

## **The state of accounting in Egypt: a case**

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### **Abstract**

Egypt, one of the largest Middle East economies, is beginning its transition to a market economy. As a developing nation, Egypt has witnessed several changes in its accounting system during last two decades. This case provides an analysis of the Egyptian accounting system with emphasis on the development of the Egyptian Accounting Standards. In addition, this case makes recommendations for the reformation of the Egyptian accounting system.

Keywords: Egypt, International accounting standards, Egyptian accounting standards, Egyptian accounting system, Privatization, Culture



## 1. INTRODUCTION

The purpose of this case is twofold. The first goal is to present an analysis of the development of the Egyptian accounting system. The second goal is to provide several recommendations to facilitate the Egyptian accounting reformation. Once accounting reformation occurs, Egyptian companies can prepare financial reports that will be of greater benefit than those at present. To Egyptian companies the result will be an increase in foreign investment and funds raised from external sources. With these goals as the objective, Egyptians need to comprehend successful accounting systems and extract that which may be applied to the Egyptian system. The process of accounting reformation in Egypt and the politics of setting standards are the main issues discussed within this case. This case may be used in international accounting courses at both the undergraduate and the graduate levels. It is important to note that this case follows 'The State of Accounting in Armenia' by Bloom et al. (1998).

## 2. EGYPT

Egypt is a developing nation at the beginning of its transition to a market economy. Egypt, one of the largest economies of the Middle East, is undergoing liberalization to a large number of its major economic sectors. This transition makes Egypt a relatively attractive market and one that continues to grow.

The Egyptian Stock Exchange is considered one of the oldest stock exchanges dating back to 1882. It steadily grew, and it was ranked the fifth most active market in the world in the 1950's (ACCE, 1995). By the late 1950's and early 1960's, nationalization started taking place in various economic sectors of Egypt. This resulted in a socialist era. Accordingly, there was a trend towards moving to central economic planning and an expansion out of the public sector. As a result, the role of the Egyptian Stock Exchange decreased until it became inactive for approximately thirty years. In the mid 1970's, the Egyptian government had followed a so-called 'Open Door Policy' to liberalize the national economy and it initiated several improvements to the accounting standards and practices. The new policies revived the accounting profession in Egypt and started to impact the regulation in technical matters. These regulations provided accountants with an opportunity to participate in the discussions of government actions or policies.

The development stages that Egypt experienced can be divided into 5 stages: the Colonial Period, Central Planning, Slow Development, Moderate Development, and Rapid Development (HassabElnaby and Mosebach, 2005). The transformation of an economy from a centrally planned economy to a market based economy is a long term process that requires several changes in a society's philosophy as well as its economic sectors (Samadian, 1996; HassabElnaby et al., 2003).

Egypt witnessed a capitalist economy starting from the British colonialism until 1952. In 1952, the private sector controlled 76% of the Egyptian investment (Carana, 2002). When the Egyptian revolution against the British colonialism took place, a shift from a capitalist economy to a socialist economy started to occur. The government established a course for a centrally planned economic model (Carana, 2002; HassabElnaby and Mosebach, 2005; Hassan, 2008b). Public sector's dominance increased dramatically since 1952 and lasted for the next three decades (Carana, 2002). In 1974, the government enacted the Foreign Investment Law that aimed to encourage foreign investments in the form of joint ventures with domestic, foreign or Arab investors. Accordingly, this resembled a trend towards a more liberalized economy began the so called 'Open Door Policy' (HassabElnaby and Mosebach,

2005; Ragab and Omran, 2006; Hassan, 2008b). The policy aim was to let the market access modern technology, business management and advanced industrial projects (Samaha, 2004).

Nevertheless, the new policy was improperly implemented. Mounting deficits in the balance of payments occurred by the end of 1980's due to an increase in imports (Oweiss, 1988; Carana, 2002). Moreover, private companies commenced operations in Egypt in the 1980's creating a more rapid privatization pace (HassabElnaby and Mosebach, 2005; Hegazy, 1991). Moving towards a market based, liberal economy prompted the Egyptian government in 1981 to issue a Company Act Law. This law allowed the establishment of different kinds of private companies such as: joint stock companies, limited liability and limited by shares partnerships (Hassan, 2008b). For the first time, the Company Act Law required audits of the financial statements of the private sector companies (HassabElnaby et al., 2003).

