THE RELATIONSHIP BETWEEN PRIVATIZATION, CULTURE, ADOPTION OF
INTERNATIONAL ACCOUNTING STANDARDS,
AND ACCOUNTING IN EGYPT

DISSERTATION

Presented to the Graduate Council of the
University of North Texas in Partial
Fulfillment of the Requirements

For the Degree of

DOCTOR OF PHILOSOPHY

By

Khaled M. Dahawy
Denton, Texas
December, 1998

This study explores how the Egyptian socioeconomic factors impacted the implementation of International Accounting Standards (IASs) in Egypt. Prior research concluded that developing nations have special needs when it comes to accounting and financial reporting and recommended nation-specific analysis. I adapt Gray’s (1988) model, which connects Hofstede’s cultural dimensions with accounting practice, to fit the Egyptian environment.

This exploratory study uses the pattern model as its framework of analysis. Exploratory research and the pattern model are appropriate for this study because of the lack of theoretical frameworks for assessing the role of accounting in transitional economies. Very little is known about the dynamics of the transformation process in general. More specifically, there is no prior research that has been done on the transformation occurring in Egypt. I conduct an in-depth examination of the financial statements of three recently privatized Egyptian companies and corroborate my findings by conducting interviews with the top management of these companies.

The findings of this study indicate that socioeconomic factors impact how IASs are implemented in Egypt. None of the companies implemented the insider trading and/or the consolidation standards. The interviews suggest that these standards were not implemented because they conflict with the collectivist nature of the Egyptian society.
how business is conducted in Egypt, and the fact that the Egyptian tax code does not allow consolidated reporting.

The disclosures of the three companies were considerably lower than the IASs requirements. The interviews suggest that this may be due to the Egyptians high propensity for secrecy. Also, none of the companies changed their accounting methods to take advantage of the alternatives allowed by the IASs. As posited by the model, the interviews suggest that high uncertainty avoidance and strong power distance, inherent in the Egyptian culture, increased secrecy and resistance to change.

The companies used a mixed strategy, in terms of income reporting, because they face opposing pressures. The Egyptian government and the media have placed pressure on the newly privatized companies to use income-increasing techniques to attract investments and to highlight the positive impacts of privatization. These pressures also have resulted in misstatements of assets to increase working capital and misstatements of cash flows to increase cash flows from operations. Tax compliance, however, has tempered the use of income increasing techniques since any increase reported to income will increase taxes. Overall, consistent with expectations, the IASs have been selectively implemented to minimize conflicts with Egyptian sociocultural factors.
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CHAPTER I

RESEARCH PROBLEM AND RESEARCH QUESTION

Research Problem

International accounting research offers a relatively new frontier for researchers to explore. Saudagaran and Meek (1997) argue that most of the descriptive work to date focuses on developed nations, and that additional research that addresses developing countries is needed. Even when research has focused on developing countries, it has focused on aggregates, making it difficult to discern the reporting practices in specific countries (Abdul-Rahim 1993). A challenge exists that necessitates research involving studies at a nation-specific level. Specifically, we need to understand how socioeconomic factors impact a developing country’s financial accounting and reporting. Enthoven (1985) notes that the socioeconomic environment has a strong effect on accounting because accounting is a service function that operates within a socioeconomic framework. Also, accounting has a significant effect on the transformation of the surrounding environment.

The transformation of Egypt from a socialist/centrally planned to capitalist/market system represents an attractive opportunity to study accounting’s role in facilitating socioeconomic transition. Egypt’s decision to privatize state owned companies is part of
a more comprehensive movement towards capitalism, promotion of economic democracy and widespread stock ownership throughout the world. Privatization entails a complete change in a nation's socioeconomic structure. This change in orientation means that the country has to change its legal, political, economic, and social environment to accommodate private enterprise (Tesche and Tohamy 1994). Egypt needs to generate local and foreign investments if the transition is to be successful. The Egyptian government announced that the main goal of the privatization program is to attract foreign and local investment. This goal is to be reached through (a) sale of state owned corporations (as a whole or as shares in the stock market) and (b) restructuring the rest of the companies to make them more attractive to outside investors (Abdul-Mouty 1997). Accounting, which quantifies some of the economic attributes of privatized corporations, plays a central role in the process (Nahapiet 1988).

Several researchers have argued that developing countries have special needs when it comes to accounting and financial reporting. Peasnell (1988) suggests that we do not know how governmental officials and others (in developing and newly industrialized) countries use (or hope to use) financial statements. The United Nations Commission on Transitional Corporations (UNCTC) (1988, 22) concurs, calling for efforts to "identify specific country needs in the area of accounting and reporting." The International Accounting Standards Commission (IASC) decision to create a special committee to assess the development of accounting standards in developing and newly industrialized countries reflects the importance of the issue (Coopers and Lybrand 1996). In summary,
economic transition provides a unique opportunity to analyze the interrelationship of accounting and its surrounding environmental factors.

**Research Question**

Accounting is not a passive discipline that only responds to environmental changes. Berger and Luckman (1966) and Hines (1988) argue that accounting is an interactive discipline that simultaneously reflects and creates reality. As an information system accounting provides the basis for measurement and reporting of an organization’s activities. Accountants employ various techniques to measure corporate efficiency. The accounting process facilitates the calculation of the value created by a firm by attempting to trace the flow of resources through the value creating process. It identifies, measures, records, summarizes, and reports transactions. How these transactions are internalized determines how they flow through the accounting process. Because the former State Owned Enterprises (SOE’s) are complex organizations in transition, decisions on when and how to record transactions, after privatization, can be very diverse.

In the case of developing countries, like Egypt, accounting information is seen as both passive and active. Passive in the sense that financial reporting practice may be explained by a country’s particular cultural history or stage of development (Mueller 1967) and active in that the choice of financial reporting practices can actively encourage or deter economic development (El Safty 1989). Enthoven (1965, 31) explains that:

Accountancy has a dual effect on economic development. On one hand it is the basis for generating sufficient investor contribution to stimulate the flow of investment capital and restrict unproductive savings practices. On the other hand, effective accounting techniques are a necessary perquisite
to the efficient use of capital. Both aspects are important and will play a role in a nation’s economic programming and the national accounting on which it is based.

Prior research suggests that the question of the role that accounting plays in the transition from the socialist/state owned to the capitalist/market system needs to be addressed in all transitional economies. Table 1 depicts the posited interactive relationships that occur in a transitional economy. This dissertation focuses on the changes in financial reporting and disclosures in Egypt, to provide insights into the above relations.

Table 1

Relationships between Accounting and Transition

| Facilitate | Accounting | Sale of State Owned Corporations | Effect |

Since the interactive effect of accounting on culture is a long-term phenomenon, this dissertation focuses on the more limited short run effects of implementation of the
International Accounting Standards (IASs) in Egypt. This dissertation only examines the following two questions:

1. How did culture and other socioeconomic variables impact the implementation of International Accounting Standards in Egypt?

2. What are the short run effects of the Egyptian culture on the acceptance of changes in accounting practice in Egypt?

In summary, this dissertation aims to provide insights into the relationships between accounting and the transition occurring in Egypt by focusing on the implementation of IASs in the financial statements of newly privatized Egyptian companies.

**Research Strategy**

To examine the implementation of International Accounting Standards (IASs) in Egypt, I conduct an in-depth analysis of the financial statements of three Egyptian companies. Specifically, I analyze each company's financial statements two years prior to privatization and one year after. Evans and Taylor (1982) recommend in depth examination of published financial statements to measure the degree of compliance with IASs by a nation because it allows a more comprehensive picture of the implementation process.

I follow this analysis with open-ended interviews with the Chief Executive Officers (CEO’s) and the heads of the accounting departments of the three companies. These interviews permit a better understanding of the application of the IASs. Also, they shed some insights into the reasons behind the companies' implementation/non-
implementation of the individual standards. These interviews are focused, open-ended interviews, in which I ask the respondents about the facts and their opinions. The interviews are focused because they are based on a set of questions that I prepared prior to the interview (Yin 1989).¹

Justification for Choice of Industry

The three companies analyzed in this study operate in the infrastructure sector of the Egyptian market. Investment in infrastructure is the most important first step for transformation from a socialist to a market economy (Koslowski 1992). The Egyptian situation and transition requires large investments in infrastructure. The construction, housing, infrastructure and building materials sector contains the largest number of state owned companies. Fifty-five of the 393 state owned companies are in the area of construction, housing, infrastructure, and building materials (El-Hayawan and Sullivan 1992) (See Table 2). Moreover, the first company in which the government sold a majority of its equity operated in this sector (Ash 1996).

The World Bank recognized the importance of the infrastructure sector in the development of Egypt during this period. The Bank chose infrastructure, in addition to two other sectors to receive $300 million in lines of credit to encourage investment in these areas (Harik and Sullivan 1992).² Moreover, a report from the Commercial International Investment Company (1997a, 10) reports a “noticeable increase in the level

¹ An Egyptian accountant who has extensive knowledge of the Egyptian accounting market prepared the translation of the interview questions from English to Arabic. An Egyptian accounting professor and a financial analyst in an international financial firm that operates in Egypt reviewed the translation.

² The other two sectors are small and medium scale industries and export and promotion.
of foreign participation in the infrastructure industry, and (that) investment in infrastructure remains urgently sought". Focusing on one industry also allows me to avoid the problems of differences in industries. A report issued by Business America Magazine concluded that the infrastructure sector in Egypt is one of the most promising sectors for U.S. products and services (Anonymous 1987).

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**Summary of Findings**

The findings of this study suggest that socioeconomic factors impact with the implementation of IASs in Egypt. The propensity for secrecy that is embedded in the
Egyptian culture overrides the IASs requirements. As a result, the disclosures reported by the three companies, analyzed in this study, were considerably lower than the IASs requirements. Also, due to the high uncertainty avoidance and the strong power distance that are deep-seated in the Egyptian culture the three companies used the same methods that were prescribed by the Egyptian Unified Accounting System (EUAS) and did not take advantage of the alternatives allowed by the IASs.

In terms of income reporting, the three companies used mixed strategies because they are facing opposing pressures. These companies are newly privatized and the media, government, and investors expect them to perform better and to portray the economic benefits of privatization. This pressured the companies to use income maximizing accounting methods. On the other side, the tax and financial accounting compliance that is required by the Egyptian laws pressured the companies to use income minimizing accounting methods to save taxes cash outflows.

The pressure placed on these companies to portray themselves as being more liquid after privatization also affected the companies classifications of accounts. The three companies misclassified long-term assets as current to overstate working capital. Also, the companies' misclassified cash flow statement accounts overstating net cash flows from operations.

The companies were also selective in their choice of standards to implement. They did not implement standards that conflict with the Egyptian socioeconomic factors. None of the companies implemented the insider-trading standard because it conflicts with the collectivist nature of the Egyptian society and the way business is conducted in
Egypt. Also, the consolidation standards were not implemented because the Egyptian tax code does not allow consolidated reporting.
EXPLORATORY RESEARCH AND THE PATTERN MODEL

The purpose of this research is to advance understanding of the relationship between accounting and economic transition. Because the investigation in this area is in its early stages and an adequate theoretical model of such a relationship does not exist, the nature of this research is exploratory. The main aim is to explore and explain the relationships between accounting and social transition in Egypt. The complex changes occurring in Egypt require dynamic rather than static analysis.

Exploratory research "has as its object the exploration and classification of some phenomena where accurate information is lacking" (Forcese and Richer 1973, 79). This type of inquiry is intended to provide a better understanding and guidance for subsequent research. In the case of exploratory research, Forcese and Richer (1973, 70) state that researchers start by "specifying propositions of general tenability." Moreover, Kaplan (1964, 282) argues that in cases when theory does not offer much guidance in terms of what factors should be included and what factors should be excluded, then a "crude but more realistic set of hypothesis may serve the purpose of inquiry" more than a set of oversimplified hypothesis.
Kaplan (1964, 298) distinguishes between hierarchical theory "whose component laws are presented as deductions from a small set of basic principles" and a concatenated theory. Kaplan (1964, 298) defines a concatenated theory as a theory whose component laws enter into a network of relations so as to constitute an identifiable configuration or pattern. Most typically, they converge on some central point in the phenomenon that the theory is to explain.

This dissertation while being exploratory is also explanatory because it aims to explain what happened and why. The main focus of the dissertation is on understandability not predictability. Interpretation contains "both semantic and scientific explanations" (Kaplan 1964, 328). Kaplan (1964, 328) states that an interpretation occurs "when what is being explained is viewed both as symbol and as fact; a statement has a meaning, but it is also an object or event occurring at a particular time or place." In this sense, he argues that we can interpret speech by what it means. But it is also an event that is occurring at a specific time and place. The connection between the two types of explanation can occur in two ways. On one hand, the semantic explanation may suggest and support the scientific explanation. For example, we explain a dream by making apparent its latent content, and by explaining also why the dreamer produced the symbols he did. On the other hand, the relation between the two types of explanation may be

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3 Kaplan (1964, 328) defines semantic explanation as "a translation or paraphrase, a set of words having a meaning equivalent or similar to those being explained, but more easily or better understood." He also defines scientific explanations as explanations that "are not of meaning. These are not relative to the consumer, though they may be offered up for his acceptance. A statement is offered as explaining a certain event, say, may in fact explain this event even though no one accepts the explanation." Furthermore, he states that "the difference between a semantic and a scientific explanation is in this respect like the difference between a statement being clear and its being true."
reversed. For example, we may understand what a person says because we know why he
is saying it.

