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## Araştırma Makalesi • Research Article

### A Statistical Analysis of the Effects of the Development of Accounting and Auditing Standards on the Financial Soundness of Banks

*Muhasebe ve Denetim Standartlarındaki Gelişmenin Bankaların Mali Sağlamlığı Üzerindeki Etkileri İçin İstatistiksel Bir Analiz*

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#### ÖZ

Bankaların finansal sağlamlığı sadece firmalar için değil, fakat aynı zamanda ülkeler için de sürdürülebilir ekonomik kalkınmaya ulaşmak için hayati önem taşımaktadır. Bankaların finansal sağlamlığını hem firma düzeyinde hem de ülke düzeyinde etkileyen birçok faktör söz konusudur. Bu çalışmada, denetim ve muhasebe standartlarındaki gelişmenin bankaların sağlamlığını etkileyip etkilemediği Kruskal-Wallis testi kullanılarak 140 ülke için test edilmiştir. Kruskal-Wallis test sonuçlarına göre, denetim ve muhasebe standartları geliştikçe, bankaların finansal sağlamlığının arttığı söylenebilir. Sonuç olarak, bankacılık sektörünün ve ülkelerin, bankaların mali sağlamlığının güçlenmesine ve sürdürülebilir ekonomik kalkınmaya ulaşmak için denetim ve muhasebe standartlarını geliştirmesine büyük önem vermesi gerektiği sonucuna ulaşılmaktadır.

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#### ABSTRACT

Financial soundness of banks is vital not only for the firms but also countries in order to achieve sustainable economic development and the welfare of the society. There are many factors affecting financial soundness of banks both firm level and country level. In this study, it is tested whether development of auditing and accounting standards affects the soundness of banks or not for the 140 countries by using Kruskal-Wallis test. According to the Kruskal-Wallis test results, it can be argued that as auditing and accounting standards develops then financial soundness of banks rise. As a result, it can be concluded that the banking sector and the countries should give great importance to develop auditing and accounting standards in order to achieve better financial soundness of banks and sustainable economic development.

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## Introduction

The soundness of banks is critical to maintain economic, social and political stability and ensure sustainable development at national and international level. It is of great importance that the financial performance and financial strength of banks are closely monitored by the competent authorities and that continuous reinforcing measures are taken in this regard. Therefore, it is important to reveal the factors affecting the soundness of banks and to consider these factors in economic policy designs.

There are many factors affecting financial soundness of banks both firm level and country level. In strengthening the financial soundness of banks, it is important to have strong financial performance of banks. The quality of human capital working in banks, the level of development of corporate risk management capacity, the level of development of credit allocation policies, the level of development of corporate governance capacities, the level of transparency and accountability, and the correct and reliable implementation of accounting and auditing standards are among the important factors affecting the financial strength of banks. Despite all these studies, an adequate theoretical and empirical literature has not been formed regarding the effects of the level of development in accounting and auditing standards on the soundness of banks. However, the quality of the indicators of bank soundness depends on the level of improvement in accounting and auditing standards in countries. The underlying reason of the bankruptcy scandals of many companies in the past and the negative effects of these scandals on financial and economic stability lies in the ineffective application of accounting and auditing standards.

In this context, the effects of the level of development in accounting and auditing standards on the financial soundness of banks will be tested empirically in this study. On the other hand, banking sector is a critical sector not only financing real sector investments but also a confidence indicator for the investors and consumers to economic situation. For this reason, financial soundness of banks is vital not only for the firms but also countries.

Strengthen auditing and accounting standards is an important factor affecting financial soundness of banks not only by contributing effecting enterprise resource planning and management but also contributing shareholders and investors to provide better and sound information about the financial performance of the banks.

In this study, it is tested whether strengthen auditing and accounting standards affects the soundness of banks or not for the 140 countries by using Kruskal-Wallis test. The data used in the study for the 140 countries is from World Economic Forum, The Global Competitiveness Index 4.0, 2018 Dataset. The variables are strength of auditing and accounting standards and soundness of banks, the scale for the two variables is 1-7 interval scale and 7 is the best.

The original aspect of this article is - to the best of our knowledge - the first use of the strengthen auditing and accounting standards variable for the analysis of affects the soundness of banks in the literature.