However, the financial reporting reliability of the private sector companies was doubted. The Company Act Law focused on the type of reports provided, types of records, formats and audit procedures, and did not question the technical issues regarding recording transactions and the implemented accounting measures (Hegazy, 1991). The justification for the process was that accounting and reporting practices are primarily affected by the economic conditions (Choi and Mueller, 1992). As a result of the mounting deficits by the end of the 1990's, a well tailored economic reform program between Egypt, the World Bank and the International Monetary Fund was established in 1991. The program aimed at developing the stock market and increasing privatization. The economic reform program had several major elements including: lessening consumer subsidies and returning them to the poorest niche in Egypt, privatization of state-owned companies so as to decrease the public sector, and increasing energy and transport prices to realistic levels (Carana, 2002; Omran, 2002; Abd-Esalam and Weetman, 2003; Ragab and Omran, 2006). From an investment viewpoint, the program required eliminating controls over investment, cancelling tariffs on imports and enhancing private investment in all sectors including financial services (Omran, 2002).

### **3. ACCOUNTING IN EGYPT**

According to the socialist regime prevailing in Egypt, government issued laws to promote legislative control and to maintain the centrally planned economy (Gamal, 2002; Hassan, 2008b). Among the issued regulations was the Uniform Accounting System. Issued in 1966 it was first implemented in the 1967/1968 annual reports (Briston and El-Ashker, 1984). Accordingly, the annual reports of the public sector companies were not publicized, and this process was the same as before the new system's implementation (Samaha, 2004). The secretive trend was justified by Hegazy (1991) as follows: First, information included in the annual reports of those public enterprises was deemed sensitive and related to the national security; second, public companies' faced severe losses which if publicized would create an economic disturbance. The belief was that such losses might cause the people to doubt the government's ability to lead in the socialist era.

The main driver of the Uniform Accounting System was to plan and control economic activity (Briston and El-Ashker, 1984). Since that time, the accounting profession was powerless in improving the Egyptian financial reporting regulations (Youssef, 2003; Hassan, 2008b). Moreover, education and research at that time not only mirrored the socialist ideals, but were also used to proselytize for the socialist regime (Hargreaves, 2001). HassabElnaby et al. (2003) argue that the implementation of the Company Law illustrated the significance of the International Accounting Standards. As a result, companies voluntarily used the International Accounting Standards until the Egyptian Accounting Standards were adopted in

1997 and implemented by listed companies (Ragab and Omran, 2006; HassabElnaby et al., 2003).

The rapid development that has occurred in Egypt since 1991 and the shift towards a market economy required changes in accounting. Development of new accounting standards assisted in this shift. The changes helped investors in their financial performance analysis and it provided relevant information based on reliable financial reporting (HassabElnaby et al., 2003). Furthermore, since Egypt is now heavily dependent upon foreign investments, accounting information tends to play a more important role in the economy. This is supported by Islam (2006) when examining compliance with disclosure requirements in four developing countries: India, Pakistan, Bangladesh and Sri Lanka. In other words, for Egypt to move to a market based economy, it needs to develop accounting measures and reports to meet the demand of this transition.

The Egyptian Society of Accountants and Auditors (ESAA) supported several proposals that created the first set of nineteen Egyptian Accounting Standards in 1997. These standards were primarily based on the International Accounting Standards. By the end of 2002, there were twenty-two Egyptian Accounting Standards implemented by listed companies. In 2006, an entire set of Egyptian Accounting Standards was released to replace those of 1997 and 2002. The complete set of the new Egyptian Accounting Standards is comprised of thirty-five standards which are based on the International Accounting Standards (currently referred to as the International Financial Reporting Standards (IFRS)). The EAS differed from the IFRS in four areas. The differences were: EAS 1, 10, 19, and 20. These standards dealt with financial statements presentation, fixed assets and depreciation, disclosure in financial statements of banks and similar financial entities, and rules and accounting standards related to finance lease transactions respectively (Hassan, 2008a).