An explanation may be said to be concatenated when “it does its work, not by
invoking something beyond what might be described, but by putting one fact or law into
relation with others” (Kaplan 1964, 329). The linkage and the connections that are
presented clarify each fact by placing it within a broader context. Clarity occurs because
“they come to a common focus that together they throw light on what is being explained”
establishing an undergoing pattern (Kaplan 1964, 329). 4 Kaplan (1964, 334) concludes
that “the particular relations that hold constitute a pattern, and an element is explained by
being shown to occupy the place that it does occupy in the pattern.” The perception of the
pattern is what gives the “click of relations” (Kaplan 1964, 238). In this sense we
understand the individual element through its relation with the whole. In the pattern
model one explains by “instituting or discovering relations” (Kaplan 1964, 239). For the
pattern model objectivity is reached when the “pattern can be indefinitely filled in and
extended: as we obtain more and more knowledge it continues to fall into place in this
pattern, and the pattern itself has a place in the larger whole” (Kaplan 1964, 335).

Explanation has three major functions: (1) a technological function, (2) an
instrumental function and (3) a heuristic function (Kaplan 1964). The technological
function of explanation is “used for a better adaptation to the environment, a more
effective adjustment of available means to desired ends” (Kaplan 1964, 356). In this

4 For example, one can state that a person is incapable of work because he is lazy. However, by taking this
statement and connecting it to other elements that we know about this person we might explain his acts
differently. One situation might be that this person works two jobs to fulfill the needs of his family and so
on the second job he is so tired that he can’t put in the needed effort.
sense, explanations provide understanding so that we can better orient ourselves, choose more wisely among the courses of action open to us. Kaplan (1964, 356) argues that "knowledge is power." The instrumental function is embedded in the communication of this explanation. Kaplan (1964, 356) states that "we can produce results... not just by applying knowledge but even by merely communicating it." In this sense "an effect can be produced by helping others see an explanation" (Kaplan 1964, 356). Finally, the heuristic function serves to stimulate and guide further inquiry (1964, 357).

This dissertation focuses on the technical function of explanation by providing an explanation of the relationships between privatization, culture, and international accounting in Egypt. By understanding these relationships the International Accounting Standards Committee (IASC) can make better decisions in terms of choice of standards that fit developing countries better. Also, by understanding these relationships the Egyptian government, accountants and managers can make better choices in terms of implementation of IASs and choice between alternatives. By focussing on the technical function this dissertation also serves the heuristic function of explanation. By communicating the findings of this dissertation I hope to stimulate other researchers and guide them to further research in this area.

Exploratory research and the pattern model are appropriate for this study because of the lack of theoretical frameworks for assessing the role of accounting in transitional economies. Very little is known on the dynamics of the transformation process in general. More specifically, there is no prior research that has been done on the transformation occurring in Egypt. Although other transformations occurred in some former eastern
block countries, it is important to note that there are major differences between those transformations and the Egyptian experience. The socioeconomic constructs and the mechanism of transformation in Egypt do not parallel those in Eastern Europe. One clear example can be found in the speed of accounting change. Poland has decided to gradually change its accounting system from the socialist system to International Accounting Standards (IAS).³ On the other hand, Egypt has taken a more revolutionary approach by decreeing that all companies that have stock traded on the stock exchange have to adopt the IAS (Law 95 for 1992 code 85).

Gray’s Model

International accounting research is “all encompassing, including issues such as managerial, and financial accounting, taxation, auditing, currency translation, harmonization/standardization, translation, foreign direct investments, and internalization of financial markets” (De La Rosa 1996, 9). This section concentrates on the development of a framework to present the relationships between financial accounting and its surrounding factors (economic, political, international, and cultural) in Egypt.

In recent years, increasing attention has been directed to the cultural dimension of accounting (Gray 1988; Hamid, Craig, and Clark 1993; Saudagar and Meek 1997). The theory that has been most accepted in the international accounting area has been Gray’s (1988) model that extends Hofstede’s (1980) theory on cross culture psychology to

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³ For example Poland has adopted a shock therapy policy to change its economic structure, it has been very deliberate in changing its accounting system (Interview with Professor W. Novak, University of Lodz, November of 1997).
accounting (Baydoun and Willett 1995). Several conceptual and empirical studies have examined the impact of national culture on accounting (e.g. Beazley 1968; Singhvi 1968; Acheson 1972; Jaggi 1975; Chevalier 1977; McComb 1979; Belkaoui 1983; Bronwich and Hopwood 1983; Soeters and Schreuder 1988; Belkaoui and Pincur 1991; Frechnner and Kilgore 1994; Salter and Niswander 1995). All of these studies conclude that accounting is highly affected by national culture. There is a consensus that accounting needs to be studied in the context in which it operates to minimize the methodological problems of cross cultural research (Gray 1989).

Based on Hofstede’s (1980) framework for development and maintenance of culture Gray (1988, 5) “introduce(d) a global environmental and cultural framework ... to identify international forces at a national level.” He suggests that the forces for change are a result of cultural patterns that are developed over time and that individual cultures need to be studied when researching international issues.

Gray bases his framework on Hofstede’s (1984, 83) four dimensions of societal values which Hofstede defines as follows:

- Individualism versus Collectivism:

The fundamental issue addressed by this dimension is 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. In opposite, collectivism stands for a preference for tightly knit social framework in which individuals can expect their relatives, clan, or other in-group to lookout for them in exchange for unquestioning loyalty.
- Large versus Small power distance

The fundamental issue is addressed by this dimension is 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

The fundamental issue addressed by this dimension is 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.

- Masculinity versus Femininity

The fundamental issue addressed by this dimension is 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.

Gray (1988) suggests that accounting researchers need to modify Hofstede’s (1980) framework for the application in specific cultures. He derives a framework that proposes an interactive accounting process. Based on his review of accounting literature and practice, he concludes that a society’s structures influence societal values, which in turn influence family patterns, social class structure, political system, business ownership, organization, and educational systems. Furthermore, he argues that these relations are dynamic. The pattern of change can be influenced by external forces of nature as well as by the intentional actions of people.
Gray (1988) extends Hofstede’s model by proposing a framework for international accounting change and development. He derives four distinguishable accounting values/subcultures that he argues are related to societal values. Gray (1988, 8) defines these four values as follows:

- Professionalism versus Statutory Control

A preference for the individual professional judgement 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.

Gray (1988) postulates the directions for the relationships between the accounting values and Hofstede’s cultural values (Table 3).\(^6\) Gray (1988, 9) argues that a preference for independent professional judgment conforms with a “preference for a loosely knit

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\(^6\) Table 3 is adapted from Baydoun and Willett (1995).
social framework where there is more emphasis on independence, a belief in individual decisions and respect for individual endeavor." In addition, he states that a preference for high professionalism is consistent with weak uncertainty avoidance "where practice is all important, where there is a belief in fair play and as few rules as possible, and where a variety of professional judgments will tend to be more easily tolerated" (Gray 1988, 9). Also, Gray (1988, 9) argues that professionalism will be more accepted in a small power distance society where "there is more concern with equal rights, where people at various power levels feel less threatened and more prepared to trust people, and where there is a belief in the need to justify the imposition of laws and codes." He doesn't present any significant links between masculinity and professionalism.

<table>
<thead>
<tr>
<th>Accounting Values (Gray)</th>
<th>Cultural Values (Hofstede)</th>
<th>Professionalism</th>
<th>Uniformity</th>
<th>Conservatism</th>
<th>Secrecy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power Distance</td>
<td>-</td>
<td>+</td>
<td>?</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Uncertainty Avoidance</td>
<td>-</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
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<tr>
<td>Individualism</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Masculinity</td>
<td>?</td>
<td>?</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

7 "+" indicates a direct relationship between the relevant variables; "-" indicates an inverse relationship. "?" indicate that the nature of the relationship is indeterminable.
As for uniformity and its relation with Hofstede's cultural dimensions Gray (1988, 9) states that a preference for uniformity is "consistent with a preference with uncertainty avoidance leading for concern for law and order and rigid codes of behavior, a need for written rules and regulations, a respect for conformity and the search for ultimate, absolute truths and value." Uniformity is related to collectivism "with its tightly knit social framework, a belief in organization and order, and respect for group norms (Gray 1988, 9). Also, Gray (1988, 9) asserts that uniformity is more easily advanced in "large power-distance society in that the imposition of laws and codes of a uniform character are more likely to be accepted." He doesn't present any significant link between uniformity and masculinity.

In terms of conservatism versus optimism, Gray (1988, 10) asserts that there is a direct relation between a preference for more conservative measures of profits and strong uncertainty avoidance "following from the concern with security and a perceived need to adopt a cautious approach to cope with the uncertainty of future vents." He also suggests that there is a relation between "high levels of individualism and masculinity on one hand, and weak uncertainty avoidance on the other, to the extent that an emphasis on individual achievement and performance is likely to foster a less conservative approach to measurement" (Gray 1988, 10). He doesn't present any significant relationships between power distance and conservatism.

As for secrecy versus transparency Gray (1988, 11) states that there is a direct relationship between preference for secrecy and strong uncertainty avoidance "following from the need to restrict information disclosure so as to avoid conflict." He also asserts
that "high power-distance societies are likely to be characterized by the restriction of information to preserve power inequalities." Gray (1988, 11) states that secrecy is "consistent with a preference for collectivism, as opposed to individualism, with its concern for those closely involved with the firm rather than external parties." He also suggests that "a significant but less important link with masculinity also seems likely to the extent that more caring societies where more emphasis is given to the quality of life, people and the environment, will tend to be more open especially in regarded socially related information" (Gray 1988, 11).

Frechner and Kilgore (1994) conclude that uncertainty avoidance and individualism are the most influential dimensions in relation to the accounting subculture dimension in Gray’s model. Gray (1988) argues that values of accounting subculture are expressed in accounting practices of authority, enforcement, measurement and disclosure. Table 4 contains Gray’s (1988) model that links Hofstede’s cultural variables to accounting practices through accounting subculture.⁸

In addition, Gray (1988) argues that financial statements vary across different countries based on the differences in users and the comparability between tax and financial accounting. For example, the emphasis in the UK is on equity investors who are mainly interested in the distribution of profits. On the other hand, in France and Germany, the emphasis is on creditors and debt financiers who are more concerned with ensuring long term corporate viability. Gray concludes that the differences in emphasis lead to distinctive financial reporting alternatives. Furthermore, he posits that

⁸ Table 4 is adapted from Radebaugh and Gray (1993).
professionalism and uniformity affect standard setting processes and compliance with existing standards, while conservatism and secrecy affect measurement and disclosure practices of financial reports.

Perera (1989b) and Perera and Mathews (1990) extend Gray’s work. Perera (1989b) suggests that the accounting subculture dimensions combined can have a strong impact on accounting practice. He argues that the value orientations of the preparers of the financial statements are formed by societal/cultural values. Frechner and Kilgore (1994, 267) support this argument and state that “accountants are a product of their environments and to some lesser degree disciples of their profession.” Perera (1989b), like critical researchers, concludes that accountants perform more than just a technical function.
Perera (1989b) further extends this framework by suggesting that societal values are affected by a broader set of environmental variables including economic variables. He extends his scope to developing countries and argues that transferring accounting skills from developed countries to developing countries is unlikely to be successful because developing countries lack adequate professional subcultures to develop standard accounting skills. As a result, in developing countries governments step in to formulate accounting principles and provide the legal authority to ensure reliability of published financial information.

Perera and Matthews (1990) extend the framework by introducing the idea that development of accounting is further affected by global organizations like the United Nations (UN) and the European Economic Union (EEC). They argue that efforts to standardize accounting can be seen as efforts to reduce national influences in reporting practices. This line of research argues that there is a relationship between the accounting subculture values and accounting practice dimensions and that culture can influence this relationship. However, Frechner and Kilgore (1994, 274) argue that "this line of research has failed to explain the differences in accounting practices within and across cluster groupings identified by Hofstede and Gray." As a result, they extend Gray's model to include societal culture and economic factors as a moderating variable that directly affect accounting practices. In this model economic and cultural factors can have a direct effect on the accounting practice without going through the accounting subculture.
Limitations of Gray’s Model

Lee (1997, 20) notes that Gray considers culture to be the most significant factor in shaping accounting systems. He ignores other factors, such as political systems, legal systems, and colonial influences. His model may be appropriate in the case of countries that gradually transform from one economic/political system to another. The gradual change allows society time to adapt to socioeconomic changes. However, in the case of Egypt the transformation is not gradual. The country is very quickly moving from one economic/political system to another due to the economic problems that it faces and the pressures exerted by international bodies like the World Bank and the International Monetary Fund (IMF). The government has mandated the use of IASs for financial reporting. Mandelbaum (1977) argues that specialized disciplines, such as accounting, produce cultural products that are subject to importation. The transition process has resulted in importation of IASs into Egypt. Since developing countries have little influence on promulgation of IAS, the imported standards may conflict with Egyptian socio cultural values. For example, the IAS's emphasis on disclosure directly conflicts with the deep-rooted propensity for secrecy embedded in the Egyptian society. Similarly, the IASs requirements to report related party transactions conflicts with traditional business practices in Egypt. Finally, the Egyptian tax requirement of not permitting consolidation conflicts with the consolidation requirements of the IASs.

There are three main factors and/or relations that Gray’s model and the subsequent literature seem to have ignored. First, Gray’s model ignores the idea of importation of accounting standards. Second, Gray presents a uni-directional model,
which assumes that culture affects accounting, but he does not consider the effect that accounting might have on culture. Third, the model assumes that societal culture is the most important vehicle that affects the accounting subculture. It does not consider the effect of other socioeconomic factors like the tax system and the degree of development of the equity exchange market on the accounting subculture.

Perera and Mathews (1990) suggest that there are important direct effects that are introduced by global organizations on developing countries professions. In the case of accounting the most prominent global standard setting body is the International Accounting Standards Committee (IASC) (Rivera 1989). The effect of the IASC on Egyptian practice is very important because Egypt decided to adopt the IASs for all the privatized companies stock traded on the Egyptian Stock Exchange.9 IASs issued by the IASC directly affect accounting practice in Egypt. Therefore, I modify the model by adding a direct connection between IASs and the Egyptian accounting practice.

