audit firms gave the following comments:

> "Judgment in accounting is a wide area, and one will probably get different answers depending on the nature of the business being discussed. For instance, the type and extent of judgment made by accountants differs in a banking environment from a manufacturing one, and in most cases exercising judgment is not entirely to the wisdom of accountants. Such decisions mostly involve top management's recommendations and resolutions, given that accountants might not always comprehend the bigger picture or fully understand the nature of business. In general, we as auditors have the responsibility of authenticating the financial statements in their entirety, the factual part and the subjective, whether at the end of the day the judgment was made by accountants or by a higher authority. The fact remains that such judgmental issues were determined by parties who could not be referred to as neutral to the financial reporting process. As a result, we as auditors do not depend on the given premises and assumptions underlying the reported figures. We always recheck every material aspect in the financial statements using our own knowledge, experience, and on-site gathered information to assess the reasonableness of all presented facts and figures".

The respondents were also asked to what extent they were aware of Brunswik Lens and Simon's model of the decision process which are considered as the scientifically constructed decision models. The respondents were generally aware of these models. However, they were divided between those professionals in favor of the employment of such models and those against.
Those respondents (21%) who were in favor of the use of systematic models, justified them

Results of the survey on this issue are presented in Table 3.

Table 3
Factors Influencing the Judgment of Accountants
(Ranked in order of importance)

Factors	No. of responses	%
Experience	31	96.8
Company policies	27	84.4
Accounting standards	24	75.0
Awareness of changes in accounting principles & methods	23	71.8
Company law	23	71.8
Accounting education	21	65.6
Industry practices	17	53.1
Timing	13	40.6
Marketing	4	12.5

Table 3 shows that the majority of the respondents ranked both experience and company policies as the highest factors in influencing an accountant's judgment. People with more professional experience tend to comprehend more fully and apply judgment in solving problems faced by them. Next in the relative significance were accounting standards, company law, personal awareness of changes in accounting standards, and accounting education and these were regarded as highly relevant in influencing judgment. A Finance Controller from Bahrain Tourism Company commented

> "In addition to complying with law and other reporting requirements, accountants have a duty to the shareholders and other stakeholders to provide a true and fair view of the position of the entity. In providing a true and fair view it is essential to make some judgmental decisions e.g., in assessing the adequacy of the provision for doubtful debts we consider":
>
> a) Factual evidence/records
>
> 1. Age analysis of debtors
> 2. Frequency of settlements
> 3. Debtors turnover in general
>
> b) Judgmental factors influence over debts
>
> 1. Past experience with the debtor
> 2. Awareness of debtor's business
> 3. Information from other contacts.

One respondent from a flourmill company pointed out:

FACTORS INFLUENCING ACCOUNTANTS' JUDGMENT

Abdolmohammadi and Wright (1987) argued that differences in judgments of experienced and inexperienced decision-makers (e.g. auditors and accountants) depend on the differences in the task structure. A low level of knowledge is required if the task is highly structured and programmable (e.g., calculation of depreciation expense). On the other hand, in an unstructured task structure, the problem is usually ill-defined, and the tasks are complex and non-programmable. A high level of knowledge is required in the latter situation which indicates the use of a considerable degree of judgment and insight in order to choose alternatives (e.g., accounting for financial instruments). In such cases, an accountant's personal and other situational attributes aid him to apply judicious judgment. Miller (1974) pointed out that judgment develops from the interaction of education and experience. Therefore, knowledge, past experience, educational background, ability and awareness of the surrounding environment are some of the variables which influence an accountant's judgment (see, for example, Moore, 1989; Abdolmohammadi and Shanteau, 1992; Libby and Luft, 1993; Shanteau, 1995). Furthermore, company policies, nature of accounting standards and law, affect to a great extent the degree to which judgment is applied in various situations. For example, Psaros (1997) describes the results of an experiment that attempts to test the impact on the consolidation judgment of two variables namely, vague statements and incentive in an Australian context. His study found that standards are unlikely to achieve the objectives if the statements contained within them are interpreted differently by accountants. Accountants may abuse the discretion inherent in substance-over-form accounting standards. Therefore, accountants/managers may make opportunistic judgments when accounting standards provide them with the discretion to do so. Additionally, it is also argued that a principle-based accounting standard requires accountants to apply professional judgment in more circumstances rather than less (e.g. Berkowitz and Rampell, 2002).