#### **4. MAJOR ACCOUNTING MODELS**

The most commonly used classification of accounting models that exist through the literature is the Anglo-American model and the Continental model (Kantor et. al, 1995; D'Arcy, 2001). The Anglo-American accounting model is applied in English-speaking countries. This model is a microeconomic based model that is applied in countries with common law (Kantor et al., 1995). Common law stems from markets that have commonly accepted practices (Ball, 1995). Investors and creditors are considered as the principle users of financial reports since they depend heavily on publicly disclosed information due to a lack of close relationships with companies. These reports are mainly used in the financial decision-making process as significant disclosures are generally provided. The accounting standards and the income tax regulations are different in countries adopting this model (Ball, 1995).

On the other hand, the continental accounting model is a macroeconomic legalistic based model (Kantor et al., 1995). This is the result of the presence of government ministries codifying legal systems and accounting rules. Close interaction exists between the government and the markets major players. Typically, these market players are few in number to have an efficient system. Accordingly, the main users of financial reports are bankers, governments and sometimes wealthy land owners where transactions depend heavily on private information. The Continental model focuses on conveying stewardship information for credit purposes and maintains national economic policies. According to the Continental model, accounting standards have a legalistic bent, and the government, in most cases, is the only setter of these standards. Unlike the Anglo-American model, the accounting standards and the income tax regulations tend to be similar in countries adopting the Continental model (Ball, 1995).

Kantor et al. 1995 argues that culture and history would situate Arab countries, including Egypt, in the Continental group. However, Arab countries have been closely associated with the United States, which permitted a shift in economic trends, leading to the prevailing Anglo American accounting model.

## 5. CASE QUESTIONS

Students can be assigned the following questions to prepare before or after covering this case in class. However, students should read outside materials on Egyptian culture and the Egyptian accounting system before answering the case questions. A list of suggested readings is listed at the end of the case. Also, students are advised to use the Internet to obtain up-to-date information about Egypt.

1. How can Egypt be described in terms of Hofstede's cultural model, and the accounting framework developed by Gray?
2. To what extent does Egypt's accounting system reflect its culture? Do you think that the influence of culture is appropriate?
3. Describe the development of accounting standards in Egypt?
4. What are the main problems that Egypt faced in setting its own accounting standards?
5. What are the reasons for choosing the International Accounting Standards?
6. What is the difference between the Egyptian Accounting Standards and the International Accounting Standards?
7. How do investors evaluate the quality of financial reporting in the Egypt's financial statements?
8. Describe the laws and regulations that impact the accounting practices in Egypt?
9. Explain the advantages that Egypt gained by developing the Egyptian Accounting Standards?
10. What, specifically, do you think Egypt should do to develop its accounting system?

## 6. APPENDIX: TEACHING NOTES

### **Question 1: How Can Egypt Be Described in Terms of Hofstede's Cultural Model, and the Accounting Framework Developed by Gray?**

Hofstede; 1980 asserts five cultural values and as indicated in Table 1 (Appendix).

Hofstede scores Egypt in respect to the four dimensions as follows: uncertainty avoidance; 80, individualism; 26, power distance; 72, and masculinity; 46 (Hofstede, 1983). Accordingly, high uncertainty avoidance, large power distance, low individualism is present in Egypt, reflecting a high collectivistic society, and a masculine one where a separation between traditional gender roles occurs. Brown and Humphreys (1995) and Humphreys (1996) examined Hofstede's cultural aspects for both Egyptian and Anglo-American managers and reached the same findings also.

Gray (1988) used Hofstede's societal dimensions to derive a framework that proposes an interactive accounting process. He derives four distinguishable accounting values/subcultures that he argues are related to societal values, as indicated in Table 2 (Appendix). He also argues that these relations are dynamic.