## Literature

With the increasing financial and commercial liberalization in the world economy, the international business volume is also increasing significantly. However, over time, decision makers and investors in businesses have realized the importance of using a common account language when conducting business transactions with each other. The problems created by the differences between the national accounting standards of the countries have affected the establishment of a common standard framework that can be generally accepted between

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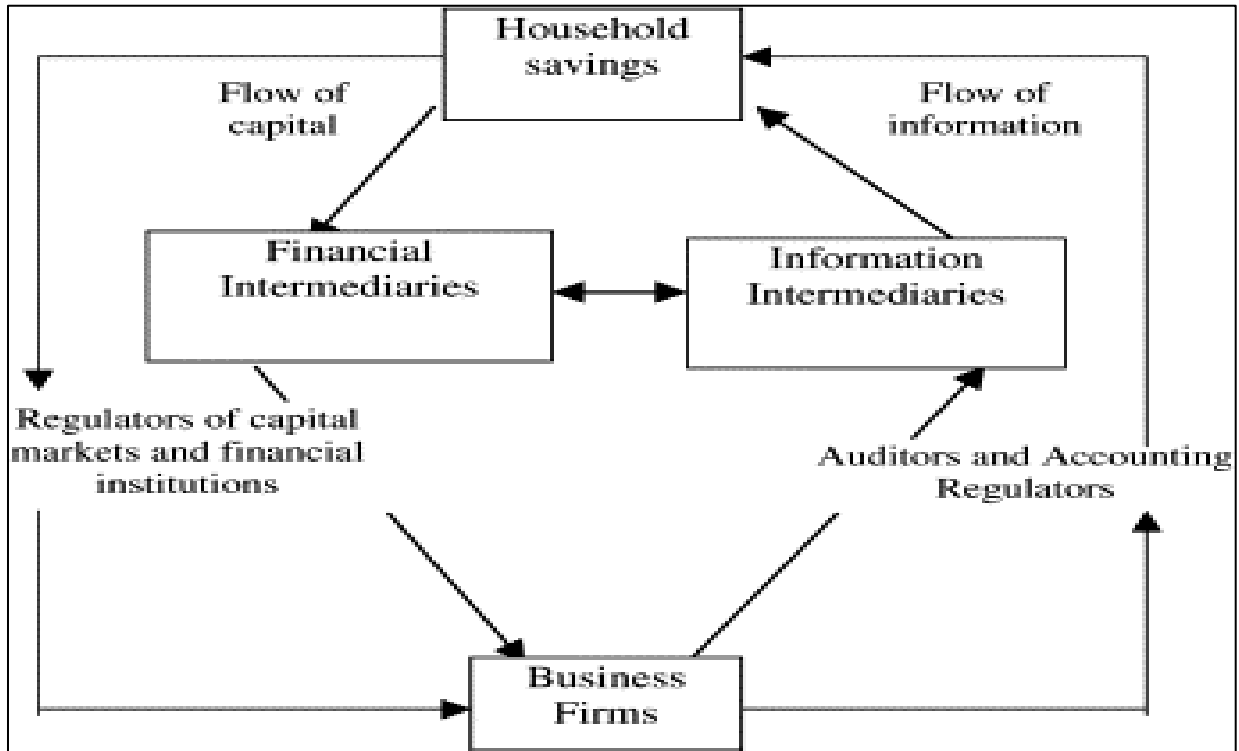
countries. Under these circumstances, international accounting and auditing standards were developed and used widely in the world. Today, while international accounting and auditing standards are changing according to new developments, they are accepted and used by more countries and businesses on the other hand. The widespread and development of international accounting and auditing standards, while contributing to the access of all internal and external stakeholders related to businesses to healthier, reliable and transparent information, on the other hand, increased the accountability obligations of businesses. Thanks to the widespread and development of international accounting and auditing standards, it has contributed to the transformation of international savings into investments more effectively and to the determination of more reliable and successful businesses. These positive developments also contribute to sustainable development at national and international level and to increase social welfare. On the other hand, the problems in the implementation of international accounting and auditing standards and / or the manipulations made in the financial statements caused the investors to take wrong decisions and negatively affected the financial and economic stability and caused financial and economic crises in some periods.

The health of the information produced by the accounting information system contributes to making healthier decisions by reducing the asymmetry between all parties using the information. Audit services are also of great importance as they provide assurance services to ensure that the information produced by the accounting is healthy (Frankel and Li, 2004). Existence of information asymmetry (see also, lemon problem, Akerlof, 1978) can lead to making wrong decisions (adverse selection) between decision makers. Especially in the financial system (See Figure 1), the information asymmetry that savers are exposed to in their investment decision processes can reach a level that can trigger financial crises.