Literature provides evidence that time pressure also affects the judgment of auditors and accountants, specially in case of materiality related decisions (e.g, Dezoort, 1998; Arnold et al., 1997).

Attempts have been made to incorporate these attributes into a systematic model, to aid the application of judgment in the decision making process. These models build on the diversity of the accounting fields, the decision-makers and the ultimate users of the accounting information. These models regard the provision of information as a process, the most relevant component of which, is considered to be output to which judgment greatly applies. Examples of such models are the Brunswik Lens model (1952), Simon's model (1960) of the decision process, and expert judgment (see, Shanteau, 1995).

The survey also investigated the perceptions of the respondents of the most important factors influencing their judgment in solving complex problems.

It is to be noted that the IAS 1, 2, 3, 4, 5, 7, 8, 10, 14, 23, 27, 28, and 30 respectively proved, to be judgmental as their mean values exceed to be above the cut off point of 2.91. Table 2 shows that a high level of judgment is applied in conjunction with IAS 28 'accounting for investment in associates', IAS 5 'information to be disclosed in financial statements', and IAS 10 'Contingencies and Events Occurring After Balance Sheet Date'. Similarly, IAS 8 'Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies', IAS 27 'Consolidated Financial Statements and Accounting for Investment in Subsidiaries' and IAS 1 'Disclosure of Accounting Policies' were also found to require the employment of an above average level of judgment in their interpretation and implementation. A few respondents were of the opinion that high degree of judgment is required in determining whether a change in the carrying value of assets and liabilities is required.

Surprisingly, IAS 7 'Cash Flow Statement' also proved to be judgmental standard (Mean =3.09 SD =1.51) despite the fact that accounting for cash transactions is highly objective and should require little judgment. IAS 11 (Construction Contracts), IAS 17 (Accounting for Leases), and IAS 26 (Accounting and Reporting by Retirement Benefit Plans) require the least degree of judgment. The reason may be that accounting rules are clear in respect of these accounting standards. IAS 23 'Borrowing Costs' was also regarded as requiring a higher level of subjectivity. On the other hand, IAS 30 'Disclosure in the Financial Statements of Banks and Similar Financial Institutions' proved to be irrelevant to non-finance companies. Most financial institutions, banks in particular, indicated a moderate level of judgment required in the application of this standard.

On the other hand, IAS 16 'Property, Plant and Equipment', and IAS 18 'Revenue' were regarded as requiring a somewhat lower level of subjectivity. One respondent stated that in identifying what constitutes a separate item of property, plant and equipment, some judgment may be required in applying the criteria in the definition to specific circumstances or specific types of entities.

IAS 6 'Accounting Responses to Changing Prices', IAS 12 'Accounting for Taxes and Income', IAS 15 'Information Reflecting the Effects of Changing Prices", and IAS 29 'Financial Reporting in Hyperinflation Economies' were regarded as irrelevant to companies and/or to the general economy of Bahrain. The reasons are that there are no corporate and personal taxes in Bahrain and rate of inflation has remained well below three percent for the last decade.

The statistical analysis (t-test) shows no significant differences in the responses of large versus small size companies, except for IAS-11, IAS-23 and IAS-28 where significant differences were noted at 0.05 level. The reasons for the differences were believed to be that these standards were somewhat difficult to understand as well as the fact that there were many options available in their treatment. Therefore, these standards were subject to different interpretations by the respondents. For example, IAS –28 has been recently revised by the IASC, which perhaps justifies the above belief.

"Accountants may find difficulty in applying IASs as in the IASs, the wording is somewhat general so it makes it hard for members to apply them particularly if they are smaller or sole practitioner or the general members in Fiji themselves".

Therefore, the second question covered in the questionnaire dealt with the degree of judgment applicable to the thirty-one IASs in their implementation and interpretation by accountants in Bahrain.

Table 2 presents the results of this question in order of mean values. Responses were measured using Likert scale (5 represents the highest degree of judgment) and (1 represents the lowest degree of judgment).