Larson (1993), Perera (1989a) and Amenkhienan (1986) point out that the complete implementation of IAS in developing countries is close to impossible. They argue that the IASC mainly focuses on developed nation’s cultures and needs (especially the US and the UK) when they promulgate standards. The mandated adoption of IASs means that neither the Egyptian society nor the Egyptian accounting profession had time to adapt to the IAS. Conflicts exist, therefore, I posit that although the Egyptian government mandated adoption of IAS, the actual implementation will be moderated by

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9 The adoption was mandated by provision 85 of the law 95 for the year 1992 promulgating the law on the capital market.
the Egyptian socioeconomic constructs. Therefore, I add Egyptian socioeconomic variable as a moderating factor between the IAS and the Egyptian financial accounting practice.

The variables include, but are not limited to, Hofstede and Gray’s cultural dimensions. They include the factors and forces that can be expected to affect and shape Egyptian accounting. The socioeconomic factors also include tax laws, development of the equity market, and the degree of privatization of the country. All of these factors affect the degree and type of implementation of the IASs by Egyptian companies. I treat them as intervening variables that may moderate the impact of the IASs on accounting practice in Egypt.

Gray’s model is an uni-directional model that only looks at the effects of societal culture on accounting culture and practice. It ignores the possibility that accounting may also create reality (Berger and Luckman 1966; Bateson 1972; Baker, Haslem, and Juchau 1977; Burchell et al. 1980; Hines 1988). In the case of developing countries, like Egypt, accounting information is seen as both passive and active. Passive in the sense that financial reporting practice may be explained by a country’s particular history or stage of development (Mueller 1967) and active in that the choice of financial reporting practices can actively encourage or deter development (El Safty 1989). Enthoven (1965, 31) explains that

Accountancy has a dual effect on economic development. On one hand it is the basis for generating sufficient investor contribution to stimulate the flow of investment capital and restrict unproductive savings practices. On the other hand, effective accounting techniques are a necessary perquisite to the efficient use of capital. Both aspects are important and will play a
role in a nation’s economic programming and the national accounting on which it is based.

Accounting can affect culture in several ways. For example, it can lead people to focus on measurable monetary profit instead of other qualitative attributes. In individualistic western economies there is a strong private property rights tradition that holds managers primarily accountable to owners (shareholders) justifying the use of profit as a measure of corporate performance. In Egypt, there still exists a strong hierarchical system that renders measurement of managerial performance by use of accounting profit questionable. One of the objectives of the privatization process is to establish the necessary socioeconomic environment to support private property rights. The acceptance of traditional accounting profit as an appropriate measure of management’s performance should facilitate the necessary sociocultural changes.

Gray’s model assumes that accounting values only change when a societal change occurs (Lee 1997). This assumption is not appropriate for privatization in Egypt. Societal change generally occurs over a long period of time (Koslowski 1992). Economic and political factors may have a direct effect on professional cultures that precedes societal change. For example, in the medical industry when a new drug is introduced the doctors and health professionals are the first to be affected by its existence. In the case of accounting culture, I argue that sometimes economic and political changes affect professionals in general, including accountants, before they affect societal values, and that these changes may conflict with societal values. In this sense, the accounting subculture and practice will adapt more quickly to economic and political changes than
will society. It is important to note that I am not arguing that economic and political factors do not affect societal values. My argument is that sometimes economic and political changes take longer to affect the general societal culture than they do to affect professional cultures and practices. Salter and Niswander (1995, 387) argue that the “more developed the country’s capital market the higher the degree of professionalism, and the lower the degree of legal uniformity, pessimism and secrecy.” This is especially important for Egypt because of its transitional economic/political environment. Therefore, my model includes a direct connection between political and economic factors and the accounting subculture and practice. It is important to note that my framework acknowledges the relation between societal culture and economic and political factors. I present this relationship using a dashed line to indicate the expected lag.

I do not include the influence of Masculinity/Femininity variable in my model due to the inability to specify the expected direction of the variable on accounting practice. As Lee (1997, 18) notes “the relationships between masculinity and accounting values suggested by Gray are vague.” Subsequent research, based on Gray’s model, found masculinity/femininity to be less important than the other societal values in influencing accounting subculture, concluding that this variable lacks explanatory power (Lee 1997). Lee (1997, 18) also points out that “Hofstede’s definition of masculinity includes assertiveness and materialism which do not necessarily coexist in the same society.” The masculinity/femininity dichotomy appears to be too general to serve as a surrogate for the relations and variables posited.
The New Model

Based on the previous discussion I suggest a more applicable model to the Egyptian situation (Table 5). The new model introduces the direct effects that the IASs have on the accounting profession in Egypt. In addition, it presents socioeconomic factors as intervening variables that can hinder or enhance the application of the international accounting standards. The model also highlights the duo-directional relationships between accounting and its surroundings.

Table 5
The Suggested Model

<table>
<thead>
<tr>
<th>Economic and Political Factors (Privatization)</th>
<th>International Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cultural Factors</td>
<td>Socioeconomic Factors</td>
</tr>
<tr>
<td>Individualism/Collectivism</td>
<td></td>
</tr>
<tr>
<td>Power Distance</td>
<td></td>
</tr>
<tr>
<td>Uncertainty Avoidance</td>
<td></td>
</tr>
<tr>
<td>Accounting Culture</td>
<td></td>
</tr>
<tr>
<td>Professionalism/Statutory Control</td>
<td>Authority and Enforcement</td>
</tr>
<tr>
<td>Uniformity/Flexibility</td>
<td>Measurement of assets &amp; profits</td>
</tr>
<tr>
<td>Conservatism/Optimism</td>
<td>Information Disclosures</td>
</tr>
<tr>
<td>Secrecy/Transparency</td>
<td></td>
</tr>
</tbody>
</table>
In summary, this study is an exploratory study that is based on Kaplan's (1964) pattern model. I adopt Gray’s (1988) model that relates Hofstede's (1984) cultural dimensions to accounting values. However, I adapt the model to fit the Egyptian situation. First, I add a direct link between the IAS and the accounting practice in Egypt to accommodate the idea of accounting importation. I also introduce Egypt's socioeconomic factors as moderating variables between the IAS and the accounting practice in Egypt. Second, I present the model as duo-directional. Third, based on the results of prior literature, I do not include masculinity/femininity in the analysis.

The Egyptian Culture

The previous discussion highlights the importance of understanding the cultural factors of a country. Therefore, this section includes a brief presentation of the Egyptian culture. The discussion in this section is divided based on Hofstede's cultural dimensions.¹⁰

The Anglo American approach to financial reporting dominates International Accounting Standards Committee (IASC) standard setting (Flower 1997). Since accounting is a product, subject to importation, standards can be adopted that conflict directly with a nation's culture (Mandelbaum 1977). As a result, one would expect that the IASC approach to financial reporting would conflict with aspects in the Egyptian culture.

¹⁰ This is not intended to provide a comprehensive cultural comparison between the Egyptian culture and the western culture. Instead I'm trying to highlight the presence of such major differences.
culture. In this section I examine the Egyptian situation in relation to Hofstede's cultural dimensions and compare it to the American culture when appropriate.\textsuperscript{11}

*Power Distance*

Hofstede states that power distance deals with how people accept inequalities and hierarchical orders. Hofstede (1984) reports Egypt as having a very strong power distance when compared to the US. He found that the power distance index level reported in Egypt is double the power distance index level that is reported in the U.S. (Hofstede 1984, 85). This means that Egyptian society accepts the presence of a strong hierarchical system. Table 6 contains a comparison between the power distance levels in Egypt and the U.S.

| Table 6 |
|---|---|
| **Power distance in Egypt and the U.S.** | **Egypt** | **U.S.** |
| Power Distance Index | 80 | 40 |
| Ranking | 45 | 16 |

There are several reasons that lead to the high power distance ranking in Egypt. Children are taught from birth that they have to respect and obey anybody who is older or

\textsuperscript{11} I'm using the US for comparison for two reasons. First, Flower (1997) argues that it has the strongest influence on the IASC. Second, because the dissertation is presented to a university in the U.S. it makes the conceptualization of the differences easier.

\textsuperscript{12} The higher the index values the larger the power distance. Hofstede's ranking is based on the results of his analysis of 50 countries. The higher the ranking the larger the power distances.
more experienced. Children are required not to question any adult (Patai 1983). There is even an order of authority among children; younger children are expected to yield to older ones. Parental respect is expected to last as long as the parents are alive. There is a pattern of dependence on seniors that is always present. The permission of parents is always sought even when the children are mature and married (Lamb 1987).

This type of acceptance of the hierarchy carries over to the Egyptian schools. In school the teacher takes over the role of a parent. Students are not expected to argue with the teacher. They are encouraged to ask questions, but they are not allowed to disagree with the instructor. They have to accept any answer that the instructor gives as correct. This attitude continues through the university level, where classes are very large, sometimes reaching 5,000 to 6,000 students. In this atmosphere, students listen and rarely participate. Students seldom ask questions and if they do they have to accept the professor's answer (Ayalon 1990). The instructor is the center of the educational process. He/she sets the learning path.

This hierarchical setting is supported by the religious beliefs of Egyptians. For example in the Koran God orders Muslims to obey their parents and not ever disobey them.13 One of the most prominent Egyptian proverbs is ‘whomever teach me a letter I become his slave.’ This proverb reflects the widespread acceptance of this hierarchical order.

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13 The Koran is the Muslims holy book, which Muslims believe provides religious and life advice. The only time a Muslim is allowed to disobey his parents is if they ask him/her to believe of any equal to God.
In the work atmosphere the same attitude prevails. Superiors and subordinates consider each other inherently unequal. Egyptian employees are always expected to agree with the employer/manager. Communications are usually from the top down (Patai 1983). Subordinates expect to be told what to do and believe that the employer/manager should always be obeyed. The hierarchical structure is bolstered by the promotion and salary structure, where promotion and salaries are not based on performance but on tenure and age (Harik 1997). While this may change in the newly privatized companies, the evidence suggests that change will be slow, since most of the top management in these companies hasn't changed.

Uncertainty Avoidance

Hofstede (1983, 336) defines uncertainty avoidance as "the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity." Hofstede (1984, 85) reports that Egypt has strong uncertainty avoidance when compared to the U.S. Table 7 contains a comparison between the level of uncertainty avoidance in Egypt and the U.S.

Given the strong hierarchical structure of Egypt, Egyptians are used to obeying the rules. Uncertainty, which may lead to conflict with people who have power, creates discomfort (Harik 1997). In addition, the economic situation in Egypt leads people to try and avoid uncertainty. Many Egyptian families are poor; they have few economic resources. Therefore, most Egyptians prefer to avoid taking risks because of its probable effects on their economic situation (Patai 1983). One of the implicit assumptions
underlying western standard setting is contracting (Watts and Zimmerman 1979). However, as Dahl (1957) points out that people do not have the power to contract when they are very poor. Therefore, in Egypt contracting, as defined by the western world, may take time to happen.

Table 7

<table>
<thead>
<tr>
<th>Uncertainty Avoidance in Egypt and the U.S.</th>
<th>Egypt</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uncertainty Avoidance Index</td>
<td>68</td>
<td>46</td>
</tr>
<tr>
<td>Ranking</td>
<td>25</td>
<td>11</td>
</tr>
</tbody>
</table>

Uncertainty avoidance is also clear in schools. Students expect their teacher to be the expert and to be able to answer any and every question relating to the topic that he/she is teaching. Class schedules are highly structured and the students usually find out every detail in advance. Students do not accept a teacher who says ‘I don’t know’. As a matter of fact if a teacher does that he/she loses respect and authority in his class (Lamb 1987).

Uncertainty avoidance is even clearer in the workplace. Everything in Egypt is regulated by a law to avoid uncertainty about how things need to be done. Egypt has one of the highest rates of generating laws in the world (Harik 1997). In accounting, the Egyptian Unified Accounting System (EUAS) exemplifies the Egyptian preference for

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14 The higher the index value the stronger the uncertainty avoidance. Hofstede's ranking is based on the results of his analysis of 50 countries. The higher the ranking the stronger the reported level of uncertainty avoidance.
uncertainty avoidance. It provides very detailed and comprehensive procedures of what needs to be done in every situation. This rule book approach is diametrically opposed to the concept that the accountant should be free to exercise professional judgment.

Power distance complicates the problem even further. Usually employees, who are in the lower levels, have a higher familiarity with the technical aspects of the job but avoid initiating change because they fear conflict with people who hold power. Religion is another force that advocates uncertainty avoidance through “faith.” Religions help us accept uncertainties that we cannot defend ourselves against (Hofstede 1991). Islam offers the certainty of life after death. Moslems believe that the truth (with a capital T) is revealed through the Koran, which was revealed from God to Mohamed.

*Individualism/Collectivism*

Individualism/collectivism comparison deals with the difference between "I" and "we" attitudes (Hofstede 1984, 83). Hofstede (1984) finds that Egypt has a significantly lower individualism level than the U.S. The U.S. had the highest level of individualism in the world (Hofstede 1984, 85). Table 8 contains a comparison between the level of individualism/collectivism in Egypt and the U.S.

In the western world, individualism coupled with private property are thought of as the base for capitalism and market operations. Since the 1950's Egypt has had a communal economic system. The government controlled the economy in pursuit of nationalistic goals. The era of privatization started in the early 1990s and is still at a
Egypt can be seen as a cooperative community, where community goals override individual goals. In such a scenario, profit maximization is secondary to economic security. While privatization is now being promoted the government still maintains control of the economy.\textsuperscript{15}

<table>
<thead>
<tr>
<th>Table 8</th>
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<tbody>
<tr>
<td><strong>Individualism/Collectivism in Egypt and the U.S.</strong>\textsuperscript{17}</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Individualism/Collectivism Index</td>
</tr>
<tr>
<td>Ranking</td>
</tr>
</tbody>
</table>

Egyptians are encouraged to think about the effects of their actions on the public in general. Children are directed to collectivism by being taught the importance and value of extended family and kinship (Patai 1983). Self-interested behavior, a central tenet of western capitalism, conflicts directly with Egyptian communal culture (Lamb 1987). In contrast to the western aim of making children reach independence, Egyptian children expect to stay dependent on their parents until they get married (Pryce-Jones 1989).

