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Review of practical implementation issues relating to international financial reporting standards

Case study of Egypt

Note by the UNCTAD secretariat**

Executive Summary

This case study illustrates the approach Egypt has taken to implementing international financial reporting standards (IFRS). It provides an overview of the efforts the country has undertaken to strengthen its accounting, financial reporting and auditing standards over the last two decades. The current set of Egyptian accounting standards are based on IFRS, some of which have been adapted to take into account the specific situation of the country. These include: presentation of financial statements; property, plant and equipment; disclosure of financial instruments; and accounting rules and standards for financial leasing operations. The auditing standards of Egypt are based on international standards on auditing (ISAs). The study discusses the roles of various regulatory bodies – including the Capital Market Authority, the Central Bank and the Insurance Supervisory Authority – in the implementation and enforcement of accounting standards. It notes that the process of issuing Egyptian Accounting Standards, including translation into Arabic, is lengthy. As a result, there is a gap between the set of Egyptian Accounting Standards that are currently in effect and IFRS. The paper highlights the need for capacity-building in accounting and auditing to facilitate implementation of standards in those areas. The need for a system of continuing professional education in accordance with internationally recognized requirements is also highlighted.

* ISAR documents were previously issued under the symbol TD/B/COM.2/ISAR/...

** This note was prepared with substantive input from Ashraf El Sharkawy, PhD, Professor of Accounting, Cairo University; Ahmed Fouad, PhD, Lecturer of Accounting, Cairo University; and Dalia Ibrahim, Assistant Lecturer, Institute of National Planning.

I. Background

1. In view of the widespread adoption of international financial reporting standards (IFRS) in recent years, UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been reviewing practical issues that arise in the course of implementing IFRS, with a view to facilitating the sharing of experiences and lessons learned among member States. At its twenty-second session, ISAR deliberated on a background note (TD/B/COM.2/ISAR/28) prepared by the UNCTAD secretariat which highlighted major practical implementation issues pertaining to institutional and regulatory arrangements, enforcement mechanisms, technical issues and capacity-building. On the basis of this framework, country case studies covering Brazil, Germany, India, Jamaica and Kenya were prepared and considered at the twenty-third session of ISAR. Furthermore, country case studies of Pakistan, South Africa and Turkey were discussed at ISAR's twenty-fourth session.

2. In concluding its twenty-fourth session, ISAR requested the UNCTAD secretariat to continue conducting studies on practical implementation issues relating to IFRS, including on related topics such as implementation of international standards on auditing (ISAs). Accordingly, country case studies on practical implementation of IFRS covering Egypt, Poland, Switzerland, and the United Kingdom – as well as a study on practical challenges and related considerations in implementing ISAs – were prepared for consideration by the twenty-fifth session of ISAR. The main objective of these papers is to facilitate sharing of experiences among member States.

3. This note presents the findings of the case study conducted in Egypt. It discusses key regulatory provisions in Egypt regarding accounting, financial reporting and auditing. It gives examples of the practical implementation of IFRS-based Egyptian accounting standards. The study provides insights into key issues that arise in the implementation and enforcement process.

II. Introduction

4. Egypt has greatly benefited from reforms to open up and liberalize its economy in recent years and has quickly become a dynamic market economy led by the private sector and well integrated in the global economy.¹ It has achieved excellent GDP growth rates of 7.1 per cent in 2006/07 – up from 4.6 per cent in 2004/05 and 6.9 per cent in 2005/06² – and a rate of about 7 per cent has been predicted by the International Monetary Fund for the next few years. This performance has been accompanied by record foreign direct investment (FDI) of more than US\$6 billion dollars in 2006. There have been improvements in most economic and social indicators. Private investment increased from an average of 8 per cent of GDP in fiscal years 2001–2004 to 13.1 per cent in 2007. Moreover, FDI increased from an average of 0.6 per cent of GDP during 2001–2004 to 8.6 per cent in 2007.

5. Egypt has taken important steps to liberalize trade in financial services, in line with World Trade Organization standards. Under Egyptian law, foreign investors are free to participate in the securities market without any ownership-related restrictions. The same administrative and legislative rules apply to both Egyptian companies and international financial organizations. Likewise, listing and trading rules are the same for both local and foreign securities. Finally, foreign investors are

¹ Organization for Economic Cooperation and Development. *African Economic Outlook*. OECD, 2007.

² PEmbassy of the United States of America. *Economic Trends Report: Egypt*. May 2007.

now free to engage in securities trading without any limitations on capital movement.

6. As a developing country with an emerging capital market, Egypt closely follows developments in international financial reporting and auditing. The Capital Market Authority (CMA) is fully committed to bring the Egyptian capital market in line with international standards, and promotes adherence to securities regulation rules established by the International Organization of Securities Commissions, the corporate governance principles of the Organisation for Economic Co-operation and Development, securities numbering schemes set forth by the Association of National Numbering Agencies, as well as clearing and settlement best practices, Egyptian and international accounting and auditing standards, and the anti-money-laundering recommendations issued by the Financial Actions Task Force.

7. This report presents the historical development of accounting and financial reporting in the country and discusses recent regulatory developments following the attempts at convergence with the global set of financial reporting standards, commonly referred to as international financial reporting standards (IFRS). In doing so, this report details the Egyptian experience in adapting to IFRS and lessons learned in the implementation process.