Table 2
Use of Judgment in the Interpretation and Applications of IASs

Accounting Standards	Mean	SD	t -test	df
IAS-28 Accounting for investments in associates	3.57	1.39	-2.85**	(12)
IAS -5 Information to be disclosed in financial statement	3.56	1.18	1.65	(30)
IAS-10 Contingencies and events occurring after balance sheet date	3.53	1.16	0.19	(28)
IAS-8 Net profit or loss for period, fundamental errors and changes in accounting policies	3.45	1.38	1.46	(29)
IAS-27 Consolidated financial statements and accounting for investment in subsidiaries	3.38	1.41	0.92	(16)
IAS-1 Disclosure of accounting policies	3.28	1.34	-0.35	(30)
IAS -4 Depreciation accounting	3.28	1.41	0.08	(30)
IAS -2 Inventories	3.23	1.45	1.10	(24)
IAS -3 Consolidated financial statements	3.13	1.40	0.95	(28)
IAS- 11 Construction contracts	3.11	0.78	-5.66*	(28)
IAS- 7 Cash flow statement	3.09	1.51	1.25	(30)
IAS -23 Borrowing costs	3.07	1.12	-2.17**	(24)
IAS- 30 Disclosure in the financial statements of banks and similar financial institutions	3.00	1.30	-0.79	(6)
IAS-14 Reporting on financial information by segment	2.95	1.06	-0.55	(21)
IAS- 21 The effects of changes in foreign exchange rates	2.88	1.42	0.16	(24)
IAS- 22 Business combinations	2.75	1.28	-0.99	(6)
IAS-20 Accounting for Government grants and disclosure of Gov. assistance	2.66	1.52	--	--
IAS- 19 Retirement benefit costs	2.64	1.18	-0.67	(23)
IAS -24 Related party disclosures	2.63	1.07	1.22	(25)
IAS- 17 Accounting for leases	2.61	1.07	-1.65	(19)
IAS-26 Accounting and reporting by retirement benefit plans	2.60	1.14	0.31	(18)
IAS- 25 Accounting for investments	2.55	1.08	-0.46	(25)
IAS- 18 Revenue	2.43	1.30	-0.35	(28)
IAS- 16 Property, plant and equipment	2.10	0.67	0.07	(27)
IAS-13 Presentation of current assets and current liabilities	2.00	0.93	1.19	(29)
IAS-9 R & D costs	1.00	--	--	-

•At the time this study was conducted, there were only 31 accounting standards released by IASC. Now there are 41 standards. There was only one response for R & D Cost.
* significant at 0.01 level; ** significant at 0.05 level. T-test and Mann Whitney U test showed similar results

Table 1, further shows that accountants regard expensing versus capitalizing required high judgment. There are certain situations in which it may become difficult for accountants to ascertain which costs should be expensed and which one should be capitalized. One of such the examples is the expenditure on an old building whether it is for permanent improvements, such as replacing a roof on building, remodeling, additions to structures or just ordinary repairs like interior and exterior painting, repair of building roof, repairing termite or pest damage.

The respondents considered that high judgment (mean =3.12; SD =1.22) is required for bad debt expense and in its estimates. However, a significant difference was observed in the responses of large verses small companies (Mann- Whitney Z = -2.03; p<0.05). Furthermore, Table 1 shows that despite the fact that accounting standards obligate accountants to expense all R & D costs, the responses indicate the use of some moderate degree of judgment in deciding the appropriate accounting treatment of R & D related expenses.

With regard to the differences in responses of the respondents according to their length of experience, the Mann Whitney U test shows significant differences only in respect of 'contingencies' (Z = -2.21; p<o.o5), 'impairment of assets' (Z= -2.09; p<0.05), and 'footnote disclosure' (Z = - 1.98; p<0.05). Since these are some of the most difficult areas in accounting, it seems that the more experienced an accountant, the higher will be the degree of judgment applied.

Thus, from the above discussion it may be inferred that accountants use a high level of judgment in those areas where the information is unstructured or alternative accounting choices are available.

INTERNATIONAL ACCOUNTING STANDARDS

Mason and Gibbons (1991), analyzed the US financial accounting standards and pointed out to the close relationship between the standards and the judgment of preparers and auditors, who apply the standards. They concluded that those who set the US accounting standards should move to make the standards' relationship with judgment, explicit and recognize the importance of that relationship to the effective application of the standards. Wixley (1999) states that IASs allow room for judgment, whereas those standards used by FASB rely on a cookbook and step-by-step approach that reduces judgment and latitude. For example, revaluations are disallowed by US standards but are permitted by IASs.