The level of development in accounting and auditing standards is important in terms of contributing to the reduction of information asymmetry in the flow of information between all parties in the economic system. Shahzad et al (2019) found that financial reporting quality and audit quality have a positive impact on investment efficiency.

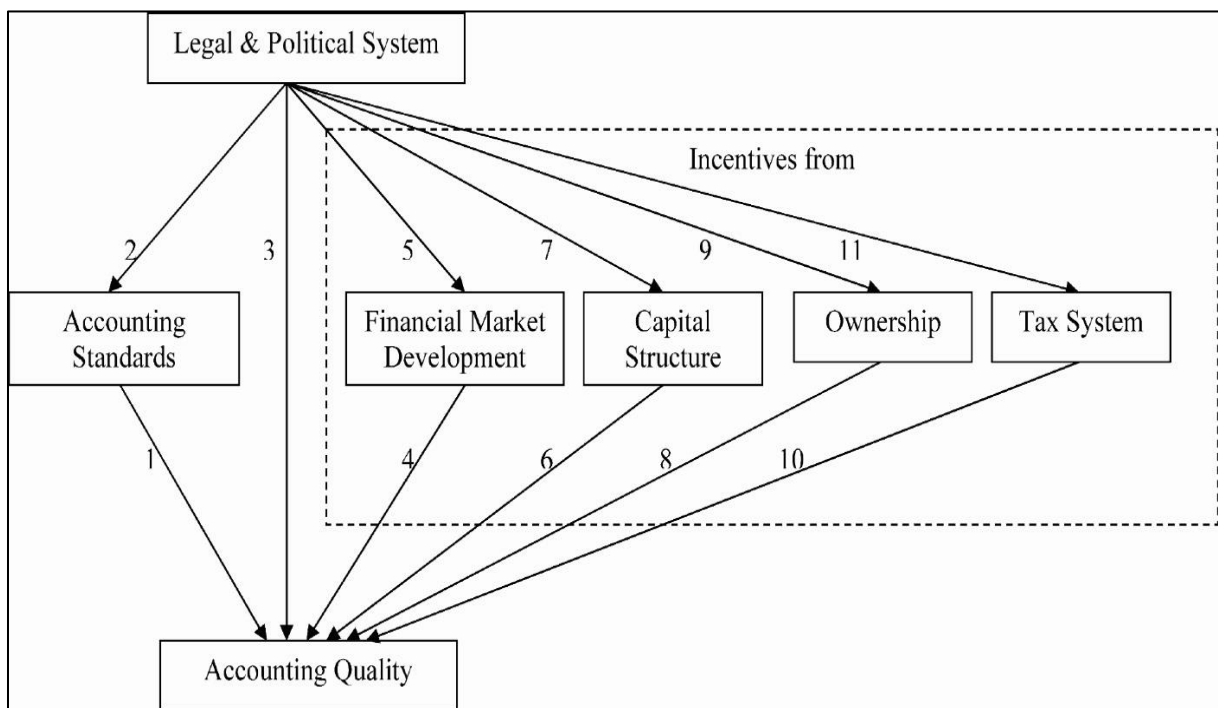
Figure 2 shows the determinants of accounting quality. Although international accounting and auditing standards contribute to the improvement of accounting quality, this alone will not be sufficient. Because international accounting and auditing standards are affected by both the corporate governance quality at the firm level and the economic and political business environment at the national level (see Soderstrom, 2007).

**Figure 1:** Financial and information flows in a capital market economy.



Source: Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of accounting and economics*, 31(1-3), 405-440.