8. Egypt has an eventful history in the field of financial management and accountability. During the 1960s, with the move to economic management based on central planning, nationalization, and rapid expansion of the public sector, the Central Auditing Organization became the governmental agency responsible for auditing the public sector, including state-owned companies. In the mid-1970s, the Egyptian government introduced an “open-door” policy to liberalize the national economy; in 1991, the Government launched a comprehensive economic reform and structural adjustment programme supported by the World Bank and the International Monetary Fund. Key international donor/lending institutions such as the World Bank and the International Monetary Fund exert pressures on developing and transitional countries to adopt IFRS as part of their reform programmes. They argue that the application and implementation of internationally accepted accounting standards is necessary to command the confidence of investors.

9. Egypt is aware that sustaining such a programme depends on the existence of a sound financial regulatory framework, availability of credible corporate information and adoption of internationally accepted accounting and auditing standards. As part of these efforts, the Government of Egypt launched several initiatives to reform corporate financial reporting and disclosure requirements, as well as accounting and auditing standards and practices.³

10. The Government of Egypt has made efforts to modify the law to achieve compliance with internationally accepted accounting and auditing standards. These modifications include drafting a new accounting practice law and modifying the Company Act, the Capital Market Act and the Banking Act. Consequently, important improvements have been made to accounting and disclosure requirements the publicly traded companies and financial institutions, as well as to the Egyptian Accounting Standards (EAS), as benchmarked against the International Accounting Standards (IAS). Moreover, a new accounting practice bill has been drafted. As a result of various reforms and in order to improve the quality of financial reporting and disclosure, a new set of EAS based on IFRS were issued in 2006. Furthermore, a new set of Egyptian Standards on Auditing (ESA) based on ISAs was prepared and issued pursuant to the Decree No. 166/2008 of the Minister of Investment.

³ PWorld Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

A. A brief history of accounting in Egypt

11. Historically, Egyptian accounting was not capital-market oriented but followed the principles of macroaccounting with strong government intervention to control the economy, and was closely connected with accounting for tax purposes. Economic liberalization in the 1990s – aimed at creating a guided free market economy – involved the reactivation of the stock exchange market in 1995 and a privatization programme. The transition posed challenges for the Government, private sector institutions and the accounting profession. The aim being to increase the role of the private sector, there was therefore a need for changes to and reforms of accounting systems to improve decision-making, attract investment, stimulate economic development through increased competition and enhance the level of confidence of foreign portfolio investors in the Egyptian capital market.⁴

B. Egyptian accounting and auditing standards (1997–2002)

12. As part of the reform process, the Government of Egypt pursued a policy of harmonizing EAS with IAS issued by the International Accounting Standards Board (IASB). Egypt decided to harmonize its national accounting standards with IAS, while ensuring that specific characteristics of the Egyptian environment were taken into account. As a result of Ministerial Decision No. 503, in October 1997 Egypt established the Permanent Committee for Accounting and Auditing Standards to issue EAS that were to be based on IAS, though adapted for local conditions. Although official responsibility for setting accounting and auditing standards rests with the permanent committee, the Egyptian Society of Accountants and Auditors has, in practice, the main responsibility for drafting accounting and auditing standards. The society's standard-setting committee selects international accounting and auditing standards that are applicable to the Egyptian situation. Once the committee selects an international standard, it is translated into Arabic and becomes the basis for drafting an Egyptian standard that reflects specific requirements under Egyptian laws and regulations. The draft standard is submitted to the permanent committee for discussion, finalization and adoption. The final version of the standard is transmitted to the Ministry of Foreign Trade for issuance by a ministerial decree.⁵

13. As from 1998, all listed companies in Egypt were required to comply with the new EAS. By 2000, there were 22 EAS, most of which are comparable to the corresponding IAS excepting minor differences. The main aim of the approach taken was to enhance the quality of information issued by listed companies, improve decision-making, attract investors, stimulate economic development through increased competition and enhance the level of foreign portfolio investors' confidence in the Egyptian capital market.

14. In 2002, Egypt had 22 accounting standards and 6 auditing standards. ESA issued in 2000 deal only with reporting issues and ignore the other areas of ISAs. However, ISAs are applied in the absence of ESA, as stated in the ESA introduction.

C. Egyptian accounting and auditing standards (2002–2008)

15. The new Government that took office in June 2004 set a major agenda for macroeconomic and structural reform and modernization. As part of this agenda, it submitted a program of financial reforms that was formally endorsed by the President of Egypt in September 2004. Known officially as the Financial Sector

⁴ Samaha K and Stapleton P. Compliance with International Accounting Standards in a national context: Some empirical evidence from the Cairo and Alexandria Stock Exchanges. *Afro-Asian Journal of Finance and Accounting*. 2008. 1 (1).

⁵ Ibid.

Reform Programme, it is to be implemented over the period 2005–2008. The programme represents the most far-reaching, substantive and comprehensive drive towards financial sector strengthening to have been launched in Egypt to date.⁶

16. As the need to improve the financial reporting and disclosure system had been recognized, a new set of EAS were issued, as a part of many other reforms, pursuant to the Decree No. 243/2006 of the Minister of Investment and thus replace the old standards issued under the two ministerial decrees Nos. 503/1997 and 345/2002. These standards are applicable to all listed joint stock companies.

17. The new EAS have been issued to comply with economic changes and scientific and technological developments either on the business performance level of the companies or on the level of the accounting systems that they apply. The issuance of these standards is an important step in improving the application of principles of good corporate governance by listed companies.