Kroll Worldwide., (2001) conducted a survey of various user groups of financial statements on behalf of the CICA. The survey reported that when it comes to the issue of professional judgment, only a minority of users believe that accountants and auditors have a lot of flexibility in using judgment. However, the latitude for professional judgment is perceived to vary by sector as the accounting standards offer greater scope for judgment in knowledge-based industries than in traditional sectors such as manufacturing.

Furthermore, IASs have been criticized for their lack of directives, which allow the accountants and auditors to apply a lot of professional judgment. For example, Parmod (2001) reported that a problem with the IASs is that they are not very specific and require judgment by the preparer. In his study on the adoption of IASs in Fiji, Promod (2001) pointed that generally regarded highly subjective, requiring ample consideration and deliberation. The respondents considered this item an area for applying semantic judgment. There is also a significant difference in the responses of the large versus small companies (Mann Whitney $Z=-1.97$; $p<0.05$ level). Generally, large size companies have a higher tendency to disclose more information about provisions .

Similarly, respondents indicated that a particularly difficult area in accounting is deciding on the amount and type of footnote disclosures, requiring a high degree of judgment. However, there is a lot of variation in the value of the standard deviation (SD= 1.39). One of the reasons could be that banks and other financial institutions in Bahrain, are bound by a long list of Bahrain Monetary Association (BMA) disclosure requirements, which limits the scope for judgment. The non-financial sector companies have more room for judgment when it comes to meeting disclosure requirements because it may give them flexibility and freedom to form an opinion based on circumstances.

Investigating the level of judgment used for other balance sheet and income statement items, Table 1 clearly indicates the general agreement among the respondents on the relatively high degree of judgment needed in information disclosure in footnote, amortization of intangible assets, accounting for financial instruments, revenue recognition, inventory valuation, and accounting for non-controlled subsidiaries. The high value of standard deviations in respect of some of these items indicate the availability of alternative valuation methods, for example, LIFO, FIFO, etc., and the relative liberty in the selection of the appropriate method by accountants. Financial instruments are required to be valued at 'fair value' and the concept of 'fair 'value' has several variations (e.g. market to market value, present value, entry value, negotiated value and appraisal value).

Furthermore, it was found that the amortization of intangible assets' requires only a moderate/low degree of judgment (a mean value of 3.25) with a tendency towards higher subjectivity. However, a considerable number of respondents stated that the accounting issue in this area is of less significance to Bahrain because companies acquire less intangible assets.

The other accounting area covered is the fixed assets. The area that creates the greatest controversy and requires the application of a high level of judgment is the impairment of assets (also see, Munter, 1995). The mean score for this item was 3.16 (SD =1.19). The valuation of fixed assets' surprisingly was pointed out as an area of high degree of judgment because only a few respondents marked it as an area of low judgment (mean =3.04; SD =1.15). Mann Whitney U test shows a significant difference ($Z =- 2.51$; $p<0.05$) in the responses of large versus small companies. This is contrary to the belief that the use of historical cost convention for recording fixed assets would narrow down the boundaries of subjectivity in this item. In contrast, the determination of the useful lives of fixed assets (mean =2.93; SD=1.11) and subsequent recording of wear and tear by means of depreciation (mean =2.63; SD =1.28) proved to be less judgmental to accountants. This may be explained by the fact that the assessment of an asset's useful life and depreciation is determined by a company's policies and resolutions of its Board of Directors, which guide the accountants in this area. There was no significant difference in the perceptions of the accountants between the large versus small companies on the determination of the useful life of assets measured on a Likert type scale ranging from high (5) to low (1). The responses are analyzed into two major categories of high judgment and low judgment. This is done on the basis of overall mean value of the respondents. The overall mean value is worked out to be 2.90. The mean value of the items above 2.90 is considered to be items requiring high degree of judgment and the items with mean of 2.90 and below are considered the items requiring moderate/low degree of judgment. Furthermore, the responses are also analyzed by large versus small size of companies using Mann Whitney U test. Mann Whitney U test is used because the sample size is not very large and the nature of data is generally non-parametric type. All 32 companies were grouped into large and small categories on the median value of their total assets. This resulted in large companies being defined as greater than US $6.7 million and small companies less than US $6.7 million using the total assets criterion. 21 (65.6%) companies were included in the former category (large) and 11 (34.4%) companies in the latter category (small).