School, reinforces the concept of community. Competition is not encouraged. Students rarely ask questions unless the teacher specifically asks them. A student does

\textsuperscript{13} During the presidency of Sadat (1970-1980) there were attempts to revive the role of the private sector (Infitah). However, these efforts were not successful because they aimed at a limited change and did not attempt to abandon the wide state ownership structure.

\textsuperscript{15} However, it is important that Abercrombie (1986) concludes that individualism is not important for capitalism. He uses Japan as an example of communal capitalism.

\textsuperscript{17} The higher the index value the higher the level of individualism Hofstede's ranking is based on the results of his analysis of 50 countries. The higher the ranking the higher the degree of individualism.
not usually try to stand out in his group. As a matter of fact, morality and behavior in Egypt are dealt with as a social matter as opposed to in the west, where they are dealt with, as individual matters (Lamb 1987).

Most employers do not depend on qualifications alone when making hiring decisions. They usually hire people that they think will fit in with the group. The employee is expected to act in the interest of the company even if the actions conflict with his/her individual goals (Harik 1997). The hiring process reflects communal attributes. Companies usually prefer to hire employees who have relatives in the firm or people that are recommended by someone known to management. 'Business Card Hiring' is very common in Egypt. In this type of hiring a relative or a friend of the candidate or the candidate’s family, who has high status in the community or knows the employer, writes a recommendation note on one of his/her business cards. The prospective employee then takes that card to the company when applying for a job. Personal relationships outweigh educational credentials in most employment situations.

Islam, unlike Christianity, supports collectivism. The Koran asks Muslims to consider the impact of their actions on the societal well being. One of the very well known sayings of the prophet Mohamed is that Moslems to each other are like one body, if one part is sick the rest of the parts need to stay up looking for him. Based on the previous discussion, familial, educational, religious, and work environments all promote community not individualistic based behavior.

In summary, accounting is an interactive cultural discipline that both shapes and is shaped by socioeconomic conditions. The greater the degree of harmony between
accounting standards and a nation's culture the greater the likelihood that the standards will be implemented.\textsuperscript{18} Flower (1997) notes that the IASC is strongly influenced by the Anglo-American approach which conflicts with the Egyptian cultural values. Therefore, while the World Bank and the International Monetary Fund (IMF), have forced Egypt to adopt IASs, I anticipate that those standards will be selectively implemented.

\textsuperscript{18} It is also worth noting that Egypt is also very different from other western industrialized countries that have influence on the IASC. For a more detailed analysis of this difference refer to Hofstede (1984: Exhibit 1, page 85).
CHAPTER III

PROPOSITIONS RELATING TO THE EFFECT OF THE ADOPTION AND IMPLEMENTATION OF THE INTERNATIONAL ACCOUNTING STANDARDS

Proposition 1: Adoption versus Implementation of International Accounting Standards (IASs)

Harmonization of accounting standards through the International Accounting Standard Committee (IASC) has had widespread support from the accounting profession (Ernst and Whinney 1986; Coopers and Lybrand (International) 1991) and the academic world (Wyatt 1989; Nobes and Parkers 1991). Arapan and Radebaugh (1985), Belkaoui (1988), and Wyatt (1989) concluded that the adoption of International Accounting Standards (IASs) would facilitate the growth of equity markets and promote economic development. However, it is not clear that these benefits will accrue to developing nations that adopt IASs. Amenkhienan (1986), Hove (1989), Perera (1989a), Briston (1990), and Larson (1993), argue that harmonization will be detrimental to economic growth in developing countries. They argue that the strict adoption of IAS by developing countries may be harmful because developing countries’ environments, cultures, and
accounting needs differ from those of developed countries” (Larson 1993, 2). However, developing countries, like Egypt, that need external capital, have been required to adopt IASs to gain external credibility for financial reports. These standards reflect the Anglo-American culture; therefore, it is reasonable to posit that some of these standards will conflict with the Egyptian culture. The adoption of the IASs constitutes a radical change in Egypt, where accounting was regulated by the Egyptian Unified Accounting System (EUAS). The EUAS offered detailed rules on how to record accounting transactions and prepare financial statements. Accountants were technicians who applied the rules. The IASs require Egyptian accountants to exercise professional judgement, increasing uncertainty and conflicting with risk aversion inherent in Egyptian culture. In addition, the IASs switch the focus of accounting from taxes and measurement of communal well being to profit measurements and disclosures.

The ability of users to understand and use financial statements is the main objective of the IASC (Coopers and Lybrand 1996). The IASs mandate full disclosure so that the primary suppliers of capital, investors, and creditors can make informed investment decisions. Disclosures conflict directly with the propensity for secrecy in Egypt. This in turn will have major effects on the implementation of the disclosure standards. Most accountants and managers will be unwilling to disclose information about their companies. This problem is complicated even further by the tax and financial accounting compliance requirements that are present in Egypt. Many managers and accountants in Egypt are afraid that the full disclosure policy will disclose information to the tax authorities in Egypt.
One of the IASs that might be hardest to implement is IAS 27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries." This standard requires the parent company to issue consolidated financial statements and specifies disclosures that need to be included. Bernard (1991) notes that in Egypt there is no provision for filing consolidated financial statements. This is not surprising since the Egyptian tax code prohibits consolidated reporting and requires each company to present its financial statements individually (Price Waterhouse 1996). This leads to an irrevocable conflict. Companies must report one set of financial statements, which are not consolidated, to satisfy the Egyptian tax laws. Conversely, companies must present consolidated financial statements, to satisfy the IASs requirements. As a result, companies have two alternatives. They can either ignore the Egyptian tax laws and provide consolidated financial statements or provide two sets of financial statements one for tax purposes and one for investors (meeting the IASs requirements). However, since tax compliance is required the two-statement alternative would be illegal. Accountants and corporate managers also seem to believe that presenting two statements would undermine the 'objectivity' and credibility of the Egyptian financial statements. The second alternative, the only legal option, is to ignore the IASs requirements and present unconsolidated financial statements.

Egypt's high level of collectivism which, as discussed earlier, makes extended family and kinship relations very strong and very important in the Egyptian culture, conflicts with the IASs requirements of disclosure of related party transactions (IAS 24). IAS 24 identifies key management and directors as related parties. The main focus of
this part of the standard is to limit insider trading. But, the Egyptian business environment has not yet evolved to the point where insider-trading transactions are deemed negative. In Egypt, corruption and insider dealings continue to be the norm; many people accept bribery as a way of doing business (Harik 1997). In this environment, exchange of information among related parties does not appear to the government to be a critical problem. In fact, close family relationships and insider trading are seen as a source of stability rather than a threat to the economic system.

The previous discussion offers some examples of standards that would conflict with the Egyptian socioeconomic situation. I posit that the incompatibilities between a nation's social and cultural environment and imported IASs will generate conflicts that will be resolved by selective implementation of IASs. Given the disagreement over the effect of IASs on developing countries the Egyptian government might find that new Egyptian accounting standards, consistent with the Egyptian culture would facilitate and ensure greater compliance with standards. Due to the cultural conflict, I posit that

Proposition 1: IAS will be selectively implemented in Egypt

I examine this proposition through in-depth analysis of the financial reporting practices of the three companies and interviews with the corporate management, government officials and accountants practicing in Egypt.

Proposition 2: Uniformity

Based on Gray's (1988) model this dimension can range from strict uniformity to complete flexibility in accounting practices. Gray (1988, 9) states that “a preference for
uniformity is consistent with a preference for strong uncertainty avoidance leading to a concern for law and order and rigid codes of behavior, a need for written regulation, a respect for conformity and the search for ultimate, absolute truths and values.”

Financial reporting in Egypt prior to privatization required strict compliance with uniform rules. The Egyptian Unified Accounting System (EUAS) provides rigid rules for application, while the IASs allows accountants to exercise their professional judgment to choose between alternative practices. Therefore, the adoption of IASs may result in less uniformity.

The decrease of uniformity here should not be considered as negative. IASs require that financial statements present a "true and fair" view. "True and fair" is not defined by the IASC, but the tenor of the concept is that no one accounting treatment will be appropriate in all circumstances. Accountants must exercise professional judgment to determine how to apply a standard in a particular circumstance. EUAS directly conflicts with the underlying premise of IASs, because it is a uniform system that allows for no judgment. Under the EUAS, all companies had to use the same exact methods and techniques whether these methods were appropriate or not for the company’s specific activities. Accounting under the IAS decreases uniformity in the sense that it moves accounting in Egypt from a strict format to a more flexible but internationally comparable format.

However, Egyptian companies and accountants may find greater flexibility unappealing. Hofstede (1991) reports that Egypt has strong uncertainty avoidance, large power distance and low individualism. Uniformity is positively related to uncertainty
avoidance and power distance and negatively related to individualism. In this scenario, I expect Egyptian companies to continue to favor uniform methods that avoid the uncertainty inherent in use of professional judgement. In addition, managers may resist change in fear that it may create conflicts with people in power. Thus, while IASs allow choice the Egyptian culture favors uniformity. Egyptian accountants and managers may be expected to reflect the culture and resist changing from uniform to a more flexible set of accounting standards. Since compliance with IAS requires judgment, I posit that

Proposition 2: Although IASs offer alternatives, the privatized companies will not change their accounting methods

Proposition 3: Conservatism

Frechner and Kilgore (1994) argue that the economic factors of a country can have a direct effect on the accounting practices. Prior to the transition, Egyptian accounting focused primarily on tax accounting. In this case the goal of accounting was to produce the lowest income possible. However, the new interest in attracting investors' capital may require the opposite philosophy. Companies may perceive a need to use accounting methods to portray their performance in a better light to encourage private investment, which is especially critical for an emerging market.

Prior to privatization, the Egyptian government instituted other policies that created incentives for companies to minimize profits. Rigid policies existed related to the distribution of reported surplus. The surplus of State Owned Enterprises (SOEs) must be distributed as follows: 80% must be transferred to the state, 10% is allocated for the
workers welfare, and the remaining 10% are retained for statutory reserves. In other words prior to privatization the system required that SOE’s surrender most of their surplus to the state. As a result, most of the SOE’s aimed to decrease the amount of profit and surplus that they report. After privatization, companies will not face such pressures. As a matter of fact, the Egyptian government is offering several tax incentives for the privatized companies that are listed on the stock exchange.

The government grants numerous tax incentives to promote equity financing. First "law 95," issued in 1992, frees stocks from stamp duty and makes all dividends exempt from tax. Second, listed companies receive several corporate tax incentives. In addition, the 2% tax on capital gains from sale of stock (which biased towards depositing savings in banks) was eliminated. Finally, “the 40% income tax on mutual funds profits has been abolished” (Commercial International Investment Company 1997a, 12). These tax incentives can be seen as a motive for companies to use income-increasing methods.

The Egyptian law requires tax and financial accounting compliance. This compliance limits choice and creates incentives that may be incompatible with measuring managerial performance. Companies have a tax incentive to report the lowest permissible income possible. While privatization may create an incentive for companies to maximize reported profits and enhance the corporate image because capital investments are sought. This incentive may be dampened by the cash outflow associated with increased taxes.20

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19 Companies must have at least 150 shareholders and raise over 30% of their shares from the public to be eligible for this exemption.
20 The earning management literature differentiates between real versus cosmetic smoothing. Real income smoothing is changes that have actual effects on the cash flows of the company. Cosmetic smoothing on the other hand involves changing accounting methods but not affecting the cash flows of the company.
It is important to note that it might not be fair to explain the shift in Egypt as a move from conservatism to optimism. It might be more accurate to say that the accountants under the EUAS did not have a choice on whether to be conservative or optimistic. Instead, they had to follow specified rules. Under EUAS the accountant's role was reduced to a technical recorder of facts, no judgement was permitted. However, after the adoption of the IASs and the presence of the Egyptian Stock market, income measurement and choice between accounting alternatives have become an issue. IASs allow accountants the option of choosing between alternative accounting methods, therefore, companies can choose income maximizing or minimizing strategies. But, the actual cash outflow required by higher taxes remains a formidable barrier to the profit maximization strategy.

In summary, the focus in Egyptian accounting was mostly on income decreasing methods and techniques. However, during and after privatization, some of this pressure will not be present. As a matter of fact, the pressure might be exactly in the opposite direction. In free markets that depend on financial equity, the pressure is usually to use aggressive accounting methods and techniques to present the company in the best picture possible (Deener 1996).

In addition, privatization has shaken the strong Egyptian hierarchical system. Seniority and political influence no longer protect management as managers are hired and fired based on the performance of their companies. Under the new system, accounting profit is the primary mechanism used to assess managerial performance. Thus the incentive to maximize reported profit might have increased. Management bonus plans
have started to include shares and options to motivate managers and to align managerial and stockholders interest. Managers also have started to privately buy into their company’s shares.21 As a result, managers have more incentives to report better performance.

But as long as Egypt requires financial and tax accounting compliance, the pressure to use income decreasing accounting methods will exist. However, I posit that for the companies that are being privatized, the main goal of accounting is to make these companies look appealing for investment. Moreover, I argue that this goal would outweigh any tax considerations. The use of accounting data to assess managerial performance, combined with bonus incentives, make presentation of an enhanced performance important and would outweigh increased cash outflows for taxes.

A company’s choice of accounting measurement and techniques can indicate which goal has higher priority. If the company uses income-increasing techniques and other accounting methods to enhance the performance of the company, then they are mainly focusing on a strong company picture and have less concern with taxes.22 On the other hand, if companies tend to use income decreasing measures and techniques then this will indicate that the concern with taxes overrides the investment incentive. I posit that:

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21 Managers buy these stocks either individually or through other members of their family.