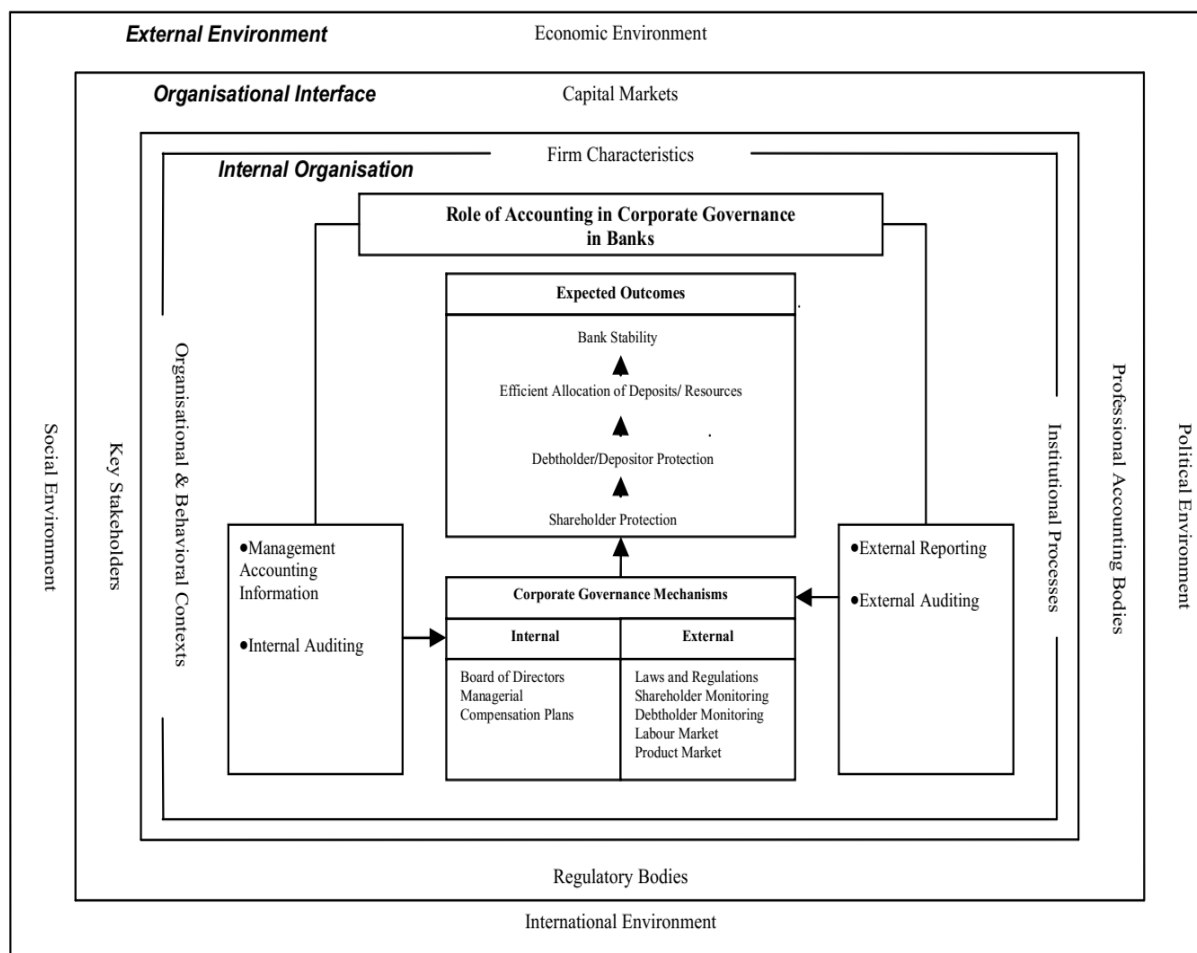
**Figure 2:** Determinants of accounting quality



Source: Soderstrom, N. S., & Sun, K. J. (2007). IFRS adoption and accounting quality: a review. *European accounting review*, 16(4), 675-702.

Soderstrom ve Sun (2007) in their study stated that the effect of the legal and political systems in the country is important in the development of accounting quality, however, promoting the quality of financial reporting will also contribute to the improvement of accounting quality. Ekanayake et al (2009) found that external reporting, internal and external auditing and management accounting are important factors in strengthening corporate governance capacity in banks (see, Figure 3).