Table 1 shows the results of the respondents in order of degree of judgment used by them.

Table 1
Degree of Judgment Used by Professional Accountants in Financial Accounting

Accounting area	Mean	SD	N	Mann Whitney U Test	Mann Whitney U Test
				By Size	By Experience
Area of High Judgment:					
Contingencies	3.55	0.97	29	- 1.97*	2.21*
Footnote disclosure	3.30	1.39	30	- 0.68	1.98*
Intangible amortization	3.25	1.08	28	- 0.79	0.74
Financial instruments	3.23	1.45	30	- 0.70	0.88
Revenue recognition	3.21	1.34	28	- 0.73	1.22
Inventory valuation	3.17	1.31	24	- 0.37	1.09
Impairment of assets	3.16	1.19	26	- 0.56	2.09*
Accounting for non-controlled subsidiaries	3.15	1.02	20	- 0.86	1.23
Bad debt expense	3.12	1.22	32	- 2.03*	0.22
Fixed assets valuation	3.04	1.15	26	- 2.51*	0.74
Expensing Vs. capitalizing	3.00	1.31	32	- 0.65	0.04
Mergers & acquisitions	2.94	1.29	16	- 0.21	1.33
Fixed assets useful life	2.93	1.11	30	- 0.35	0.94
Area of low Judgment:					
Intangible valuation	2.81	1.26	30	- 2.29*	0.59
R & D costs	2.79	1.08	19	- 0.93	0.45
Depreciation	2.63	1.28	32	- 0.83	0.11

* Significant at 0.05.

Estimation of contingencies received the highest mean score of 3.55 (SD = 0.97). This is

METHODOLOGY

SAMPLE AND RESEARCH INSTRUMENT

The target group selected for this study was 38 companies, which were listed on the Bahrain Stock Exchange (BSE) at the time this study was undertaken. The study was carried out during October-November 1999. The survey was based on a four-page questionnaire (see Appendix 1) distributed personally to the heads of accounting departments of 38 companies. The questionnaire covers general information on experience, age, qualifications, number of employees, and total assets value of the respondent companies. Other questions were related to such issues on judgment which apply to financial accounting and the implementation of international accounting standards. It also covers the decision making process and the factors that aid accountants in applying their professional judgment.

RESPONSE RATE

Thirty-two questionnaires were returned for a response rate of 84.2%. Other companies did not cooperate. Out of the total responses, 18 (56.3%) companies were from the banking, investment and insurance (financial) sector the remaining (43.7%) companies were from the industrial, services, hotel and tourism sector (non-financial sector).

It is to be noted that accountants and accounting managers completed 61.5% of questionnaires, and the other 39.5% were completed by finance managers and finance controllers. The finance managers and controllers were also accountants as most of them possess professional accounting qualifications and they were responsible for multiple functions in accounting and finance departments of their respective companies. A majority of the respondents possessed professional qualifications, such as Chartered Accountancy (43.8%), Certified Public Accountancy (28.2%), and Certified Management Accountancy (12.5%), while 15.5% were either graduates or post-graduates in accounting. It is to be noted that even finance managers and finance controllers had an accounting background and some of them had MBAs in Finance. The average experience of the respondents was 8.4 years, with a maximum of 29 years and minimum of 4.1 years at the time of conducting this survey. They had been in their present position in the company for an average of 6.11 years. 19 (59.4%) respondents had total experience of more than the average and 13 (40.6%) had less than the average experience. The purpose of the above analysis was to ensure that accounting professionals who have experience and interest in accounting practices and development in Bahrain were those who completed the survey.