22 The Efficient Market literature would argue that this type of change would not matter. However, it is important to note that in Egypt the market is not even close to being efficient. In one sense, the Egyptian stock market is still in an emerging stage and the available information is very limited. In addition, the accessibility of information is very limited. Also, Egyptians do not have the expertise or the ability to analyze detailed and complex financial statements. Moreover, as discussed earlier, the stock market in Egypt has a lot of insider trading deals (Harik 1997).
Proposition 3: Privatized companies will select accounting methods and techniques that maximize the income of the companies.

The movement toward profit maximization, however, may be mitigated by the dramatic improvement in the Egyptian economy. The companies in my study have had large increases in their rates of return due to privatization. The increases can be attributed to better management and better operational effectiveness and/or efficiency. If this is the case corporate managers may not need to use income maximizing accounting techniques. If the return on investment is sufficient to attract capital using income minimizing techniques, then companies would do so to generate tax savings.

Proposition 4: Secrecy

Gray (1988, 11) argues that “the degree of secrecy preferred in an accounting subculture would influence the extent of the information disclosed in accounting reports. The higher the degree of secrecy, the lower the extent of disclosures.” Frechtzer and Killgore (1994) support Gray's assessment pointing out that it is important to consider the direct effects of economic and cultural factors on accounting practice. Privatization requires businesspeople and accountants to change their views of how business should be conducted in Egypt. Private ownership requires that owners and stockholders be provided with adequate financial information to assess corporate performance. Disclosure is a key component of IASs reporting requirements. The transition from a centralized economy, characterized by secrecy, to a market economy, characterized by full disclosure, requires a fundamental shift in attitudes.
International accounting researchers’ interest in disclosure in annual reports started in the 1960s. This research had little impact in Egypt until the 1990s because transparency was not considered a necessary attribute in a state controlled economy. However, privatization has made disclosure a central issue. That issue remains unresolved. Disclosure research can be divided into two major types. The first type of research is based on questionnaires sent to various individuals/companies to determine the extent of disclosures in different countries. The second category involves the use of disclosure indices to measure required, voluntary or total accounting disclosures in annual reports. Studies that are based on questionnaires use the relevance ranking of disclosure items to develop accounting indices or perform statistical tests of disclosure rankings. Singhvi and Desai (1971), Buzby (1974); Chandra (1974), Baker et al. (1977), Firth (1978), and McKinnon (1984) provide examples of this type of research. These studies conclude that users in different countries assess the value of financial disclosures differently.

Singhvi (1971), Choi (1973), Barrett (1976), Firth (1979), McNally et al. (1982) and Cooke (1991) use different forms of disclosure to compare the extent of disclosure in various countries. They found that firm size, stock market listing, and industry sector are important explanatory variables with respect to disclosure. Choi (1973) found that disclosures increase when firms enter the Eurobond market. Not unexpectedly, Barrett (1976) found that disclosures differ among different countries²³ while Salter and

²³ Barrett (1976) found that disclosures of UK companies and US differ from those in France, Germany, Japan, Netherlands and Sweden.
Niswander (1995) tabulated disclosure scores for 1,000 companies and found secrecy to be negatively related to the level of annual disclosure.

Adhikari and Tondkar (1992) studied the disclosure requirements of 34 stock exchanges around the world. The authors developed a disclosure scoring method and used it to measure disclosures required for the listing on each stock exchange (dependent variable). One interesting feature of their scoring method is that it is based on actual investors' opinions across 41 countries. They found that (1) the degree of economic development, (2) type of economy, (3) size of the equity market, (4) activity on the equity market, and (5) dispersion of stock ownership in the equity market, explain the variation observed in disclosure requirements of the different stock exchanges.

In summary, most of the previous literature found that the disclosure levels increase as companies seek external funding. Privatization should increase disclosure in Egypt, but the increased level of disclosure may not be sufficient. A significant cultural norm, secrecy, conflicts with the call for more disclosure. Since Egyptian managers have been working in a secretive environment for the last 30 years, the shift from secrecy to full disclosure may be difficult. The Egyptian propensity for secrecy can be expected to moderate the effect of the adoption of the IASs disclosure requirements. Egyptian managers may be so used to secrecy that they might still prefer to provide as little disclosure as possible. I expect disclosures to increase but I posit that given cultural considerations the IAS disclosure requirements will not be met. Based on this argument I posit that:
Proposition 4: Although disclosure will increase after privatization, the degree of disclosure will be less than the level of disclosure required by the IASs.

I examine this proposition by comparing the amount and depth of disclosure in the financial statements of the three companies in this study to the disclosure level that is required by the IASs.

In summary, there is a conflict in the literature about the success of "one size fits all" accounting standards. In this study I argue that there is a difference between adoption of the IAS and actual implementation of standards. Moreover, I posit that the socioeconomic factors will act as moderating factors between adoption and implementation of IASs requirements in Egypt. As a result, I expect to find selective implementation of IASs in Egypt.
CHAPTER IV

ANALYSIS OF THE FINANCIAL STATEMENTS

This section includes the results of the analysis of the financial statements of the three companies in this study. International Accounting Standards (IAS) provide the framework for analysis.\(^{24}\) I discuss and compare the practices of each company relating to each individual international standard or group of standards. Since the three companies were privatized in the same year, I will use 1994 and 1995 to denote the 2 years prior to privatization, and 1996 to denote the year of privatization and 1997 for the year after privatization.\(^{25}\)

Based on Egyptian law, the companies should have followed the International Accounting Standards (IASs) for the latter two years. The analysis of each standard or group of standards is structured in three parts. In the first part, I present a brief description of the requirements of the standard or group of standards. The second part includes the analysis of how each company implemented the standard or group of standards. Finally, the third part includes a summary of the implementation by the three companies and the environmental reasons for the companies' implementation or non-

\(^{24}\) The description of the IASs is mainly from the International Accounting Standards 1996 bound issue, which is annually issued by the International Accounting Standards Committee.

\(^{25}\) It is important to note that to hide the identity of the companies that are being examined in this study I use fake years. In addition, the financial information that is reported in this study is disguised so as not to reflect the identity of the companies.
implementation of a standard or group of standards. Personal interviews enabled me to corroborate the explanation for non-implementation that I provide.

Profile of the Companies

Company 1 is a company that has been in operation for almost 40 years. The company was privatized in 1996. Prior to privatization the company was 100% owned by the government. The ownership structure of the company in 1997 is 75% public ownership and 25% government ownership. Specifically, the ownership is divided into 25% government ownership, 30% foreign owners, 35% local Egyptian investors, and 10% workers ownership. Table 9 contains a summary of the financial statements of Company 1 for the 4 years that I analyzed.

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>400 million</td>
<td>600 million</td>
<td>700 million</td>
<td>800 million</td>
</tr>
<tr>
<td>Liabilities</td>
<td>350 million</td>
<td>530 million</td>
<td>640 million</td>
<td>710 million</td>
</tr>
<tr>
<td>Equity(^{26})</td>
<td>50 million</td>
<td>70 million</td>
<td>60 million</td>
<td>90 million</td>
</tr>
<tr>
<td>Income</td>
<td>20 million</td>
<td>40 million</td>
<td>50 million</td>
<td>115 million</td>
</tr>
</tbody>
</table>

Company 2 has been in business for about 50 years. The company was privatized in 1996. Prior to privatization the company was 100% owned by the government. The

\(^{26}\) The equity number includes reserves.
ownership structure of the company in 1997 is 40% public ownership and 60% government ownership. Table 10 contains a summary of the financial statements of Company 2 for the 4 years that I analyzed.

<table>
<thead>
<tr>
<th>Table 10</th>
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<tbody>
<tr>
<td><strong>Summary of Company 2 Financial Statements</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td>130 million</td>
<td>150 million</td>
<td>180 million</td>
<td>220 million</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td>100 million</td>
<td>120 million</td>
<td>150 million</td>
<td>190 million</td>
</tr>
<tr>
<td><strong>Equity(^{27})</strong></td>
<td>30 million</td>
<td>30 million</td>
<td>30 million</td>
<td>30 million</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>7 million</td>
<td>8 million</td>
<td>13 million</td>
<td>15 million</td>
</tr>
</tbody>
</table>

Company 3 has been in business for about 90 years. The company was privatized in 1996. Prior to privatization the company was 100% owned by the government. The ownership structure of the company in 1997 is 28% public ownership and 72% government ownership. The 28% public ownership is divided into 18% local Egyptian investors, and 10% workers ownership. Table 11 contains a summary of the financial statements of Company 3 for the 4 years that I analyzed.

In summary, all three companies have a long history of operations. All three were government owned until 1995 and privatized in 1996. Privatization occurred through the sale of the companies stock on the Egyptian Stock Exchange. The stock exchange requires that financial statements of listed companies be in accordance with IASs.

\(^{27}\) The equity number includes reserves.
Therefore, the companies' 1996 and 1997 financial reports should reflect IASs requirements. Table 12 contains the companies' comparative profiles for 1997.

| Table 11 |
|------------------|------------------|------------------|------------------|------------------|
| **Summary of Company 3 Financial Statements** |
| **Assets** | 200 million | 270 million | 520 million | 450 million |
| **Liabilities** | 150 million | 220 million | 470 million | 390 million |
| **Equity** | 50 million | 50 million | 55 million | 60 million |
| **Net Income** | 20 million | 45 million | 70 million | 85 million |

From the previous presentation several points need to be noted. The degree of privatization differs among the three companies. Company 1 has the highest percentage of privatized shares with 75% owned by non-government entities, Company 2 is 40% privatized, while Company 3 is only 18% privatized. Company 1 also has a larger foreign investment base with 30% of its capital coming from foreign investments. Company 1 is also the largest of the three companies. Based on ownership attributes, Company 1 should have the greatest incentive to comply with IASs.

The rest of this section discusses applicable individual IAS's or groups of standards that should result in changes in financial reporting practices in Egypt in the pre/post privatization period. I divide the standards into the following four groups: (1) secrecy, (2) uniformity, (3) conservatism, and (4) selective implementation. Within each

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28 The equity number includes reserves.
standard or group of standards, I present a summary of the standard(s) followed with a comparative description of the way that each company implemented the standard(s). I conclude with the results of the implementation and link implementation patterns to Egyptian cultural and socioeconomic factors.

<table>
<thead>
<tr>
<th>Table 12</th>
<th>Comparative Analysis of the Three Companies in 1997</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Panel A: Ownership</strong></td>
<td></td>
</tr>
<tr>
<td>Government</td>
<td>25%</td>
</tr>
<tr>
<td>Local Investments</td>
<td>45%</td>
</tr>
<tr>
<td>Foreign Investments</td>
<td>30%</td>
</tr>
<tr>
<td><strong>Panel B: Balance Sheet</strong></td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>800 million</td>
</tr>
<tr>
<td>Liabilities</td>
<td>710 million</td>
</tr>
<tr>
<td>Equity</td>
<td>90 million</td>
</tr>
<tr>
<td><strong>Panel C: Income Statement</strong></td>
<td></td>
</tr>
<tr>
<td>Revenue (from sales only)</td>
<td>120 million</td>
</tr>
<tr>
<td>Net Income</td>
<td>115 million</td>
</tr>
</tbody>
</table>

**Standards Related to Secrecy**

The following standards focus on full disclosure. Prior researchers have found that disclosure is negatively tied with a country's secrecy propensity, and that Egypt has a
secretive culture. Gray (1988) argues that secrecy is positively related to power distance and uncertainty avoidance and negatively related to individualism. As discussed in Chapter II, Egypt has high power distance, high uncertainty avoidance, and low individualism relative to western societies. Gray's (1988) adapted model suggests that secrecy would intervene in the way Egyptian accountants implement the disclosure standards. Since the companies had no need to disclose any information prior to privatization, I except an increase in the level of disclosure after privatization. However, I posit that:

Although disclosure will increase after privatization, the degree of disclosure will be less than the level of disclosure required by the IAS.

I consider the following standards in this group:

- IAS 1 Presentation of Financial Statements
- IAS 5 Information to be disclosed in the Financial Statements
- IAS 8, Profit or Loss for the period, Fundamental Changes in Accounting Policies
- IAS 21 The Effects of Change in Foreign Currency Rates
- IAS 25 Accounting for Investments

IAS 1 (Disclosure of Accounting Policies) and IAS 5 (Information to be Disclosed in Financial Statements)

IAS 1 concludes that going concern, consistency, and accruals are fundamental accounting concepts. Companies need not mention the basic concepts if followed, but any deviation needs to be disclosed. The standard also states that prudence, substance over

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29 A more detailed explanation of these relationships is presented in Chapter II.
30 This standard includes measurement and disclosure requirements. However, the disclosure issues seem to be more debatable in the Egyptian situation.
form, and materiality should govern the selection and application of accounting policies. The standard requires that financial statements include clear and concise disclosure of all significant accounting policies, which have been used. The policies should normally be disclosed in one place. IAS 5 complements IAS 1 and provides a detailed list of the disclosures that are required to accompany the financial statements. The standard divides the required disclosures into three main groups. Table 13 contains the specific policy disclosures required by IAS 5.

The first group of disclosures contains general disclosures relating to an enterprise and its operations. The second and third group include disclosures relating to the balance sheet. The standard divides these disclosures into seven subcategories. First, general disclosures relating to the balance sheet. This category deals with items like titles of assets and assets used as security for liabilities. The second category deals with long term assets. It requires disclosures of Property Plant and Equipment (PPE) that is owned and leased. It also deals with disclosure of long term investments, long term receivables, and intangible assets. The third category deals with current assets, including cash, receivables, and marketable securities. The fourth category includes required disclosures for long term liabilities, including secured and unsecured loans, and the related interest rates. The fifth category contains required disclosures for current liabilities, including payables, bank loans, and overdrafts. The sixth category deals with other liabilities and provisions, such as deferred taxes, deferred income, and provisions for pensions. The final category discusses required disclosures of equity interests.
The fourth group deals with income statement disclosures. The required disclosures include sources of revenues such as sales, interest income, and/or income from investments. The standard also requires disclosure by type of expenses, and disclosure of extraordinary charges and significant inter-company transactions.