**Figure 3:** The Role of Accounting in the Corporate Management of Banks

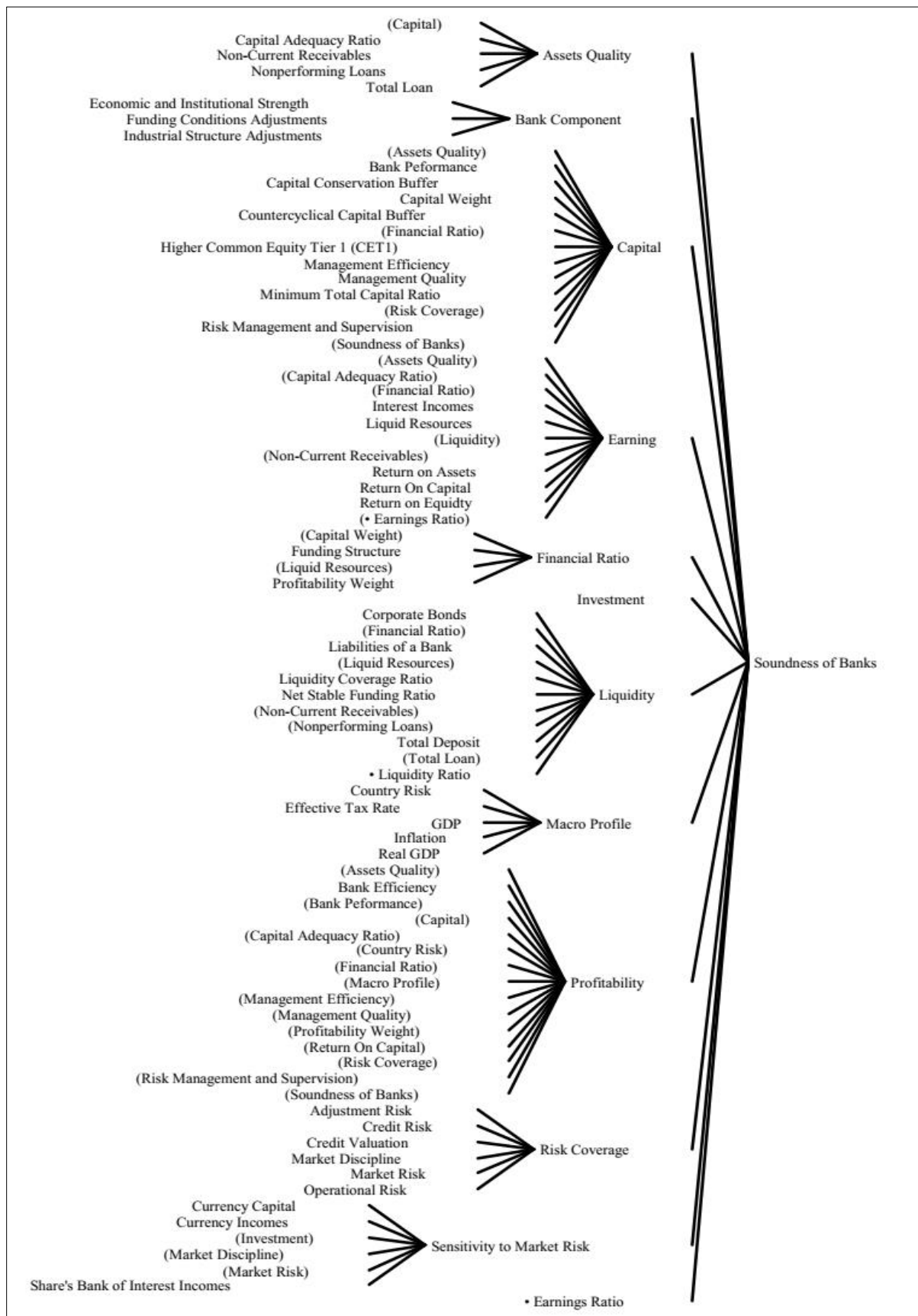


Source: Ekanayake, A., Perera, H., & Perera, S. (2009). Towards a Framework to Analyse the Role of Accounting in Corporate Governance in the Banking Sector. *Journal of Applied Management Accounting Research*, 7(2).

Jin et al (2011) examined the contribution of accounting and auditing variables to predicting bank failure during the financial crisis. In the study, they revealed that, on the one hand, the quality of the supervisors has an important role in reducing bank failures, on the other hand, accounting information also contributes significantly to predicting the future financial situation of businesses.

There are many factors affecting the soundness of banks at the firm, sector level, national and international level. The complex interaction between the factors affecting the soundness of banks may also vary continuously according to social, economic and political conditions (see Figure 4). For this reason, it is important to constantly monitor the soundness of banks according to updated data and changing conditions in more effective design of economic policies.

**Figure 4:** Casual Tree of Soundness of Banks



Soruce: Naser, (2019:36).