**Question 2: To What Extent Does Egypt's Accounting System Reflect its Culture? Do You Think That the Influence of Culture Is Appropriate?**

Since accountancy operates in a socio-economic framework as a 'service' function, the socio-economic activities and policies have a major bearing on accountancy (Enthoven, 1978). Culture has been shown to be a major factor affecting the structure of business and society (Hofstede and Bond, 1988) and, lately, accounting (Gray, 1989). Hence, it is clear that the accounting system of any country reflects its culture.

Gray argues that in societies where high uncertainty avoidance and large power distance exist, preference for individualism and enjoying a masculine attitude, tend to be secretive, affecting information disclosure practices (Gray and Vint, 1995). As indicated in Table 3 (Appendix), clarified is the relationship between societal values, accounting values and accounting practices. Hofstede (1983) reports Egypt as being a collectivist society, with large power distance and strong uncertainty avoidance. Based on these findings and Gray's model, Egyptian accounting should portray statutory control, uniformity, conservatism, and secrecy.

The Egyptian accounting system is characterized by secrecy. This secrecy preference in the accounting subculture would influence the extent of information disclosed in the accounting reports. Egypt is seeking increased privatization, where private ownership requires that owners and stockholders be provided with adequate financial reporting to assess corporate performance. Thus, a fundamental shift in attitudes of Egyptian businesspeople and accountants is required, to change from secrecy to transparency.

**Question 3: Describe the Development of Accounting Standards in Egypt?**

The Egyptian Society of Accountants and Auditors (ESAA) exerted numerous efforts that resulted in the first set of nineteen Egyptian Accounting Standards in 1997, primarily based on the International Accounting Standards. By the end of 2002, there were twenty-two Egyptian Accounting Standards that were implemented by listed companies. In 2006, an entire set of Egyptian Accounting Standards were released to replace those of 1997 and 2002. The complete set of the new Egyptian Accounting Standards is comprised of thirty-five standards based on the International Accounting Standards. There are only four exceptions to the standards: EAS 1, 10, 19, and 20 representing financial statements presentation, fixed assets and depreciation, disclosure in financial statements of banks and similar financial entities, and rules and accounting standards related to finance lease transactions respectively (Hassan, 2008a).

**Question 4: What are the Main Problems that Egypt Faced in the Setting of its Own Accounting Standards?**

Language was the major difficulty faced when first adopting the International Accounting Standards (World Bank, 2002; Abd-Elsalam and Weetman, 2003). This was due to the fact that the International Accounting Standards are officially issued in English, while the main language in Egypt is Arabic. In addition, during the time of introducing and implementing the International Accounting Standards, no official Arabic translation was available in public records in Egypt. It was, therefore, difficult for companies to understand the English language version of the International Accounting Standards. The problem remained until the end of 2002, when the International Accounting Standards Board's website reported a translation that was produced by the Arab Society of Certified Accountants, based in Jordan (AbdElsalam and Weetman, 2003).

**Question 5: What Are the Reasons for Choosing the International Accounting Standards?**

International Accounting Standards were chosen by Egyptian regulators as the best benchmark for several reasons: “The Egyptian regulators’ sources of knowledge, the lack of domestic investors’ desires to change the Egyptian financial reporting regulations and the immature accounting profession that is incapable of professionally enforcing new standards...” (Hassan, 2008b). In addition, adoption of the International Accounting Standards facilitates transformation from a socialist to capitalist economy, although adoption of these standards may be difficult due to an inconsistency with the cultural values of developing countries. The need to better reflect domestic culture justifies the minor changes that exist in the Egyptian Accounting Standards (Dahawy et al., 2002).