RESULTS AND DISCUSSION

The first question covered in the questionnaire dealt with the degree of judgment applicable to various financial accounting areas. Accordingly, sixteen items from the accounting area were included in the questionnaire for the respondents to explain the degree of judgment concerning them, while preparing financial statements. The degree of judgment was determining whether an investor is capable of exercising significant influence over an investee. The results indicated that the "20% interest" threshold is the most important factor in these judgment processes. Although the "20% interest" threshold is often criticized for being arbitrary, the results of the study suggested that the use of this cut-off as a judgment cue might help achieve greater consistency and comparability in financial reporting.

Rentfro (2001) examines the role that professional judgment plays in earnings management in the US context, from 111 financial statement preparers. His study findings support the contention that financial statement preparers use professional judgment, allowed by US accounting standards, to manage earnings. Some of the study's participants were more likely to manage earnings when standards allowed significant exercise of professional judgment than when standards allowed limited amounts of discretion in reporting.

Thus, it is argued that accountants and auditors use their judgment in financial accounting, auditing, and management accounting (see, e.g., Gibbins and Swieringa, 1995; Bell and Wright, 1995). Exhibit 1 shows the possible areas for an accountant's judgment in financial accounting[4], managerial accounting, and auditing.

Exhibit-1
Possible Applications for Judgment in Accounting

Financial Accounting	Managerial Accounting	Auditing
Bad debt expense	Pricing	Materiality
Inventory valuation	Budgeting	Sampling
Provisions & contingencies	Cost allocation & estimation	Risk evaluation
Revenue realization	Cost control	Selection of audit tests
Product liability	System and environment evidence	Financial audit Sufficiency of
Intangible assets valuation and amortization	Profitability analysis	Adequacy of disclosure
R & D costs	Technology	True and fair view
Depreciation	Customer demands	Assessment of the adequacy of internal control
Expensing versus capitalization		
Financial instruments		
Footnote disclosures		
Accounting for non-controlled subsidiaries		
Fixed asset valuation, determination of useful life and impairment		

*Compiled from various sources e.g. Maines (1995); Solomon and Shields (1995); Abdolmohamamdi and McQuade, (2002); Gibbins, and Mason (1989).

This study focuses only on the financial accounting side of the applications of an accountant's judgment.

research. To support them, Schipper (1991) and Maines (1995) argue that our knowledge of this area is limited; therefore, there have been calls in recent years for more judgment-related research in financial accounting. The researchers from time to time have made some references about judgment in financial accounting but the relationship between judgment and accounting standards has not been examined extensively.

Murdock and Stephens (1987) argued that some of the specific situations requiring an accountant's judgment, when management elects to substantially omit all disclosures are: related party transactions, pledged assets, economic dependency, contracted dilution, future contracted cash flows, and foreign denominated sales and purchases. Likewise, according to United Kingdom's Statement of Standards Accounting Practice (SSAP) 6, "Extra-ordinary Items and Prior Year Adjustments", extra-ordinary items and their tax implications should be identified and disclosed separately from operating profit in the financial statements. Pizzey (1987) found that this process involves the use of judgment by the accountant despite the fact that the revised SSAP-6 provides some guidelines on identifying extra-ordinary items.

Gibbins and Mason (1988) conducted a survey in Canada on professional judgment in financial reporting in the private sector. In their study, the authors surveyed a sample of auditors and senior financial statement preparers to identify those aspects of professional judgment they found difficult. Out of 118 issues cited by the 52 respondents, 10 related to difficulties in making estimates, forecasts, and valuations and 12 related to difficulties in sorting out the real issues (ascertaining facts and the substance of transactions). In contrast, 68 references (58% of the total) related to the accounting standards, such as problems with clarity, alternatives allowed, and lack of coverage.

Brown et al. (1993) attempted to clarify the role of accountants by focusing on the types of judgment they are required to exercise, rather than on the technical skills they must acquire. They classified an accountant's judgment into three types:

- Semantic judgment: applying standards to inherently vague concepts like transaction and control.

- Pragmatic judgment: making determinations on how people will react given that it is often difficult to specify clearly bounded, necessary and sufficient conditions for applying concepts in abstraction from the purposes they are intended to serve .

- Institutional judgment: possessing the ability to jump out of the system and analyze it externally, since there is no logical limit to the number of conditions that standards may incorporate.

These types of judgments have become increasingly important for accountants over the past decade as technological advancements and complex business markets have further expanded their roles and responsibilities.