18. The latest Income Tax Act No. 91/2005 requires that net profits for tax purposes be based on the accounting profit in the audited financial statements which are prepared according to EAS, after adjustments by the tax inspectors, with some tax rules also being used for financial reporting purposes.

19. The 35 EAS were prepared on the basis of IFRS (2005 version), except for some departures and adaptations (see table below). Preparers of financial reports refer to IFRS in cases where EAS does not address specific issues.

20. The main departures and adaptations from IAS/IFRS are:

- (a) EAS 1 “Presentation of financial statements” (corresponding to IAS 1):
 - (i) Profit distribution to employees and members of the Board of Directors (employee benefits) are not recorded as expenses in the income statement, rather they are recorded as dividends distribution in accordance with the requirements of local law;
 - (ii) This departure also affects other two standards, namely, EAS 22 “Earnings per share” and EAS 38 “Employee benefits”;
- (b) EAS 10 “Fixed assets and their depreciation” (corresponding to IAS 16):

Paragraphs 31–42 of this standard on the revaluation model have been modified, as this model can not be used except in certain cases, and when it does not contradict the laws and bylaws. Otherwise, the entity should use the cost model as provided in paragraph 30 of IAS 16;
- (c) EAS 19 “Disclosure in financial statements of banks and similar financial institutions” (corresponding to IAS 30 which has been superseded by IFRS 7):

Paragraphs 44, 51 and 52 of this standard have been omitted, as they prohibit forming a general provision for loans and borrowings as a deduction from profits and losses (expense item), instead stipulating that this provision be formed as a deduction from the owners’ equity (reserve). According to the regulations of the Central Bank of Egypt and generally accepted Egyptian banking practices, however, this provision may be treated as an expense and therefore is deducted from revenue before calculating profits and losses.
- (d) EAS 20 “Accounting rules and standards for financial leasing operations” (corresponding to IAS 17):

⁶T PMinistry of Investment and Central Bank of Egypt. *Program Information Document: Appraisal Stage*. 2006. Report No. AB2097.

This standard is different from IAS 17 for leasing, as the Egyptian Financial Leasing Act No. 95/1995 issued by the Minister for Economics and Foreign Trade stipulates a completely different accounting treatment to that widely used internationally (arts. 24 and 25), under which the lessor records the leased asset in his books and depreciates it, while the lessee records the value of the payments of the leasing contracts in the profits and losses as expenses in the period in which they are paid.

D. Egyptian Standards on Auditing

21. In cooperation with the Egyptian Society of Accountants and Auditors, CMA prepared Egyptian Standards on Auditing (ESA), periodic reviews and assurance services that comply in form and content with ISAs issued in 2007. The draft was discussed among stakeholders and the final set of standards was issued in Arabic on 30 June 2008, and will be applicable to all audit engagements starting from 1 January 2009. The set of standards includes: a preface, the theoretical framework for assurance services, 32 Egyptian auditing standards, a standard for reviews, two Egyptian standards for assurance services, two Egyptian standards for other related services and guidance on the issues that the auditor must consider in his audit for small entities. The new set of standards will replace the old set issued in 2000.

Egyptian Accounting Standards and Corresponding IAS

	Egyptian Accounting Standards	Corresponding IAS (IFRS)
<i>EAS 1</i>	<i>Presentation of financial statements</i>	IAS 1
<i>EAS 2</i>	<i>Inventories</i>	IAS 2
<i>EAS 4</i>	<i>Statement of cash flow</i>	IAS 7
<i>EAS 5</i>	<i>Accounting policies, changes in accounting estimates and errors</i>	IAS 8
<i>EAS 7</i>	<i>Events after the reporting period</i>	IAS 10
<i>EAS 8</i>	<i>Construction contracts</i>	IAS 11
<i>EAS 10</i>	<i>Fixed assets and their depreciation</i>	IAS 16
<i>EAS 11</i>	<i>Revenue</i>	IAS 18
<i>EAS 12</i>	<i>Accounting for Government grants and disclosure of Government assistance</i>	IAS 20
<i>EAS 13</i>	<i>The effects of changes in foreign exchange rates</i>	IAS 21
<i>EAS 14</i>	<i>Borrowing costs</i>	IAS 23
<i>EAS 15</i>	<i>Related party disclosures</i>	IAS 24
<i>EAS 17</i>	<i>Consolidated and separate financial statements</i>	IAS 27
<i>EAS 18</i>	<i>Investments in associates</i>	IAS 28
<i>EAS 19</i>	<i>Disclosures in financial statements of banks and similar financial institutions</i>	IAS 30 superseded by IFRS 7
<i>EAS 20</i>	<i>Accounting rules and standards for financial leasing operations</i>	IAS 17
<i>EAS 21</i>	<i>Accounting and reporting by retirement benefit plans</i>	IAS 26