The financial soundness of banks means that the financial indicators of the banks are within acceptable threshold values in terms of soundness. If the financial indicators of the banks exceed these threshold values, it means that the financial health of the banks deteriorates. In this context, financial indicators are of great importance in understanding and monitoring the financial health of banks in the banking sector. On the other hand, financial statements and financial ratios showing the financial health status of banks are produced in the accounting information system and audited by auditors. The level of improvement in accounting and auditing standards is crucial in showing the true financial condition of banks. The high level of development in accounting and auditing standards will enable investors to have more accurate information about the financial structures of companies and to make healthier investment decisions. On the other hand, weaknesses in accounting and auditing standards or the misuse of these standards will lead to the dissemination of asymmetric information among the internal and external stakeholders of the firm and, accordingly, making wrong investment decisions. These systemic wrong decisions will feed finance and the emergence of economic crises (see, Salina et al, 2020).

There are many factors affecting financial soundness of banks. These factors cover firm level, sectoral and macroeconomic level. Studies examining the effects of the factors affecting the soundness of banks and the impacts of changes in the soundness of banks on economic and financial stability are summarized in Table 1.

**Table 1:** Literature On Financial Soundness Of Banks And The Role Of Accounting And Auditing

<i>Author(s)</i>	<i>Findings</i>
Enoch and Green, (1997)	Among the institutional factors that affect the soundness of banks, the corporate governance capacity of banks, the effectiveness of the internal control system, continuous monitoring of changes in financial statements and effective management of risks stand out.
Fischer (1997)	Among the global factors affecting the soundness of banks, the limited tools and policies for controlling the increasing volatility in capital movements due to financial liberalization stand out.
Guitian (1997a)	The soundness of banks is closely related with financial sector soundness of countries. It has been determined that banks' corporate governance quality, effective implementation of accounting and auditing standards, and the effectiveness of internationally accepted banking guidelines play an important role in the soundness of banks.
Frenkel (1997)	Economic policies and different performance indicators are important for the soundness of the banking system.
Crockett (1997)	The volatility in macroeconomic variables such as foreign trade terms, interest rates, exchange rates, inflation and economic growth are important for the soundness of the banking system.
Brash (1997)	In the soundness of the banking system, the role of bank auditors and the audit system is of great importance.
Roulier (1997).	In the soundness of the banking system, the role of the bank governance quality and the audit system is of great importance.
Guitian (1997b)	In the soundness of the banking system, it is important to strengthen the control mechanisms for compliance with the free market system, to maintain the balance of interest discipline between internal and external stakeholders of the banks, and to strengthen official oversight.
Rahman (1998)	It has been determined that the use of accounting and auditing standards in accordance with their purpose prevents transparency in the financial statements of companies and banks and contributes to the emergence of banking and financial crises.
Kimbro (2002)	Effective legal and financial accounting systems, good financial reporting standards and a high number of accountants have been found to be effective in reducing corruption.
Babihuga, (2007)	Changes in the profitability and financial indicators of the banking sector affect the economic fluctuations.

**Table 1:** Literature On Financial Soundness Of Banks And The Role Of Accounting And Auditing

<i>Author(s)</i>	<i>Findings</i>
Navajas and Thegeya (2013).	It was determined that the deterioration in the financial soundness of banks caused financial crises. It has been determined that the deterioration in risk-weighted assets, return on equity variables can play a role in the development of financial crises.
Naser (2019)	As micro factors affecting the soundness of banks, capital adequacy, assets, management, earnings and liquidity indicators play an important role.
Adesina et al (2020)	Adesina et al (2020) investigated the importance of forensic control in maintaining the soundness of deposit banks. In their study, Adesina et al (2020) recommended that regulatory agencies should appoint professional forensic auditors to reduce bank fraud and training bank staff in the field of audit.
Mustari et al (2020)	Mustari et al (2020) examined the role played by the internal audit profession in the financial performance of commercial banks. Mustari et al (2020) found that supervision has a positive effect on the financial performance indicators of commercial banks. Mustari et al (2020) emphasized in their study that it is important for policy makers to develop standardized measures regarding internal audit. They emphasized that it is important for managers to ensure that the internal audit function operates independently.
Ben et al (2020)	The soundness of banks has a significant impact on sustainable development.
Albrecht et al (2020)	In their study, Albrecht et al (2020) investigated whether auditors could influence persistent concern opinions in their decisions to mitigate the adverse spillover effects of systemic risk during a crisis period. In their study, Albrecht et al (2020) found that supervisors are less likely to systemically give persistent concern opinions towards risky banks.