**Disclosure Prior to Privatization**

During 1994 and 1995 Company 1 disclosed minimal information about the main accounting policies that were used to prepare its financial statements, while Company 2

<table>
<thead>
<tr>
<th>Table 13</th>
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</thead>
<tbody>
<tr>
<td><strong>IAS 5 (Information to be Disclosed in Financial Statements)</strong></td>
</tr>
<tr>
<td><strong>General</strong></td>
</tr>
<tr>
<td>- Consolidation policy</td>
</tr>
<tr>
<td>- Translation of foreign currencies</td>
</tr>
<tr>
<td>- Overall valuation policy (e.g. historical cost)</td>
</tr>
<tr>
<td>- Events subsequent to the balance sheet date</td>
</tr>
<tr>
<td>- Leases, hire purchases, or installment transactions and related interests</td>
</tr>
<tr>
<td>- Taxes</td>
</tr>
<tr>
<td>- Long term contracts</td>
</tr>
<tr>
<td>- Franchises</td>
</tr>
<tr>
<td>- Goodwill</td>
</tr>
<tr>
<td><strong>Liabilities and Provisions</strong></td>
</tr>
<tr>
<td>- Warranties</td>
</tr>
<tr>
<td>- Commitment and contingencies</td>
</tr>
<tr>
<td>- Pension costs and retirement plans</td>
</tr>
<tr>
<td>- Severance and redundancy payments</td>
</tr>
</tbody>
</table>


and Company 3 provided no disclosures. The Egyptian Unified Accounting System (EUAS) did not require any disclosures since all companies had to use uniform methods to prepare their financial statements. The Egyptian government assumed that users would examine the EUAS to determine accounting policy. Since these companies were 100% owned by the government there was no external financial analysis and/or demand for disclosure. All the reports that were prepared were managerial reports presented to governmental agencies. They were mostly prepared for control purposes, and to determine the company's taxes, distributions to government, and distributions to workers.

In anticipation of privatization, the EUAS started requiring that companies provide a set of disclosures to accompany the financial statements in 1994. However, the propensity for secrecy in the three companies that I analyzed was so strong that they were willing to violate the legal requirements of the EUAS. The financial statements for these two years do not satisfy the 1994 EUAS requirements. The government did not force compliance with the EUAS reforms. It is important to note that pre and post privatization I found that the three main assumptions of going concern, consistency, and accruals were followed.

Starting on 1996, when privatization occurred, the companies were listed on the stock exchange, and theoretically required to report their financial statements under the IASs. Since the IASs permit the use of different alternatives to measure and classify the elements of the financial statements, accounting policy disclosures become more important than they are under a uniform system.
Disclosure of Accounting Policies

In 1996, Company 1 disclosed some of the accounting policies in one place, as required by the IAS. The disclosures contained policies dealing with (1) methods of currency valuation, (2) fixed assets and depreciation, (3) inventory valuation, (4) interest calculation, and (5) valuation of financial investments. However, the financial statements did not include disclosures dealing with any of the other areas of accounting, as required by the standards.

In 1997, Company 1 did provide more disclosures. The statements included disclosures relating to accounting policies that were used during the period, and a brief summary of the history and activities of the company. The company also disclosed that all transactions were recorded using the Egyptian pound and that foreign currency transactions were recorded using the current exchange rate at the time of the transaction.\(^{31}\)

Company 1 did not report the amounts of investments in subsidiaries and associates. In addition, the company did not report the market values of these investments as required by the IASs.\(^{32}\) The company divided the long term investments into the three companies that they own shares in. However, they failed to mention that they own almost 100% of one of these companies, which clearly makes it a subsidiary company.\(^{33}\) Since

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\(^{31}\) The amounts of foreign currency included in the assets or the liabilities of the balance sheet are re-evaluated at the date of the balance sheet using the current exchange rate. The difference due to the re-evaluation is recorded in the income statement.

\(^{32}\) IAS 25 requires that the company disclose the market value of the investments when the cost is different from the market value. When I went back and reviewed the market value of the shares they own I found that they are different than the carrying value. Therefore, a disclosure should have been present.

\(^{33}\) I deal with the consolidation issues when I analyze IAS 22 and IAS 27.
Egyptian tax laws prohibit the presentation of consolidated statements and that financial reports be in conformity with tax reporting, the company may have determined that legality overrode compliance with IASs. As mentioned earlier, Egyptian preference for certainty also impedes acceptance of two different financial statements.

In 1996 and 1997, Company 2 provided minimal disclosures for a few accounts, but Company 3 provided no disclosures. Company 2 disclosed that the financial statements were based on the historical cost basis. The comparison of the financial statements prepared using the EUAS and the ones prepared using the IASs show that the companies did not change any of its accounting policies. Table 14 includes the summary of findings relating to the disclosure of accounting policies in 1997.

<table>
<thead>
<tr>
<th>Disclosures</th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>General information and valuation policy</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Accounting policies disclosed in one place</td>
<td>Some</td>
<td>Few</td>
<td>No</td>
</tr>
<tr>
<td>Contingent Assets and liabilities</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Consolidation Policy</td>
<td>No</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Conversion of foreign currencies</td>
<td>Partial</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Taxes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Long term contracts</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Table 14
Summary of Findings Related to IAS 1 and IAS 5 in 1997

34 I also confirmed that during the interviews that I conducted with the company personnel.
35 From this point onward I will use the following abbreviations: Comp1 to mean Company 1, Comp2 to mean Company 2 and Comp3 to mean Company 3.
Disclosure of Assets Accounts

In 1996 and 1997, Company 1 disclosed that it used straight-line depreciation and reported the depreciation rates for different asset groups. The company stated that long-term investments are reported at cost, but that in case of a permanent and continuous drop in value the company investments are recorded at market. Inventory is recorded at cost and is valued using the moving average method. The company also disclosed the breakdown of the long-term investment accounts. However, this disclosure was minimal, not meeting the IASs requirements. It consisted of the name of the companies that Company 1 invested in and the cost of the investment. The company presented a breakdown of the investment in real estate accounts. This account is made up of land appropriated for construction and housing projects and land owned after the buildings on it are sold. The company also disclosed the fact that the local lending account is a two-year loan to the employees. However, the company misclassified the two-year loan as a short-term asset.\(^{36}\)

Company 1 complied with IASs requirements for disclosure of property plant and equipment accounts and long-term investments. But the company failed to disclose any information about the receivables, which amount to 50% of the assets in the balance sheet. The company also did not disclose any information about the source or age of the receivables or its breakdown. The company's disclosure of inventory seems to meet the

\(^{36}\) I discovered that this loan is misclassified through my analysis of the subsidiary ledgers of the company.
IASs minimal disclosure requirements. It disclosed that inventory was reported at historical cost and that the moving average method was used for inventory valuation.

Company 2 correctly presented PPE and accumulated depreciation in the balance sheet. However, the company did not provide any other required disclosures with respect to the long term assets or depreciation. The company disclosed that the current assets include financial investments that are recorded at cost, and reported (a) the estimated market value of these investments, (b) that current assets include real estate investments, and (c) the location and size of the investments. Also, the company provided a breakdown of inventory. Table 15 contains Company 2 inventory breakdown for 1996 and 1997.

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work in process</td>
<td>85%</td>
<td>82%</td>
</tr>
<tr>
<td>Finished Goods</td>
<td>15%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Company 3 did not provide any disclosure related to the asset accounts. Table 16 includes a summary of the findings relating to the disclosures of the three companies that relate to assets for the year 1997.
Table 16
Disclosures Related to Assets in 1997

<table>
<thead>
<tr>
<th>Disclosures</th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciable Assets and depreciation</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Long term investments</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Investment in other companies</td>
<td>Partial</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Land held for development</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Long term and inter-company receivables</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Cash</td>
<td>Partial</td>
<td>Partial</td>
<td>Partial</td>
</tr>
<tr>
<td>Receivables and marketable securities</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Inventories and related costs of goods sold</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Disclosure of Liability and Equity Accounts

Company 1 reported that it changed the commitments to complete liabilities and that this change will increase profits by 14.5 million.\(^{37}\) The company also disclosed the authorized, and outstanding capital and that its long-term loans were special loans that the company acquired at almost half the market interest rate. The company reported provisions/allowances of 70 million\(^{38}\) but did not disclose any details about the

---

\(^{37}\) This account includes the estimated commitments that the company expects to incur to complete the utilities related to the current projects that it is involved in.

\(^{38}\) This number does not include the accumulated depreciation number, which is reported as an allowance in prior balance sheets, or allowance for bad debts.
provisions/allowances that appear in the financial statements. The company reported 7.5 million as land appropriated for future housing projects.

The company reported 7.5 million as long-term liabilities, but did not disclose any information about these loans. These loans were mainly loans from banks for specific infrastructure projects. The company misclassified 160 million in commitments to complete construction as current liabilities. They should be classified as long-term liabilities since they include commitments for more than one year. Twenty-one of these 38 individual accounts were unchanged from 1996 to 1997. The company provided no disclosure for the current liability accounts. The company also included provisions/allowances of 70 million in current liabilities when they appear to be long-term liabilities.

The company included sufficient disclosures for the capital in terms of the amount of shares, but provided no information on changes and movements in share capital accounts during the period. It also did not disclose the rights and restrictions with respect to distribution of dividends and to the repayment of capital. The company has 41 million in equity reserves, but does not provide any information with respect to its reserve accounts nor does it disclose the change in the reserves, surplus, or retained earnings.

Company 2 disclosed that most of the other credit account balance (which makes up approximately 50% of the current liabilities) reflects amounts received in advance from customers; i.e. unearned revenue. The company also disclosed that long-term liabilities that appear in the financial statements.
liabilities, which account for about 21% of total liabilities, are not normal bank loans. They represent low interest (4-6%), 30 years loans from the local governmental banks.\textsuperscript{42} The company also reported that borrowing costs are capitalized as part of the cost of the projects for which they are used.

During 1996 and 1997, Company 3 provided financial statements that they claim are based on the IASs. However, these financial statements did not include any disclosures. Table 17 presents a summary of the disclosures related to liabilities and equity in the three companies for 1997.

\begin{table}
\centering
\caption{Summary of Disclosure Related to Liabilities and Equity in 1997}
\begin{tabular}{|l|c|c|c|}
\hline
\textbf{Disclosures} & \textbf{Comp1} & \textbf{Comp2} & \textbf{Comp3} \\
\hline
Contingencies & No & No & No \\
\hline
Inter-company liabilities & No & No & No \\
\hline
Bank loans & Partial & Partial & No \\
\hline
Current portions of long-term liabilities & No & No & No \\
\hline
Taxes on income & Yes & No & No \\
\hline
Capital stock & Partial & No & No \\
\hline
Shares authorized, issued, and outstanding & Yes & Yes & Yes \\
\hline
Par value or legal value & Yes & Yes & Yes \\
\hline
Movement in shares during the period & No & No & No \\
\hline
Retained Earnings and Reserves & No & No & No \\
\hline
\end{tabular}
\end{table}

\textsuperscript{42} It is worth noting that the commercial interest rate on loans during that period ranged from 18-20\%.
Disclosure of Profit and Loss Accounts

Company 1 disclosed that in case of cash sales, revenue is recorded at point of sale. The company used the installment method to recognize other sales. In this case the profits and related interest are recorded in the income statement based on the amount that is collected during the year. The company disclosed sales revenue, cost of goods sold, interest income, income from investments, taxes, and extraordinary charges in the income statement. However, the company only reported a total number for expenses. The company did not offer any details about the aggregate expenses. Company 2 and Company 3 did not provide any disclosures relating to the income statement accounts. Table 18 includes the summary of disclosures of the three companies related to the profit and loss accounts for 1997.

<table>
<thead>
<tr>
<th>Disclosures</th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Methods of revenue recognition</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Maintenance, repairs and improvements</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Depreciation</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income and expense</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Taxes on income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Inter-company transactions</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Net profit or loss for the period</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
IAS 8 (Net Profit or Loss for the Period, Fundamental Errors, and Changes in Accounting Policies)

This standard is effective for financial statements covering periods beginning on or after January 1, 1995. The main objective of the standard is to present more consistent income statements through prescribing the classification, disclosure, and accounting treatment of income statement items. It also specifies the requirements for classification and disclosure of extraordinary items and discontinued operations, treatment for changes in accounting policies, changes in accounting estimates, and correction of fundamental errors.

The standard requires that the income statement be divided to show (a) profit/loss from ordinary activities and (b) extraordinary items. The nature and amount of each extraordinary item should be separately disclosed. In addition, the standard requires that income/expense be disclosed if the size and the nature of this income/expense is relevant to explain the performance of the company. The standard does not present a guideline to indicate the required size or nature of the item.\(^\text{43}\) For discontinued operations companies should disclose:

(a) the nature of the discontinued operation,
(b) the industry and geographical segments,
(c) the effective date of discontinuance,
(d) the manner of discontinuance,
(e) the gain/loss for discontinuance,

\(^\text{43}\) However, the standard gives the following examples: (a) the write down of inventories to net realizable value or property plant and equipment to recoverable amount, as well as the reversal of such write-downs, (b) a restructuring of the activities of an enterprise and the reversal of any provision for the costs of restructuring, (c) disposal of items of property, plant and equipment, (d) disposal of long term investments, (e) discontinued operations, (f) litigation settlements, and (g) other reversals of provision.
(f) the revenue and profit or loss from the ordinary activities of the operation for the period, together with the corresponding amounts for each prior period presented.