	Egyptian Accounting Standards	Corresponding IAS (IFRS)
EAS 22	<i>Earnings per share</i>	IAS 33
EAS 23	<i>Intangible assets</i>	IAS 38
EAS 24	<i>Income taxes</i>	IAS 12
EAS 25	<i>Financial instruments: disclosure and presentation</i>	IAS 32 superseded by IFRS 7
EAS 26	<i>Financial instruments: recognition and measurement</i>	IAS 39
EAS 27	<i>Interests in joint ventures</i>	IAS 31
EAS 28	<i>Provisions, contingent assets and liabilities</i>	IAS 37
EAS 29	<i>Business combinations</i>	IFRS 3
EAS 30	<i>Interim financial reporting</i>	IAS 34
EAS 31	<i>Impairment of assets</i>	IAS 36
EAS 32	<i>Non-current assets held for sale and discontinued operations</i>	IFRS 5
EAS 33	<i>Segment reporting</i>	IAS 14
EAS 34	<i>Investment property</i>	IAS 40
EAS 35	<i>Agriculture</i>	IAS 41
EAS 36	<i>Exploration for and evaluation of mineral assets</i>	IFRS 6
EAS 37	<i>Insurance contracts</i>	IFRS 4
EAS 38	<i>Employee benefits</i>	IAS 19
EAS 39	<i>Share-based payment</i>	IFRS 2

III. Regulatory framework

A. Statutory framework

22. At present, the principal legislation governing professional accountants and auditors, particularly in the private sector, is Accounting Practice Act No. 133/1951 and its amendments. Under current law, individuals joining the public practice of accounting and auditing must register on the General Register for Accountants and Auditors, which is maintained by the Ministry of Finance and does not require a qualifying examination for entry. The current law provides a broad framework for accounting and financial reporting, and authorizes the Ministry of Finance to develop a standardized chart of accounts and detailed instructions on accounting treatments and reporting formats. The legal approach, which was taken in the early 1950s to establish a uniform accounting system, inhibited the development and application of accounting standards conducive to high-quality financial reporting in a market economy.⁷

23. In cooperation with the Ministry of Finance, the Commercials' Syndicate, CMA and the Central Auditing Agency, the Egyptian Society of Accountants and

⁷ PWorld Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

Auditors has prepared a draft law to regulate practice of the accounting and auditing profession in Egypt, as an amendment of the current Act No. 133/1951. The draft law was discussed at the State Council and was referred to the Government in preparation for forwarding it to the People's Assembly for approval.

24. Auditors have greater liability under the new law. Under article 46, the auditor will be liable to the company for which he/she audits financial statements, as well as to third parties, to compensate for any damage resulted from his/her work, which should be carried out with due care and in accordance with professional standards and practices.⁸ The draft law lacks important elements, however, that could strengthen the auditing regulatory framework, for example, the need for continuing professional education. These deficiencies can be covered in the law itself or in the executive regulation.⁹

25. The Company Act No. 159/1981 provides the framework for the establishment and operation of companies within Egypt. The law covers the main establishment procedures, the management and control responsibilities, the extent of liability of owners, the required accounting and financial control procedures and other issues that a company may encounter in the course of its business.¹⁰

26. All companies registered under the Company Act should maintain sound accounting records and present annual audited financial statements. Under the Company Act, the annual general meeting of shareholders should monitor auditor performance and appoint a new auditor or renew the appointment of the existing auditor. The Company Act also requires the auditor to report the following at the annual general meeting that: (1) all data and explanations for satisfactory fulfilment of duties have been obtained, (2) the company maintains satisfactory accounting records, (3) all relevant legal requirements have been reflected in the accounts, (4) the financial statements provide a true and fair view of the company's financial condition and results of operations, and (5) the inventory has been recorded in conformity with applicable rules. The Company Act does not cover accounting and auditing standards, but requires that external audits should be conducted in compliance with the Accounting Practice Act No. 133/1951. According to provisions of the Company Act, the auditor or relatives of the auditor must not be a founder, director, permanent consultant or employee of the firm subject to the audit, but there is no restriction on shareholders being appointed as external auditor of the company.¹¹

27. A draft amendment to the Company Act, which is under discussion, includes provisions requiring all companies to observe the same accounting standards as are applicable for companies regulated by CMA. Moreover, these provisions specify the rights and duties of company auditors.

28. According to the Capital Market Act No. 95/1992, all listed companies are required to follow EAS. Egypt has had a stock exchange since 1882. In the 1990s, the Government of Egypt decided to refresh its capital market by recovering its status and the confidence of investors. The Government, encouraging new foreign capital and national capital, accordingly issued the new Capital Market Act No. 95 in 1992.¹²

⁸ Ibid.

⁹ Ibid.

¹⁰ Azab BI. *The Performance of the Egyptian Stock Market, Master Thesis*. Birmingham Business School, University of Birmingham. September 2002.

¹¹ PWorld Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

¹² Wahdan MA et al. *Auditing in Egypt: A study of the legal framework and professional standards*. Partners' conference, Maastricht School of Management. 2005.

29. The Capital Market Act requires all listed companies to prepare financial statements in compliance with IAS.¹³ The Ministerial Decree No. 503/1997 mandated the use of EAS by all enterprises and, in the absence of EAS regarding the accounting treatment, the requirements set under IAS. Subsequently, the Capital Market Act required all listed companies to publish financial statements in two widely circulated newspapers and establish an audit committee.