Laswad and Roush (1996) examined the judgment processes of financial controllers in professional judgment is likely to be most valuable in complex, ill-defined or dynamic situations, especially where standards are incomplete, and should normally involve consultation with knowledgeable people, identification of potential consequences and documentation of analytical processes leading to the decision".

The first question that comes to mind is, can detailed rule making eliminate the need for judgment in financial reporting[2]. The answer appears to be "no". For example, if one refers to the definitions of assets and liabilities, one finds that financial reporting of assets and liabilities must involve an accountant's professional judgment :

"Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained".

"Liabilities are obligations of an entity arising from past transactions or events, the settlement of which may result in the .. yielding of economic benefits in the future (CICA Hand Book, 1989)".

Skinner (1995) posits that the above definitions use the terms 'may be' or 'may result' in referring to the realization or settlement of assets and liabilities and these contain an implicit probability test. The future is always uncertain, and assessment of probability always requires the exercise of judgment[3].

The above references indicate that an accountant's judgment is important valuation in the accounting context. However, Mason and Gibbins (1991), stated that there is a lack of systematic studies of the nature and extent of judgments required by U.S. accounting standards, or of how judgments are affected by the quality of guidance in accounting standards. They further pointed out that a greater understanding of the interaction between judgment and accounting standards would have practical relevance and support the study of information preparation in such areas as disclosure, accounting, materiality, positive accounting and accounting regulation. On the other hand, a number of audit judgment models (e.g., Ashton, 1979; 1982; Solomon, 1987) are available dealing with auditing issues, including audit planning, internal control and audit evaluation (Brown, 1983), extent of testing (Emby, 1994), and materiality limits and guidelines used by auditors (Moriarity and Barron, 1979; Jordan et al., 1995).

Abdomohammadi and McQuade (2002) posit that the users of financial accounting information are diverse as compared to managerial accounting and auditing. The diversity of users and their multiple-objective settings make the understanding of the judgment-related issues in financial accounting very difficult for accountants. But judgment and decision making research is lagging behind in financial accounting. Financial research models are primarily based on capital market research, where the availability of extensive databases has provided an incentive to focus on empirical studies. On the other hand, judgment and decision making models normally require the collection of experimental data from survey questionnaires, laboratory experiments, archival studies, or field based and$4.4 billion respectively. The major trading partners of Bahrain are Saudi Arabia, India, Japan, USA, and UK. Foreign Direct investment (FDI) stood at $2.7 billion. Bahrain has established a thriving financial center, with both onshore and offshore operations and the financial sector accounted for 23 % of GDP. Bahrain was ranked ninth in a list of world wide countries by the Heritage Foundation in its 'The 2001 Index of Economic Freedom'.

Bahrain has an emerging stock exchange with 41 listed companies in 2002. By end of 1999, there were 38 companies listed on BSE, the value of total market capitalization of these companies was $7,152.35 million and the total number of shareholders were 103,884 (Bahrain Stock Exchange Directory, 1999). Foreign investors are allowed to invest and trade in shares in Bahrain Stock Exchange (BSE). The primary users of financial statements are stockholders, and investors while other users included lenders and creditors. There are ten audit firms in Bahrain, seven of which are international. Commercial Companies Act (CCA) of 1975 requires all limited liability companies to prepare books of accounts (income statement, a balance sheet, cash flow statement and statement of retained earnings) and have them audited. The 1975 CCA, does not require limited liability companies to follow a specific set of accounting standards. However, in 1994, through an official circular, the Ministry of Commerce and Agriculture advised the corporate sector companies to adopt IASs.

The remainder of this paper is divided into three parts. Part II discusses the conceptual and theoretical literature relating to judgment and accounting. Part III describes the methodology used and discusses the results of the survey. Part IV presents the summary and conclusions of the study.

LITERATURE REVIEW

A number of Commissions in the US in the past, have made references to the need for using judgment[1]. For example, the Treadway Commission (1987) observed that

> "Bona fide differences of opinion arise in financial reporting, especially if complex or novel transactions are involved. Generally accepted accounting principles may not always be clear on the appropriate accounting treatment and the company and its independent public accountant must use judgment in making decision".