In the case of changes in accounting estimates the standard requires that the effect of the change in an accounting estimate be included in the determination of net profit and loss. The effect of the change should be included in all the periods affected (present and future). The standard stresses that the effect of the change in estimate be included in the same income statement classification as used previously for the estimate. The standard also requires that the amount and nature of the effect of the change in the estimate be disclosed. Disclosure should cover effects in present and subsequent statements.44

The standard allows two treatments in the case of prior period errors. The benchmark treatment is to adjust the beginning balance of the retained earnings account and include comparative information. In this case, the following disclosures are required: (a) the nature of the error, (b) the amount of the correction for the current and subsequent periods, (c) the amount of the correction related to periods prior to those included in the comparative information, and (d) whether the comparative information have been restated or not. The alternative treatment is to include the effect of the error in the income statement for the current period. But, additional information must disclose the effect had the benchmark treatment been used. Similar to the benchmark treatment, the nature of the error and the amount of the correction should be disclosed. In addition, the standard requires the inclusion of the effect of the correction on pro forma information.

44 In case the effect on subsequent statements cannot be quantified, the standard requires that the company should disclose this fact.
The standard stresses that a change in accounting policy should be made only if required by statute, standard setting body, or if the change results in more appropriate presentation. The standard allows for two treatments. The benchmark treatment is to apply the change retrospectively unless the amount of the effect is not reasonably determinable. The resulting adjustment should be reported through the opening balance of the retained earnings account. If the retrospective effect is undeterminable then the change should be applied prospectively. The following information should be disclosed: (a) the reason for the change, (b) the amount of the adjustment to the current period statements, (c) the amount of the adjustments to the prior period accounts, and (d) whether the comparative information is restated or not.

The alternative allowable treatment requires that the change in accounting policy be applied retrospectively unless the amount is undeterminable. This treatment allows the company to include the adjustments in determining the net profit or loss for the current period. The company must disclose the effect of the application of the benchmark treatment. Similar to the benchmark treatment, the nature of the error and the amount of the correction should be disclosed. In addition, the standard requires the inclusion of the effect of the correction on pro forma information.

Prior to 1996, all Egyptian companies had to follow EUAS standards that did not allow for changes or alternatives in accounting methods or estimates. In terms of presentation, the EUAS requires three statements in lieu of the income statements. In 1994 and 1995 the three companies followed the requirements of the EUAS. These requirements resulted in more detailed breakdowns between different categories of
revenue and expenses. The EUAS did not have specific requirements for discontinued operations.

The IASs permits the use of alternatives, methods, and estimates. In 1996, the companies in this study adopted the required IASs income statement classifications.\footnote{Although the IASs does not present a complete and preferred format for the presentation of the income statement, they are consistent in presenting one format in their standards and examples.} The companies also distinguished between ordinary and extraordinary items, in 1997. In 1996, Company 1 did not distinguish between profits/losses from ordinary activities and extraordinary activities. For example, the company reported other income of seven million but failed to break this number into its two major components of five million in income from prior years and two million of other income.\footnote{I found this breakdown from the analysis of the subsidiary ledgers of the company.} In 1997, the company reported more details in the income statement. For example, the company reported seven million in unusual earnings and five million in unusual expenses. The company provided minimal disclosure about the unusual earnings. The income resulted from reclassification of two and a half million of allowances that would not be needed. By going back to the subsidiary ledger, I discovered that this amount included a reversal of two million charged to earnings in previous years. This could not be determined through the analysis of the published financial statements. The company did not include any disclosures to explain the five million in unusual expenses.

In 1996 and 1997, Company 2 and Company 3 distinguished between ordinary income and extraordinary income. The companies divided the ordinary income into meaningful categories that included items like gross profit, revenues from interest, and
revenues from financial investments. But they reported the extraordinary income as an aggregate sum, which precluded further analysis. Table 19 contains the summary of the findings related to the implementation of IAS 8 by the three companies for 1997.

<table>
<thead>
<tr>
<th></th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Differentiate between ordinary and extraordinary items</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Significant extraordinary items presented individually</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Disclosure for the extraordinary items</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

**IAS 21 The Effects of Change in Foreign Exchange Rates**

This standard was initially introduced in 1983 and revised in 1993. The standard is effective for financial statements covering periods beginning on or after January 1, 1995. This standard should be applied for transactions using foreign currencies and transactions in foreign countries. The standard requires companies to recognize the foreign currency amounts using the exchange rate at the time of the initial transaction. In addition, at each balance sheet date the companies are required to report foreign currency monetary items at closing rates. The exchange differences that result from the settlement of monetary items or reporting of monetary items, at rates that are different from those reported at the initial recognition, should be reported as income or expense in the period.
when they arise.\footnote{This treatment is not accepted for transactions relating to investments in foreign entities. Since none of the companies that I analyze have investments in foreign entities I will not present these treatments in this section.} In addition, companies must disclose the amount of exchange differences that are reported in the income statement.

During 1994-1996, Company 1 did not include any disclosures relating to the policies followed to record the foreign currency transactions. In 1997, the company disclosed that all transactions are recorded in the accounting books using the Egyptian currency. Any foreign currency transactions are recorded using the exchange rate at the time of the transaction. The company stated that the foreign currency accounts included in the current assets and current liabilities are revalued at the balance sheet date using the exchange rates that are published at that time. Any differences that result from the reevaluation (debits or credits) are reported in the income statement. However, the company did not disclose the amounts of foreign currency translations, as required by the standard.

Company 2 and Company 3 did not provide any details or analysis related to the foreign currencies or foreign currency differences. In addition, they did not include any disclosures relating to the policies that govern the foreign currency transactions. However, it is worth mentioning that through the interviews that I conducted, I found that the two companies follow the IASs directions in terms of recording and measuring foreign currency transactions. Table 20 includes a summary of the findings related to the foreign currency transactions.
Table 20
Summary of Findings Related to IAS 21

<table>
<thead>
<tr>
<th></th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclose information related to foreign currency</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Foreign currency recognized amounts using the exchange rate at the time of the initial transaction</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Foreign currency monetary items recorded at closing rates</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Exchange differences disclosed</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

IAS 25 (Accounting for Investments)

This standard was originally introduced in 1985, revised in 1991 and reformatted in 1994. The standard requires companies to distinguish between long-term and current investments. Current investments should be reported in the balance sheet at either market value or at lower of cost or market. If the company uses the lower of cost or market, the carrying amount can be determined either on an aggregate portfolio or individual basis. Long-term investments can be carried at, cost, revalued amounts, and in case of marketable equity securities, the lower of cost or market. In the latter case, a portfolio basis must be used. The standard allows companies the freedom to choose their own basis.

48 This standard does not address: (a) recognition of interest, royalties, dividends, and rents earned on investments (IAS 17, accounting for leases, and IAS 18, revenue), (b) investment in subsidiaries (IAS 27, investment in subsidiaries), (c) investment in associates (IAS 28, investment in associates), (d) investment in joint ventures (IAS 31, financial reporting of interests in joint ventures), (e) goodwill, patents, trademarks, and similar assets, (f) finance leases (IAS 17, accounting for leases), and (g) investment in retirement benefit plans and life insurance enterprise.
policies with respect to the frequency of the revaluation. However, it requires companies to revalue all long-term investment portfolios at the same time. In addition, companies must immediately recognize any non-temporary decline in the value of long term investments, on an individual investment basis.

The standard states that long-term investments should be treated as either PPE or long term investments. If a company carries current investments at market value the standard allows two treatments. The first treatment requires that the changes be recognized as income or expense. Current investments can also be accounted for in the same manner as the long-term investments. In this case revaluation increases are credited to shareholders equity as a revaluation surplus, i.e. the increase is not realized. If decreases occur, then the decrease must first be offset against any prior increase in the revaluation surplus generated by the individual investment. It is important to note that the pervious treatment should be applied to individual investments. Other decreases should be recognized as expenses. Finally, if increases occur and the company had previously recorded a decrease for the same investment as expenses, the company should credit income to the extent that it would reverse the previous decrease.

The profit or loss on disposal of investments is calculated as the difference between net proceeds from disposal and carrying value. The standard also allows flexibility in selection of measurement attributes and classification of gains and losses. If the investment was a current asset carried on lower of cost or market on a portfolio basis,
then the carrying value of an individual investments is cost.\textsuperscript{49} If the investment was revalued, or carried at market value and a revaluation surplus created, the company has two options. The company may (1) credit any remaining related revaluation surplus to income, or (2) transfer that amount to earnings. The standard also requires the following eight categories of disclosures:\textsuperscript{50}

1. Accounting policies for:
   (a) determination of carrying amounts of investments;
   (b) the treatment of changes in market value for current investments carried at market;
   (c) the treatment of revaluation surplus on the sale of re-evaluated investments.
2. Significant amounts included in income for
   (a) interests, royalties, dividends, and rentals on long-term and current investments;
   (b) profits and losses on disposal of current investments;
   (c) changes of value of such investments.
3. Market value of marketable investments if they are not carried at market value
4. Fair values of investment properties if they are accounted for as long-term investments and not carried at fair value
5. Significant restrictions in the reusability of investments
6. For long-term investments stated at reevaluated amounts
   (a) the policy for frequency of revaluation,
   (b) the date of the latest revaluation,
   (c) the basis of the revaluation and whether an external value was involved
7. Movements for the period for revaluation surplus and the nature of such movements
8. companies whose main business is the holding of investments should disclose an analysis of the portfolio of investments.

The three companies reported two types of investments during 1994 and 1995, real estate investments and financial investments. The real estate investments accounts

\textsuperscript{49} Any change in the value is considered a change in the value of the portfolio not the individual investments.

\textsuperscript{50} It is important to note that I do not discuss all the disclosures in these lists, but I limit my discussions, in this dissertation to disclosures that are relevant to the companies that I am analyzing.
consisted of land that the companies are keeping for future housing projects and land that
the company owns while the buildings that are on it are sold or rented. The EUAS
requires that companies record this type of investments at lower of cost or market. The
law also requires companies to keep a provision account to record any non-temporary
drops in the value of these investments below cost.

In 1996, Company 1 reported seven million in real estate investments and 16
million in financial investments. The company disclosed that the investments were
recorded at lower of cost or market and that a provision account would be created to
record non-temporary drops in the financial investments values. In 1997, Company 1
reported 7.5 million in real estate investments and 42 million in financial investments.
The company reported investments at cost and created a provision for permanent declines
in value. In addition, the company reported the book value of each investment. Company
1 reported the names of the companies that they invested in and the number of shares of
stocks it owns in each of them. But the company did not report the percentage of
ownership or the degree of control it had over investees.

Company 2 reported two types of investments during the 4 years that I analyzed.
The company reported real estate investments of 24 million and 54 million in 1996 and
1997 respectively. The company also reported financial investments of 18 million during
1994-1997. It is important to note that 17.9 million of the 18 million are long term
investments in two companies.\footnote{The company did not make the distinction between current assets and long term assets and reported all the financial investments as current assets. However, I deal with them in their proper classification in the discussion of IAS 13.} During 1996 and 1997 Company 2 provided a detailed
disclosure of the identity of the two companies. The disclosures included the name of the company and the total amount of shares that the company owns from total shares offered. The company also disclosed the PPE of these two companies.

It was interesting to note that company 2 reported its ownership percentage and the amount of PPE of the two companies in which they owned shares. Company 2 has always trailed Company 1 in all the disclosures except for this one instance where Company 2 disclosure was better than Company 1. The reason may be that Company 2 is significantly smaller than the other two companies and below the average size of the companies that operate in this market. Therefore, Company 2 made a point of showing that they invest in two companies and tried to show how large these companies are to enhance the company’s attractiveness to the consumers and investors. The style of the disclosure itself, which mainly focused on presenting the PPE of these companies and how impressive the market values of these assets are, suggests that Company 2 views its size as a liability. The interviews that I conducted support the above explanation. The CEO of the company stated that since they are a small company relative to the other companies in the industry, they provided detailed disclosures of their investments in other companies to show that the company can undertake large projects.

Company 3 reported 0.8 million in financial investments in other companies during 1994-1997, but did not reveal the identity of these companies or group of companies. Also they did not report the percentage of ownership or the other disclosures required by the standard. The company also reported four million in real estate

---

52 I learned this information from the interviews that I conducted.
investments in 1997. Table 21 contains a summary of the findings related to IAS 25 for the three companies in 1997.

Table 21

Summary of Findings Related to IAS 25

<table>
<thead>
<tr>
<th></th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Differentiate between current &amp; long-term investments</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Current investments carried at market cost</td>
<td>Cost</td>
<td>Cost</td>
<td>Cost</td>
</tr>
<tr>
<td>Profits or losses on disposal of investments calculated correctly</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Show profits/losses on disposal of investments</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Does the company disclose:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment policy</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Income from investments</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Profits/losses on disposal of current investments</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Changes of value of investments</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Market value of the investments</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Given the sharp increases in stock market prices, it was interesting to note that the three companies used cost instead of reporting the investments using the market value. Reporting the market value would result in a higher income, which seems to be one of the main goals of the companies. However, the tax laws prohibit the revaluation of assets or the use of market values and require that all companies report the assets at cost.

Based on the discussion in Chapter II, I posited that the Egyptian secrecy propensity would moderate the implementation of the disclosure standards. Gray (1988) argues that secrecy is positively related to power distance and uncertainty avoidance and
negatively related to individualism. Egypt has high power distance, high uncertainty avoidance, and low individualism relative to the western. Therefore, I expect that the Egyptian accountant’s disclosures will be lower than that required by the IASs. In this section I analyzed IAS 1 (Presentation of Financial Statements), IAS 5 (Information to be disclosed in the Financial Statements), IAS 8 (Profit or Loss for the period and Fundamental Changes in Accounting Policies), IAS 21 (The Effects of Change in Foreign Currency Rates), and IAS 25 (Accounting for Investments).