30. In 2002, CMA approved new listing rules that introduced enhanced administrative actions against those issuers who do not comply with the reporting requirements. As a result, hundreds of companies were delisted for failing to observe the new listing rules. The rules aim to ensure timely preparation and presentation of financial statements and full compliance by issuers with accounting, auditing and other legal requirements. According to these rules, CMA can impose an administrative penalty if the issuer failed to disclose information that resulted in losses to investors. The penalty could be doubled in cases of recurrent nondisclosure during the same year. Article 65 of Capital Market Act No. 95/92 states that a penalty of 2,000 Egyptian pounds per day is imposed on companies that do not file the required information within 45 days of the end of each quarter and 90 days after the end of each financial year. According to the new rules, all listed companies are required to establish an audit committee with the objective of strengthening corporate governance and improving financial reporting. Mandatory financial disclosure includes the balance sheet, income and cash flow statements, changes in stockholder equity and board composition, as well as the external auditor's report and directors' report. Companies are required to publish a summary of their semi-annual and annual reports in two newspapers, at least one of which is in Arabic. Companies are not required to publish a full annual report, although many actively traded companies do publish a detailed report (but without any standard form). It is worth mentioning that CMA recently issued Decree No. 96/2006 that clarifies the role of CMA in monitoring corporate financial reporting, including assessing the quality of auditors. Act No. 123/2008 which contains some amendments to Capital Market Act No. 95/92 states that CMA is responsible for establishing a register for public companies accountants and that CMA will set the requirement for listing and delisting auditors in that register.

31. The Banking Act No. 88/2003 requires all banks to follow accounting and auditing requirements and guidelines set by the Central Bank of Egypt. The Central Bank issues guidelines to banks on financial reporting and requires them to follow EAS. The Central Bank has not, however, released new guidance on reporting for the banking sector yet; banks therefore report under the guidance of the Central Bank on EAS, which are largely in line with the 2002 version of IAS. The Central Bank also requires banks to file annual, semi-annual and quarterly reports, including financial statements. Regulations which aim at ensuring audit quality state that two licensed auditors must audit bank financial statements and that individual auditors cannot sign audit reports for more than two banks per year. The two signatories may not be partners of the same audit firm. It is also worth mentioning that the Banking Act and its executive regulation require banks to have an internal audit department that reports to the bank's audit committees. The Central Bank is currently preparing a new set of financial reporting guidelines which are based on IFRS.

32. The Central Auditing Organization is responsible for the audit of state-owned enterprises. Central Auditing Organization Act No. 144/1988 governs the auditing of

¹³ PMinisterial Decree No. 503/1997 was issued by the Ministry of Economy and Foreign Trade, which was the supervising ministry of CMA. The name of the ministry has been changed to the Ministry of Foreign Trade, which continues to issue accounting and auditing requirements for all enterprises falling under the CMA regulatory framework. Currently, the Ministry of Investment is responsible for issuing these standards.

government departments and agencies, public sector enterprises and companies in which ownership interest of public investment is not less than 25 per cent. It controls government funds and those of other public corporate bodies. It helps Parliament to control financially both accounting and legal sections, check performance, follow up the implementation of the plan and review legally decisions issued on financial irregularities. The Central Auditing Organization submits its reports to the People's Assembly (Parliament), which remits them to specialized committees for review. The Central Auditing Organization has taken important steps towards harmonizing public sector accounting and auditing standards with the internationally accepted standards. The capacity of the Central Auditing Organization needs to be strengthened, however, to improve compliance with internationally accepted public sector accounting and auditing standards.¹⁴

33. Audit firms cannot be appointed as statutory auditors of companies. Under the current legislative framework in Egypt, only licensed individuals can act as auditors. In practice, companies appoint individual partners of audit firms.

B. Regulatory bodies

34. The three financial regulators in Egypt are: the Capital Market Authority (CMA), the Central Bank of Egypt and the Egyptian Insurance Supervisory Authority.¹⁵

35. CMA is the market regulatory agency responsible for ensuring the development of a transparent and a secure market for investors in Egypt and is subject to the supervision of the Minister for Investment.

36. CMA plays a major role in creating an environment that establishes public confidence in promoting investment in Egyptian companies. CMA promotes market transparency by monitoring compliance with disclosure rules of all listed companies and investment funds. CMA also reviews and analyses accounting, auditing and disclosure malpractice. CMA enforces the Capital Market Act, its executive regulations and related decisions by: (1) receiving and approving requests to issue new securities; (2) handling licensing of all companies in the securities industry; and (3) ensuring disclosure by market participants and adherence to EAS based on the IAS.¹⁶ CMA can draft new secondary regulations, which are then issued as decrees of the Minister for Investment. New executive regulations and rules have been issued to address a number of issues, including disclosure, stock exchange listing, tender offers, corporate governance requirements, mutual funds, minority shareholder rights, and securitization.¹⁷

37. CMA reviews annual financial statements presented by listed companies. The main purpose of the review is to ensure timely filing of financial statements. This review uses a checklist that reinforces reporting and disclosure requirements and that helps monitor compliance with accounting and auditing requirements in preparing financial statements. With regard to compliance, it is the reviewers' task to focus on whether companies and auditors have resorted to accounting manipulations that distort the company's financial condition and operating performance. Reviewers also check whether audit reports that accompany financial statements follow the reporting format prescribed by ESA.

¹⁴ World Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

¹⁵ Bahaa-Eldin Z. *Legal Constraints on the Role of Financial Regulators in Egypt*. January 2001.

¹⁶ Dahawy K and Conover T. *Accounting Disclosure in Companies Listed on the Egyptian Stock Exchange*. *Middle Eastern Finance and Economics*. 2007. 1.

¹⁷ PWorld Bank. *Report on the Observance of Standards and Codes – Corporate Governance Country Assessment: Egypt*. March 2004.