The Professional Judgment in Financial Reporting (PJFR) of the Canadian Institute of Chartered Accountants (CICA) (1995) gave the following detailed explanation of judgment in accounting

> "The process of reaching a decision on a financial reporting issue can be described as professional judgment when it is analytical, based on experience and knowledge (including knowledge of one's own limitations and of relevant standards), objective, prudent and carried out with integrity and regulation of responsibility to those affected by its consequences. Such

INTRODUCTION

Accounting and auditing are a professional domain where judgment has a particularly significant role. Abdolmohammadi and McQuade (2002) state that accountants and users of financial accounting information, make a host of judgments and decisions on the basis of financial accounting data. However, the users of financial accounting information are more diverse than those who use managerial accounting and auditing information. Furthermore, the diversity of users and their objectives makes the understanding of judgment in financial accounting more difficult. Given the presently available accounting framework, accountants have a lot of discretion in determining the amount, timing and the quality of disclosures to be made, based on the assessment of the situation. Such assessment requires the employment of judgment. In this regard Belkaoui (1985) remarked that indeed, the accountant's job contains both science and art; it includes not only reporting but synthesizing and offering unbiased judgments and opinions on financial information.

When new accounting standards are adopted, whether locally developed or Internationally (IASs), there is definitely an element of judgment involved in their implementation and interpretation by accountants. Such judgments of accountants are guided or influenced by a variety of factors. However, the diversity of the objectives of the users of financial information and the inherent human bias in subjectively resolved situations, makes the application of judgment even more complex. This situation affects the quality of the decisions made by accountants, in the process of preparing financial statements and financial reporting. However, the accounting environment in each country differs greatly, and the degree of judgment by accountants may vary according to the complexity of accounting standards, business sector, the size of the company, their educational background, experience, economic situation etc.

OBJECTIVES OF THE STUDY

This paper attempts to address a largely ignored topic of how judgment is exercised by preparers of financial reports. Specifically, this study examines:
a) the extent to which accountants in Bahrain exercise judgment in the preparation of financial statements,
b) the level of judgment exercised by those accountants in applying International Accounting Standards (IASs), and
c) the identification of some key factors which influence an accountant's judgment.

ECONOMIC SCENARIO IN BAHRAIN

Bahrain is an Island nation in the Arabian/Persian Gulf and is situated about 15 miles from the east coast of Saudi Arabia. Like other oil producing countries, Bahrain also experienced remarkable economic growth following the 1970 oil boom. Petroleum processing and refining, aluminum smelting, offshore banking, ship repairs, tourism, poultry and dairy products etc. are the major industries in Bahrain. According to the Heritage Foundation (2001), by the end of 2000, the gross domestic product of Bahrain was $5.9 billion with a growth rate of 2.1%. Total exports and imports of goods and services were $4.5 billion

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JUDGMENT BASED ACCOUNTING: AN EMPIRICAL SURVEY OF ACCOUNTANTS PRACTICES IN BAHRAIN

P. L. Joshi
University of Bahrain

Jawaher Al-Mudhahki
University of Bahrain

Hasan Al-Bastaki
Bahrain Center for Studies and Research

Abstract

This study examines issues relating to accountants' professional judgment in financial accounting in Bahrain. Data were gathered through a survey of 32 companies listed on the Bahrain Stock Exchange (BSE). The study reveals that accountants use a high degree of judgment in financial accounting for which they have unstructured information and have alternative choices or have less scope for maneuverability. Examples are: estimation of contingencies, footnote disclosures, intangible amortization, financial instruments, and revenue recognition. However, in financial issues, for which company policies and procedures are documented, less judgment is applied. Accountants also apply either a high or moderate degree of judgment concerning International Accounting Standards, especially IASs 1, 2, 3, 4, 5, 7, 8,10, 14, 23, 27, 28, and 30. This evidence suggests that Bahrain needs to modify these accounting standards for local conditions. Professional experience, company policies, accounting standards, knowledge of law, and educational background also influence the level of an accountant's judgment. However, in the process of applying judgment, professionals do not rely too much on theoretical decision-making models. The study concludes that judgment is applied in situations where the actual proof is missing, future estimates are made and situations in which accounting rules either do not apply or do not provide adequate solutions.

Key Words: Judgment, Accounting, Auditing, Factors, Decision Making, International Accounting Standards, Bahrain