### Data and Method

The data used in the study for the 140 countries is from World Economic Forum, The Global Competitiveness Index 4.0, 2018 Dataset. The variables are strength of auditing and accounting standards and soundness of banks, the scale for the two variables is 1-7 interval scale and 7 is the best.

Because of the insufficient panel data for the variables, the methodology preferred in the study is Kruskal-Wallis test. The countries are separated three (low, medium and high level) groups according to strength of auditing and accounting standards. It is tested whether strengthen auditing and accounting standards affects the soundness of banks or not.

### Empirical Results

Table 2 shows the descriptive statistics for the soundness of the banks variable. According to the results, the mean of soundness of the banks for the countries with low level strength auditing accounting standards is 3.55, the mean of soundness of the banks for the countries with medium level strength auditing accounting standards is 4.67, the mean of soundness of the banks for the countries with high level strength auditing accounting standards is 5.70.

**Table 2:** Descriptive Statistics For the Soundness of the Banks Variable

	Strength auditing accounting standards		
	Low	Medium	High
Mean	3,5575	4,6715	5,7055
Median	3,6350	4,8000	5,6700
Variance	0,5702	0,4717	0,2294
Std. Deviation	0,7551	0,6868	0,4790



**Table 2:** Descriptive Statistics For the Soundness of the Banks Variable

Strength auditing accounting standards			
	Low	Medium	High
Minimum	1,7200	2,8700	3,9800
Maximum	4,7800	5,7300	6,6700
Range	3,0600	2,8600	2,6900
Interquartile Range	1,2125	0,9400	0,6300
Skewness	-0,5453	-0,6368	-0,7909
Kurtosis	-0,2915	-0,2190	2,6730

Table.3 shows the normality test results for the soundness of the banks variable. According to the Shapiro-Wilk test results, the null hypothesis the data is normally distributed is rejected at the 0.05 significant level for the countries with medium and high strength auditing accounting standards.

**Table 3:** Normality Test Results For the Soundness of the Banks Variable

	Strength Auditing Accounting Standards	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
The Soundness of the Banks	Low	,103	32	,200*	,966	32	,393
	Medium	,091	61	,200*	,955	61	,025
	High	,092	47	,200*	,947	47	,034

\*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

Table 4 shows the test results of homogeneity of variances for the soundness of the banks variable. According to the Levene test results, the null hypothesis, homogeneity of variance, is rejected at the 0.05 significant level.

**Table 4:** Test of Homogeneity of Variances Results For the Soundness of the Banks Variable

The Soundness of the Banks			
Levene Statistic	df1	df2	Sig.
5,154	2	137	,007

Table 5 shows Kruskal-Wallis test results. According to the results, the null hypothesis, the mean ranks are the same in all the groups, is rejected at the 0.05 significant level. Based on the Kruskal-Wallis test results, it can be argued that the mean ranks for soundness of banks are not same for the country groups with different level auditing and accounting standards strength.

**Table 5:** Kruskal-Wallis Test Results

Null Hypothesis	Sig.
The distribution of soundness banks is the same across categories of Strength auditing accounting standards	0.000
Asymptotic significances are displayed	

Table 6 shows pairwise test results. According to the results, the null hypothesis, the distributions are the same in all the pairwise groups, is rejected at the 0.05 significant level. Based on the pairwise test results, it can be argued that the distributions for soundness of banks are not same for the country groups with different level auditing and accounting standards strength. As a result, as auditing and accounting standards strengthens then soundness of banks rise.