**Question 6: What is the Difference between the Egyptian Accounting Standards and the International Accounting Standards?**

Difference between the Egyptian Accounting Standards and the International Accounting Standards exist in four standards as identified by Hassan (2008a). Those standards are EAS 1, 10, 19 and 20. The first Egyptian Accounting Standard (EAS 1) is related to presentation of the financial statements. It requires the distribution of profits to employees and board of directors be decreased directly from the retained earnings without decreasing the income figure in the income statement. Accordingly the earnings per share calculations would be affected. On the other hand, the International Accounting Standards charge those payments as expenses. However, Egyptian Accounting Standard 22 (EAS 22); Earnings Per Share clarifies more of that difference. The second difference is in Egyptian Accounting Standard 10 (EAS 10), regarding fixed assets and depreciation. Re-valuation of fixed assets is not allowed under EAS 10 except in situations that the Egyptian law approves, which is different from IAS 16.

The third distinction lies in Egyptian Accounting Standard 19 (EAS 19); concerning the disclosure in financial institutions. EAS 19 requires the accumulation of a general provision for loans, to be created by decreasing income in the income statement, contra to the requirements of IFRS 7 that requires provisions to be decreased from the owner’s equity. The fourth divergence is in Egyptian Accounting Standard 20 (EAS 20) concerning leasing. As leasing is based on legal codes of the Egyptian leasing laws, EAS 20 requires that the lessor keeps the asset in his accounting books and depreciates it while the lessee reports the rental payments as expenses, opposite to IAS 17 requirements.

**Question 7: How do Investors Evaluate the Quality of Financial Reporting in Egypt’s Financial Statements?**

The investor community comprised of financial analysts, investment advisors, foreign and local bank representatives believe that weak enforcement mechanisms facilitate noncompliance with established accounting requirements. Accordingly, it is believed that low quality information is disclosed in the published financial statements. Many external users depend on personal contacts to gather information about a certain company. Moreover, the investment community perceives the audited financial statements not to be highly reliable. External users identify the need for improving actual accounting practices regarding related-party transactions, impairment of assets, pension accounting, segment reporting, and accounting for leases and financial instruments. The implementation of a strong regulatory

regime and effective enforcement mechanisms are the key to ensure compliance with the accounting requirements (World Bank, 2002).

**Question 8: Describe the Laws and Regulations that Impact the Accounting Practices in Egypt?**

Laws and regulations that are enforced in an economy have a major influence on the disclosure practices of companies. Although the primary source of Egypt's corporate legal framework is the French civil law, the Anglo-American common law concepts exist in the Capital Market Law and the Central Depository Law (World Bank, 2001; United Nations, 2007). The Capital Market Law (CML, 95/2002) is the chief law governing the Egyptian capital market. The Company Law (CL, 159/1981) legalizes limited liability companies, partnerships limited by shares and joint stock companies.

The Central Depository Law (CDL, 93/2000) maintains procedures related to trading, facilitating or transactions for the purpose of promoting market liquidity, diminishing risks resulting from trading physical securities, and sustaining rapid securities exchange. The Investment Law (IL, 8/1997) grants income tax exemptions when investing in specific locations or economic sectors. The Public Business Sector Law (PBSL, 203/1991) regulates an amalgamation of public sector companies (World Bank, 2001; United Nations, 2007).

Currently, efforts are being made to draft a law that unifies companies and securities markets laws. The purpose of the unified law is to ensure that all types of companies in Egypt follow an updated and uniform regulatory system. This law would help eliminate conflicts and obstacles existing in current laws. The law would facilitate investor dealings, local and foreign investors with governmental bodies and promote transparency in the market (World Bank, 2001; World Bank, 2004; United Nations, 2007).

**Question 9: Explain the Advantages that Egypt Gained by Developing the Egyptian Accounting Standards?**

The adoption of the International Accounting Standards benefited Egypt in several aspects, such as: (1) It facilitated Egyptian access to international capital markets. (2) It reduced the time and effort spent to develop national accounting standards. (3) It ensured the fairness and meaningfulness of financial statements prepared by Egyptian enterprises for international investors. (4) It increased the importance of accounting as a profession, due to the introduction of the professional code and objectives.