38. Where violations of standards are observed, CMA has wide administrative sanctioning powers, including to issue warning, delist, suspend and revoke licences, impose monetary penalties, cancel transactions (even after settlement if there has been an illegal act), inspect and suspend shareholder decisions. It can refer cases to the Prosecutor General to initiate proceedings.

39. In addition to the above legislation, the Cairo and Alexandria Stock Exchanges set a number of listing rules for companies wishing to be listed and traded on the exchange, in liaison with CMA.¹⁸

40. The Cairo and Alexandria Stock Exchanges (now known as the Egyptian Exchange), legally a self-regulatory authority, are managed by an elected board of directors under the supervision of CMA. The stock exchanges were established in 1883 and 1903, respectively, and reached their historic peak in the 1940s when together they constituted the fifth largest market in the world. After several decades of low market activity, the exchanges started growing again in 1992, under the impetus of economic reforms, privatization and changes in the regulatory environment. As a result of the economic reforms, market capitalization grew exponentially, from 5 billion Egyptian pounds in 1990 to 602 billion as of 30 June 2007.

41. CMA has the right to object to the decisions issued by the exchanges' board of directors. The exchanges are responsible for supervising commitment to registration rules, but have no authority for investigation and inquiries. The exchanges may impose sanctions that include downgrading listing status, trade suspensions, delisting, and (since the recent changes to the listing rules) monetary penalties.

42. The Central Bank of Egypt is the oldest of the three financial regulators. It is an autonomous public legal entity. Autonomy here refers to the fact that the bank is an independent legal entity, not under the direct administrative supervision of any government body.¹⁹ The Central Bank is authorized to undertake a number of steps against banks that violate the provisions of the law. These include the cancellation of the bank's registration, deduction of sums from the bank's account with the Central Bank if it does not maintain the required liquidity ratio, conveyance of a notice to the bank stating the violation, reduction of the credit facilities accorded to the bank, prevention of the bank from undertaking certain activities, the requirement that it deposits with the central bank additional funds, convening of a meeting for the bank's board of directors in order to discuss the violations, appointment of a supervising member to the bank's board and the dissolution of the bank.²⁰

43. The Egyptian Insurance Supervisory Authority was established in accordance with Insurance (Supervision and Regulation) Act No. 10 of 1981. This legislation was introduced in order to allow for private sector participation in the insurance industry and to restructure the supervisory framework.²¹ There are new accounting regulations for insurance companies which require insurance companies to apply IAS/IFRS for general-purpose financial statements. On a temporary basis, national bylaws on the measurement of insurance technical business – mainly on calculating insurance technical provisions – are being applied.

44. The powers which the Egyptian Insurance Supervisory Authority can use against the violating insurance company include sending a notice, restricting the company's acceptance of new insurance operations, requesting that the company

¹⁸ Azab BI. *The Performance of the Egyptian Stock Market, Master Thesis*. Birmingham Business School, University of Birmingham. September 2002.

¹⁹ Bahaa-Eldin, Z., *Legal Constraints on the Role of Financial Regulators in Egypt*, January 2001.

²⁰ Ibid.

²¹ Ibid.

submit additional financial statements, requesting the convening of the company's board of directors, appointing a supervising member to the board, restricting the distribution of dividends to shareholders, amending the company's investment policies, removing some of the company's executive directors and dissolving the board of directors.²²

C. The profession

45. The Egyptian Society of Accountants and Auditors plays a central role in the accounting profession. It is an organization of chartered accountants and is responsible for developing educational and professional standards. It is a member of the International Federation of Accountants. It was established in 1946 and is managed by a board of directors.

46. The Egyptian Society of Accountants and Auditors admits members if they satisfy one or more of the following conditions: (1) membership in the Institute of Chartered Accountants in England and Wales or another acceptable foreign professional body; (2) doctoral degree in accounting or auditing with three years of full-time work experience in practice; and/or (3) at least three years of full-time work experience in the office of a practising member of the Egyptian Society of Accountants and Auditors or equivalent, and successful completion of the two-part examination. The first examination is taken after eighteen months and then the second part at the end of the three-year period.

47. The Registration Committee for Accountants and Auditors in the Ministry of Finance has a list of more than 30,000 registered accountants. Registration rules require a graduate to have a bachelor's degree in accounting to register as a trainee accountant. Trainees become licensed as first-level accountants after three years of work in an accountant's office, which authorizes them to work as auditors of sole proprietorships and partnership enterprises. After an additional five years of experience, accountants obtain a final registration certificate and become licensed to act as auditors of corporations. Auditors are not required to take any qualifying examinations before registration by the Accountant Registry. Auditors can also register directly in the Egyptian Society of Accountants and Auditors as a member, which qualifies them for a licence to audit corporations.²³

48. In 2002, a World Bank study reported that audit practitioners in Egypt were not required to follow a modern code of ethics in line with the Code of Ethics for Professional Accountants of the International Federation for Accountants (IFAC).²⁴ The Syndicate of Accountants Act No. 40/1972 discusses ethics breach criteria, such as fraud. Although the Ministry of Finance and the syndicate have been highlighting awareness of legal requirements, some accountants and auditors ignore the code of ethics to boost practical performance.