**Table 6:** Pairwise Test Results

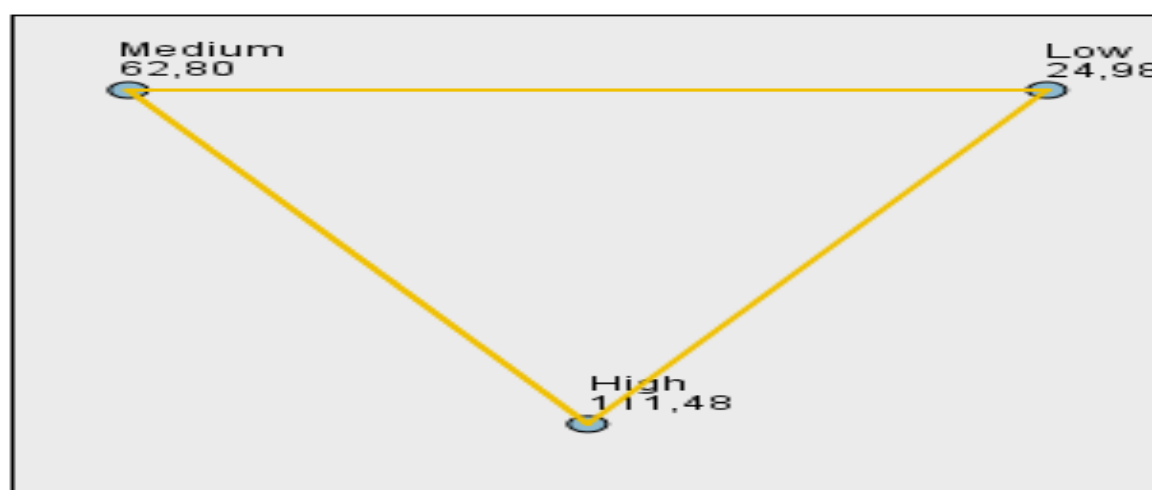
Sam ple1 – Sample2	Test Statistic	Std. Error	Std. Test Statistic	Sig.	Adj.Sig.
Low-Medium	-37,819	8,853	-4,272	0	0
Low-High	-86,494	9,295	-9.305	0	0
Medium-High	-48.675	7,872	-6,184	0	0

Each row tests the null hypothesis that the Sample 1 and Sample 2 distributions are the same.

Asymptotic significances (2-sided tests) are displayed. The significance level is ,05.

Figure 5 shows the pairwise comparison results. The results show that the samples average rank is statistically different.

**Figure 5:** Pairwise Comparison Results



### Conclusion

Financial soundness of banks is vital not only for the firms at microeconomic level but also countries at macroeconomic level in order to achieve sustainable economic development and the welfare of the society. The soundness of banks has a great importance to maintain economic, social and political stability and ensure sustainable development at national and international level. Therefore, it is important to reveal the factors affecting the soundness of banks and to consider these factors in economic policy designs. There are many factors affecting financial soundness of banks both firm level and country level. Strengthen auditing and accounting standards is an important factor affecting financial soundness of banks not only by contributing effecting enterprise resource planning and management but also contributing

shareholders and investors to provide better and sound information about the financial performance of the banks.

In this study, it is tested whether strengthen auditing and accounting standards affects the soundness of banks or not for the 140 countries by using Kruskal-Wallis test. According to the Kruskal-Wallis test results, the null hypothesis, the mean ranks are the same in all the groups, is rejected at the 0.05 significant level. Based on the Kruskal-Wallis test results, it can be argued that the mean ranks for soundness of banks are not same for the country groups with different level auditing and accounting standards strength. In our study, it was concluded that the level of development in accounting and auditing standards in accordance with the literature has a positive effect on the financial soundness of banks.

The results of the study are also in line with the findings in the literature on the subject. The more the asymmetric information problem that investors encounter while making investment decisions can be solved, the more likely they are to make the right investment decision. In this context, the development of accounting and auditing standards plays an important role in solving the asymmetric information problem between banks and all stakeholders doing business with banks. Because with the strengthening of accounting and auditing standards, the accuracy and reliability of financial and non-financial information about individuals and organizations who want to do business with the bank increases. In addition, with the strengthening of the accounting and supervision of banking activities at the bank level, mistakes and frauds are reduced and the financial strength of banks is strengthened. As a result, the development of accounting and auditing standards plays an important role in solving the problem of asymmetric information among all relevant stakeholders at both the bank level and the banking sector level, helping all stakeholders to make better decisions. Thus, as a result, the financial strength of the banks is also getting stronger. On the other hand, in solving the asymmetric information problem between companies and all relevant stakeholders, it is of great importance to continue to improve the accounting and auditing standards continuously and rapidly in the face of new problems. Because the changing business methods, the changing legal framework, the changes in the structure of the cooperation between the companies constantly create significant effects on the financial performances of the companies. Reflecting these changes to decision makers through accounting and auditing standards in the most accurate way has a vital role in the financial soundness of companies and in making the right decisions by investors.

As a result, as auditing and accounting standards strengthens then soundness of banks rise. It can be concluded that the banking sector at microeconomic level and the countries at the macroeconomic level give great importance to strengthen auditing and accounting standards in order to achieve better soundness of banks, leading to sustainable economic development and the welfare of the society.

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