**Question 10: What Specifically, Do You Think Egypt Should Do to Develop its Accounting System?**

Governors and regulators should enforce laws and regulations to guarantee full compliance with the accounting requirements. This will ensure the presence of high quality financial reporting. High quality reporting occurs when the accounting staff properly applies accounting standards when preparing the financial statements. Also, severe punishments must be leveled on violators. Furthermore, efforts must be exerted by the Capital Market Authority to motivate the top management of listed companies to comply with the required accounting and financial reporting standards. The Capital Market Authority can present case studies as an example clarifying financial reporting strengths and weaknesses in the country. Also, the Capital Market Authority can present international developments on improving transparency of corporate financial reporting, new dimensions of regulatory regimes affecting accounting,

and the role of transparent financial reporting in attracting both strategic and portfolio foreign investments could also be presented.

Moreover, the Egyptian Society of Accountants and Auditors in collaboration with the Syndicate of Accountants could introduce an outreach program for financial executives and accounting staff of business enterprises to disseminate knowledge on current developments in accounting and financial reporting standards and practices. In addition, continuous training and education should be implemented to enhance the awareness of the Egyptian Accounting Standards' practices. Furthermore, making board of directors aware of the benefits of implementing the Egyptian Accounting Standards, including benefits that may attract foreign investment, may promote greater investment and returns on those investments. Reviewing and updating the accounting curriculum can be one of the steps to develop the Egyptian accounting system so that international and Egyptian accounting standards can be incorporated. In addition, case studies may be taught to identify the ethical dimensions of business management, corporate finance, and accounting.

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## TABLES

Table 1: Hofstede's Societal Values

Societal Value	Description
Individualism versus Collectivism	The degree of interdependence the society maintains among individuals. Individualism is concerned with a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only. The opposite, collectivism stands for a preference for a tightly knit social framework in which individuals can expect their relatives, clan, or other in-group to look out for them in exchange for unquestioning loyalty.
Large versus Small power distance	How a society handles inequalities among people when they occur. People in large power distance societies accept a hierarchical order in which everybody has a place, which needs no further justification. People in small power distance societies strive for power equalization and demand justification for power inequalities.
Strong versus Weak uncertainty avoidance	How society reacts to the fact that time only runs in one way and that the future is unknown. Strong uncertainty avoidance societies maintain rigid codes of belief and behavior and are intolerant towards deviant persons and ideas. Weak uncertainty avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated.
Short-term versus long-term orientation	How society perceives the importance attached to the future versus the past and present. In long term oriented societies, people value actions and attitudes that affect the future, such as; persistence, thrift, and shame. In short term oriented societies, people value actions and attitudes that are affected by the past or the present, such as; normative statements, immediate stability, protecting one's own face, respect for tradition, and reciprocation of greetings, favors, and gifts.
Masculinity versus Femininity	The way in which the society allocates social roles to sexes. Masculinity stands for preference in a society for achievement, heroism, assertiveness and material success. Femininity, on the other hand, stands for the preference for relationships, modesty, caring for the weak and quality of life.

Source: Dahawy and Conover 2007, (p. 8)

Table 2: Gray's Accounting Values

Societal Value	Description
Professionalism versus Statutory Control	A preference for the individual professional judgment and the maintenance of professional self-regulation as opposed to compliance with perspective legal requirements and statutory control.
Uniformity versus Flexibility	A preference for the enforcement of uniform accounting practice between companies and for the consistent use of such practices over items as opposed to flexibility in accordance with the perceived need.
Conservatism versus Optimism	A preference for a cautious approach to measurement so as to cope with the uncertainty of the future events as opposed to a more optimistic, laissez faire taking approach.
Secrecy versus Transparency	A preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing as opposed to a more transparent, open and publicly accountable approach.

Source: Dahawy and Conover 2007, (p. 8)

Table 3: Relationship between societal and accounting values, and accounting practices

Societal Values	Accounting Values	Accounting Practice
Individualism/ Collectivism	Professionalism/ Statutory control	Authority and enforcement
Power distance	Uniformity/ Flexibility	Measurement of assets and profits
Uncertainty avoidance	Conservatism/Optimism	Information disclosures
Masculinity/femininity	Secrecy/ Transparency	

Source: Dahawy and Conover 2007 (p. 9)