49. The Egyptian Society of Accountants and Auditors has drafted a new code of conduct that complies with all the aspects of the IFAC code. On the basis of this draft, CMA issued some rules that apply to all registered auditors and a communication is currently being prepared by the society and the Ministry of Finance to issue this code and apply it to all the members of the Central Auditing Organization.²⁵

²² Bahaa-Eldin, Z. *Legal Constraints on the Role of Financial Regulators in Egypt*. January 2001.

²³ Wahdan MA et al. *Auditing in Egypt: A study of the legal framework and professional standards*. Partners' conference, Maastricht School of Management. 2005.

²⁴ World Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

²⁵ PThe Egyptian Society of Accountants and Auditors, Annual Report, 2007.

50. All accounting degree holders are eligible for syndicate membership. The six jobs that are deemed equivalent to work in a practising accountant's office are: (1) Central Auditing Organization's auditor, (2) tax inspector, (3) social insurance inspector, (4) Ministry of Finance accountant, (5) inspector in the Ministry of Foreign Trade, and (6) staff member dealing with financial matters in government departments.

51. The legal framework surrounding the accounting and auditing profession in Egypt includes the basic Company Act, the Accounting Practice Act (1951) and the Banking Act (1957). A revision of the Company Act was proposed in 1997 but is yet to be finalized and implemented. The Central Accounting Organization Act (1988) and Capital Market Act (1992) have had considerable impact and influence on the practice of accounting auditing in Egypt. The combined set of laws represents the legal framework for the accounting and auditing profession in Egypt.²⁶

52. The audit profession in Egypt faces challenges in complying with professional standards of accounting and auditing. Some of the factors that contribute to the lack of compliance are: (1) the lack of experience and expertise; (2) the gap between accounting and auditing education and latest practices; and (3) the lack of competitiveness of the profession in terms of salaries and incentives.²⁷

IV. Capacity-building

53. The Egyptian Capital Market Act No. 95 issued in 1992 has made it compulsory for corporations to prepare their annual and periodic financial statements and disclose them in accordance with IAS and EAS which are in compliance with IAS, with exception for a few adjustments. The law requires that annual audit reports and periodic review reports should be conducted by independent, competent and qualified auditor in accordance with ISAs.²⁸

54. The main components of the Egyptian disclosure and transparency framework are: (1) a legal framework to issue rules and regulations in accordance with international standards; (2) a regulatory agency enforcing the implementation of these standards; (3) an independent, competent and qualified auditor; and (4) a disciplined self-regulatory professional accounting association setting standards and monitoring implementation.²⁹

55. Standards alone do not guarantee the quality of financial information disclosed, rather institutional factors such as the incentives of preparers should also be considered, as well as building the capacities of the practitioners and developing independent, competent and qualified auditors.

A. Education programmes

56. Educational quality suffers from the lack of a modern syllabus and a very high student to teacher ratio. According to a World Bank study,³⁰ the teacher-student ratio in accounting and auditing departments of large public universities was about 1 to 1,000, which lowers educational quality and impedes essential teacher-student communication. Educational programmes are not improving students' critical

²⁶ Wahdan MA et al. *Auditing in Egypt: A study of the legal framework and professional standards*. Partners' conference, Maastricht School of Management. 2005.

²⁷ Ibid.

²⁸ Yassin H. www.cs.unimaas.nl/auditing-symposium/the%20new%20impact%20of.ppt#28.

²⁹ Ibid.

³⁰ World Bank. *Report on the Observance of Standards and Codes, Egypt, Arab Republic: Accounting and Auditing*. 15 August 2002.

thought and expertise. Traditional accounting and auditing courses focus on basic topics and not application of standards. As there are many new private universities and English sections in business schools in public universities, however, the teacher-student ratio is decreasing, while new international, up-to-date textbooks are being taught. At postgraduate level, the quality of accounting and auditing education is relatively high because the syllabus includes international accounting and auditing standards and practices, and encourages development and empirical research.³¹

57. Although private universities introduce high-quality accounting education, the best students rarely join the public accounting profession in Egypt. The reason is that the accounting profession's rewards and fees are not competitive. In addition, while private universities offer English-language accounting programmes using an international syllabus and English textbooks, high tuition fees for private universities are restrictive. Although many public universities have established an English-language section in the accounting department, the impact on the accounting profession is likely to be limited.

58. New majors have been now introduced in public universities in cooperation with leading international universities; these majors lead to a bachelor degree with professional knowledge. One example is an accounting major which will give students the latest knowledge in accounting and auditing and enable them to sit the exam with the required knowledge.

B. Apprenticeship programmes

59. The registration requirements do not require adequate practical knowledge from novices to perform the audit. They are fulfilled by the applicant getting a letter from an accounting office stating that the applicant has work experience for the specific apprenticeship period. Furthermore, the knowledge gap of practitioners is increased by the absence of a continuous education system. The Egyptian Society of Accountants and Auditors has started a learning programme for candidates registering for its own examinations. Most practising accountants and auditors without society membership will, however, suffer from a lack of training and the proper knowledge for supporting high-quality financial reporting.

60. The Egyptian Society of Accountants and Auditors organizes seminars and workshops open to practitioners and academics on various issues of IFRS/EAS. In addition, the society will be providing a diploma course on IFRS starting in the second half of 2008.³²

61. In light of the increasing independence on the financial information and reports, which affects the role of the accountants and auditors, and the effect of the accountants and auditors performance of the economic level in general and both on the national and international level, the society has established a project to develop general rules of continuous professional development, in accordance with IFAC, after studying the systems applied in other international professional organizations. These rules aim at improving the educational and professional level of the society members to face the advancements in the field of accounting and auditing.³³

62. Training and education on IFRS are mostly provided by universities and academic organizations. Recently, universities have already incorporated IFRS courses in their graduate and undergraduate curricula as elective courses. In some

P³¹ PWahdan MA et al. *Auditing in Egypt: A study of the legal framework and professional standards*. Partners' conference, Maastricht School of Management. 2005.

P³² PThe Egyptian Society of Accountants and Auditors. *Annual Report*. 2007.

P³³ P*Ibid*.

universities, principles of accounting courses are covered using IFRS. Accounting textbooks are revised to reflect the changes that are brought about by the implementation of IFRS.

V. Lessons learned

63. Egypt has undertaken a number of steps to improve its financial reporting and auditing system. To facilitate the implementation of IFRS and ISAs in Egypt, the Egyptian Accounting and Auditing Standards were issued in compliance with the international standards with few departures/adaptations.

64. The adoption of IFRS proved to be a gradual process. The first step was the early adoption of IAS in 1997. The process is now that, once the Egyptian Society of Accountants and Auditors selects the international accounting and auditing standards applicable to the Egyptian situation, it translates them into Arabic. These standards become the basis for drafting an Egyptian standard. The first version of such standards is introduced to the Permanent Committee for discussion and adoption, and then sent to the Ministry of Foreign Trade for issuance by ministerial decree.³⁴ The second step is the compulsory adoption of EAS which are considered to be the Arabic version of IAS. It is also stated in the preface to the Egyptian standards that IAS should be applied on issues for which no Egyptian standard is issued.

65. Despite the fact that EAS are based on IFRS, there is a delay in the implementation of new standards. There is also a delay in the issuance of implementation guidance for standards. This is due to a lengthy issuance process for local standards.

66. Significant amounts of training and education for financial-statement preparers and auditors of small local companies are needed. A lesson learned from the initial implementation is that these groups do not understand accounting standards sufficiently.

67. High-quality financial reporting depends on enforcement. Merely adopting internationally accepted accounting and auditing standards cannot ensure improvements in corporate financial reporting. There are three important links in the enforcement chain, and each must be strengthened. First, company directors, who have legal responsibility for preparing and presenting financial statements, must ensure that accounting staff members properly apply accounting standards. Second, auditors must act independently to provide assurance that financial statements comply with the established standards and portray a true and fair view of an enterprise's financial conditions and results of operations. Third, both self-regulatory organizations and statutory regulatory bodies must implement arrangements for efficient monitoring of regulatory compliance and consistently take action against violators.

68. CMA has been making efforts to raise awareness among the top management of listed companies on the requirements for compliance with accounting and financial reporting standards.

69. Continuing education requirements, which will need monitoring and enforcing, should conform to the IFAC guidelines/standards. Training programmes should enable practicing auditors and accountants to gain exposure to the practical application of IAS, ISAs and the IFAC-issued Code of Ethics for Professional Accountants. This matter can be addressed either within the new law or in

³⁴ PWahdan MA et al. *Auditing in Egypt: A study of the legal framework and professional standards*. Partners' conference, Maastricht School of Management. 2005.

regulations issued in accordance with provisions of the law. The Public Companies Accountants' Oversight Board of Egypt will be responsible for continuing professional development requirements of accountants who prepare financial statements of listed companies.

70. Egyptian public universities need to review and update their accounting curriculum to incorporate international accounting and auditing standards and include practical-oriented teaching at the undergraduate level in higher educational institutions. The ethical dimensions of business management, corporate finance, accounting, and auditing should be taught – with case studies – in the undergraduate programmes of business schools or commerce faculties.

71. Some laws and regulations need to be amended to allow full implementation of requirements in IFRS, for example, leasing. In the long term, it might be beneficial to refer to the accounting treatments and definitions outside the articles of law in order to allow for timely alignment and updating.

VI. Conclusion

72. This paper reviews practical implementation issues of IFRS in Egypt and describes the current accounting and auditing situation and the legal framework of the profession in Egypt.

73. In recent years, Egypt has made significant efforts (1) to align corporate financial reporting requirements with the IAS/IFRS and (2) to close the compliance gap in both accounting and auditing practice. Consequently, important improvements have been made to accounting and disclosure requirements for the publicly traded companies and financial institutions and in EAS, as benchmarked against IFRS. Moreover, the new Accounting Practice Act has been drafted and agreed upon by all stakeholders, though not yet been issued. Further improvements could be achieved by issuing a modern legislative framework that includes an appropriate regulatory framework for practising auditors, addressing weaknesses in professional education and training arrangements, introducing qualification examinations for auditor licensing, and developing an enforcement mechanism to ensure compliance with applicable accounting and auditing standards.

74. Notable steps have already been taken to build on the accounting reform. These steps include:

- (a) A new set of Egyptian accounting standards based on IAS/IFRS issued in 2006;
- (b) A new set of auditing standards based on ISAs issued in 2008;
- (c) New articles in the Capital Market Act that require establishing a register for Public Company Accountants' Oversight Board; and
- (d) A new unit in CMA for monitoring financial reporting.

75. Despite these steps, the financial reporting system in Egypt requires further improvements, especially in expediting the process of issuing new EAS after the release of any new IFRS, and reducing the gap between accounting education and practices in relation to international requirements.