Based on the previous analysis and the interviews that I conducted it is clear that the secretive nature of the Egyptian culture seemed to override the IASs disclosure requirements. In the minds of the management of these companies disclosures would reveal the secrets of the business. It would reveal secrets that they learned to guard for the past thirty years under the previous system. In addition, it is important to note that prior to privatization financial statements were mainly prepared for tax purposes. Therefore, accountants and managers were trained to conceal as much information as possible. The accountants of the companies that I interviewed all recognized that disclosures were important for investors. But they also noted that the job of the accountant is to be "very selective" in his/her choice of what needs to be disclosed so as not to expose the company's "secrets."

Private investments, especially foreign investments, seem to increase the adequacy of disclosures found in the financial reports. Company 1 was the most advanced in terms of disclosures followed by Company 2. Company 3, the company with the smallest private investment, had no disclosures at all. Company 1 had the highest
percentage of privatized shares (75%), and is the only company that had foreign investors. The head of the accounting department in Company 1 stated that the foreign investors are the main reason their disclosures are so advanced relative to the other companies. He noted that foreign investors ask for increased disclosures at every board of directors meeting. Most of these foreign investors are western investors and this imposes more pressure on the company because these foreign investors are used to a higher level of disclosure. Company 2 came in second in terms of disclosures and is also the second in term of privatized shares (40%). Company 3, which has the lowest percentage of stock traded and does not have any foreign investors, has no disclosures to accompany the financial statements. All of the accountants stated that they believe that disclosures are more important to foreign investors than to Egyptian investors because foreign investors have more experience with statement analysis. They also noted that in the long run, Egyptian investors would feel the importance of the disclosures and be able to understand them. As a matter of fact, two of the accountants that I met with and one CEO stated that Egyptian local investors follow the "herd strategy", in which they track the foreign investors or large Egyptian investors moves and then they follow.

The secretive nature of the Egyptian culture was magnified because under the previous system accounting was mainly directed towards tax calculations. In this sense, the net income number was the number that is taxed. Therefore, managers and accountants felt that this number should be portrayed, at the lowest possible value. The actual net income and net loss was always calculated internally in the company. This number was never publicly available.
In conclusion, as I posited the secretive nature of the Egyptian culture impact the implementation of the IAS related to disclosure, resulting in lower disclosures than required by the IASs. Foreign equity seems to be the strongest force in persuading companies to increase their disclosure level. In addition, as the company sells more stock to the public and gets away from governmental control the level of disclosure increase. However, given all of these pressures, the level of disclosure in the three companies that I analyzed was considerably below the level of disclosure required by the IAS.

Standards related to Uniformity

This section addresses standards that relate to a company’s choice between uniformity and flexibility. Gray (1988) argues that there is a direct positive relation between preference of uniformity and uncertainty avoidance and large power distance. He also asserts that there is a negative relationship between preference for uniformity and individualism. As noted in Chapter II Egypt has high power distance, high uncertainty avoidance, and low individualism. Gray’s (1988) adapted model suggests that the high uncertainty avoidance and strong power distance, which are embedded in the Egyptian culture, would moderate how the IASs are implemented in Egypt. In this scenario, the high uncertainty avoidance will deter accountants from trying to change. Also, the strong power distance will make it very hard to change due to the presence of a strong hierarchy. Employees will fear change because it might result in conflicts with people who have power. Therefore, I posit that:

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53 A more detailed explanation of these relationships is presented in Chapter II.
Although IASs offer alternatives, the privatized companies will not change their accounting methods.

I consider the following standards in this group:

- IAS 2, Inventories
- IAS 4, Depreciation
- IAS 16, Property, Plant, and Equipment

**IAS 2 (Inventories)**

IAS 2 was revised in 1993 and is effective for financial statements covering periods beginning on or after Jan. 1, 1995. The objective of the standard is to prescribe accounting treatments for inventories under a historical cost system. This standard does not apply to work in progress arising under infrastructure contracts, including related service contracts. The standard requires that inventories be measured at the lower of historical cost or net realizable value. Cost of inventories should include the total cost of purchase (includes import duties, taxes, transport, and other costs) and costs of conversion of inventories (includes costs directly related to the units of production, such as direct labor). They also include the systematic allocation of fixed and variable production overhead incurred in converting materials into finished goods. The standard states that alternative measurements of cost (standard method or retail method) may be used for convenience if they approximate cost.

---

54 The IASC states that historical cost include a systematic allocation of production overheads that relate to putting the inventory in its current location and position. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of the completion and the estimated costs necessary to make the sale (IASC 1996).
The benchmark treatment is First In First Out (FIFO) or weighted average. The alternative treatment is Last In First Out (LIFO). When inventories are sold the carrying amount of those inventories should be recognized as an expense in the period in which the related revenue is recognized. The cost and revenue from cost versus net realizable values should be recorded as an expense (if net realizable value is lower) or reduction to that expense (if net realizable value increases). This process focuses on matching revenue and expenses. The standard required disclosure of:

(a) the accounting policies adopted in measuring inventories, including the cost formula used
(b) the total carrying amount of the inventories and the carrying amount in classifications appropriate to the enterprise
(c) the carrying amount of inventories carried at net realizable value
(d) the amount of any reversal or write-down that is recognized as income in the period
(e) The circumstances or events that led to the reversal of a write-down in inventories
(f) The carrying amount of inventories pledged as security for liabilities

If LIFO is used then the financial statements should disclose the difference between the amount of inventories shown in the balance sheet and either (a) the lower of the amount arrived at in accordance with FIFO or Weighted average or; (b) the lower of current cost at the balance sheet date and the net realizable value. The financial statements should also disclose either

(a) the cost of inventories recognized as an expense during the period or
(b) the opening costs, applicable to revenues, recognized as an expense during the period, classified by their nature

During 1994 and 1995, the three companies used the moving average for calculating inventory as required by the EUAS. The EUAS does not allow for the use of any other methods. The financial statements of the three companies did not include any
disclosures related to the inventory accounting. All three companies violated requirements that financial statements include adequate disclosures with respect to inventory valuations. It is important to note that the previous practice is in conflict with the amended 1994 EUAS. However, it was acceptable because the EUAS only allows the use of moving average and there were no external users.

After privatization in 1996, the companies could choose between FIFO, LIFO, and moving average. Company 1 did not disclose which method of valuation was used. The company only disclosed that the lower of cost or market was used. In the 1997 financial statements, the company's disclosure changed. It disclosed that inventory was reported at cost and that they used the moving average method for valuation. Given the choice between FIFO, LIFO, and moving average the company still chose moving average.

During 1996 and 1997, neither Company 2 nor Company 3 reported any disclosures relating to inventory. Company 2 did provide a breakdown of inventory into work in process and finished goods. I was able to conclude that the companies used the moving average method to value inventory by comparing the financial statements using EUAS, which allows only the moving average, to the financial statements prepared under IASs for the same period. Both statements report the same amount of inventory. Since EUAS only allows the use of the moving average, it can be inferred that the companies

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55 In 1994, the amended EUAS requires that a company disclose the accounting policy used to value inventory.
56 It is important to note that the Egyptian tax laws permit the use of all of the alternatives allowable by the IAS.
57 For more details see inventory disclosures analysis in the previous sections, especially table 15.
must be using moving average for accounting for inventory in the Statements prepared based on IAS. My interviews with the accounting staff in these companies confirmed that all three companies used moving average. Table 22 reports a summary of the findings relating to IAS 2 for the year 1997.

<table>
<thead>
<tr>
<th>Table 22</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary of Findings Related to IAS 2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory include all the related costs</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Inventory method is disclosed</td>
<td>Moving Average</td>
<td>Not Disclosed</td>
<td>Not Disclosed</td>
</tr>
<tr>
<td>Lower of cost or market used</td>
<td>Yes</td>
<td>Not Disclosed</td>
<td>Not Disclosed</td>
</tr>
<tr>
<td>Required disclosures presented</td>
<td>Some</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Total carrying amount of inventories disclosed?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**IAS 4 (Depreciation Accounting) and IAS 16 (Property Plant and Equipment)**

IAS 4 was revised in 1993 and is effective for financial statements covering periods beginning on or after 1, January 1995. IAS 4 applies to all depreciable assets except:

- (a) Property plant and equipment (IAS 16)
- (b) Natural resources (forests and minerals)
- (c) Research and development (IAS 9)
- (d) Goodwill (IAS 22)
The standard requires that depreciation be allocated on a systematic basis over the useful life of the asset, that the useful life should be reviewed periodically, and depreciation rates adjusted accordingly. The depreciation method selected should be applied consistently. Also, disclosure is required for changes in depreciation method, the reason for change, valuation basis, useful life, total depreciation allocated for the period, and gross amounts of depreciable assets.

IAS 4 does not require the use of any specific method for depreciation, but IAS 16 limits the acceptable depreciation methods to straight line, diminishing balance method, or sum of the units (sum of the year's digits). The standards require the following disclosures:

(a) The depreciation method used
(b) The useful lives or the depreciation rate used
(c) Total depreciation allocated to the period
(d) The gross amount of depreciable assets and the related accumulated depreciation

IAS 16 specifies the accounting treatment for property plant and equipment. The principal issues relate to timing of recognition of the assets, the determination of carrying amounts and the depreciation charges to be recognized in relation to them, and the determination and accounting treatment of impairments of the carrying value. The IASC's Framework for the Preparation and Presentation of Financial Statements presents criteria for classification of assets as Property Plant and Equipment (PPE). The assets should be recognized as an asset when: (a) it is probable that future economic benefits associated with the asset will flow to the enterprise; and (b) the cost of the asset to the enterprise can be measured reliably (IASC Framework for the Preparation and Presentation of Financial Statements, 1996).
initially be measured at their cost. While the benchmark treatment is cost valuation, the standard, also, allows use of fair value by class of asset.

The general rule is to charge revaluation gains to a reserve account in equity, while losses are charged to income. However, if either the gains or losses reflect a reversal of a prior revaluation the treatment changes. A gain that reverses a prior relevant loss is recognized in the income statement, while a loss that reverses a prior gain is charged to the reserve account.

IAS 16 requires that depreciation be systematically allocated over the useful life of the asset. The depreciation method should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. The financial statements should disclose the following, in respect to each class of PPE:

- Basis used to determine the gross carrying amount,
- Depreciation method,
- Useful lives, or the depreciation rates used
- Total depreciation for the period
- A reconciliation of the carrying amount at the beginning and end of the period. The reconciliation should show additions, disposals, and increases/decreases from reevaluation, deprecations and effects of foreign translation

In addition the financial statements should disclose:

- Whether recoverable values were discounted or not
- Restrictions on titles and PPE pledged as security for liabilities
- The amount of expenditure on account of PPE in the course of construction
- The amount of commitments for acquisition of PPE

When items of PPE are started at reevaluated amounts the following should be disclosed:

- The basis used to re-evaluate the asset

59 It is important to note that I'm not discussing all the items on the list but I limit my discussion to the items that are relevant to the companies that I analyze.
• The effective date of the reevaluation
• Whether an independent value was involved
• The nature of any indices used to determine replacement cost
• The carrying amount of the assets if they were carried at cost
• The reevaluation surplus, indicating the movement during the period.

The EUAS requires companies to record assets at cost and to use straight-line depreciation. Also, the EUAS specify that accumulated depreciation be recorded as a liability, rather than a contra asset. The liability is usually included in the provisions/allowance accounts. In 1994 and 1995, the three companies followed the EUAS requirements and reported PPE at cost, used straight-line depreciation, and recorded accumulated depreciation as a liability. The companies presented the gross PPE divided into its main subcategories like land, building, equipment ... etc. In addition, the companies included accumulated depreciation as part of the provisions/allowances liability accounts and used the depreciation rates that the EUAS specified.

In 1996, Company 1 disclosed the valuation method used, cost, and the depreciation method used. The company also reported that it still used the depreciation rates required by the EUAS. The use of EUAS depreciation rates does not directly conflict with the IASs. However, it indirectly conflicts with the requirements of the IASs that depreciation rates should coincide with the pattern of use of the assets and that the rates should be reviewed annually. The EUAS’s depreciation rates were set in the 1960s. They are general rates that do not differentiate between individual companies and different uses of assets. The EUAS specifies depreciation rates to assets irrespective of

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60 In this case, the account is usually called provisions/allowances for depreciation.
use. The company did not provide any additional disclosure relating to the specific classes and depreciation recorded for the period.

In 1997, Company 1 classified the PPE accounts into more meaningful groups, and presented accumulated depreciation account as a contra asset account. The company continued to use straight-line depreciation and disclosed the depreciation rates that were used for each specific group of assets. The company's disclosure is in line with the IASs requirements. The company also reported the profits from the sale of PPE as a separate line item in the income statement, as required by the standard.\(^6\)

In 1996-1997, Company 2 and Company 3 did not disclose any information relating to PPE or to depreciation. By comparing the financial statements prepared using IAS to the financial statements prepared using EUAS for both years and from the interviews, I determined that both companies still used straight line depreciation and the same depreciation rates that were used in 1994 and 1995. The only changes made in 1996 and 1997 were in presentation. The companies presented the gross PPE then subtracted from it accumulated depreciation, as required by the IAS. Both companies did not provide a breakdown of PPE; they reported one aggregate account. Table 23 includes a summary of the findings related to IAS 4 and IAS 16.

In this section I discussed the implementation of IAS 2 (Inventories), IAS 4 (Depreciation), and IAS 16 (Property, Plant, and Equipment) to examine my proposition about uniformity. Gray (1988) argues that there is a negative relation between preference of uniformity and individualism. He also asserts that there is a positive relation between

\(^6\) It is important to note that the tax law in Egypt permits the use of all the alternatives allowed by the IAS.
preference of uniformity and uncertainty avoidance and large power distance. As explained in chapter II, Egypt has high uncertainty avoidance, high power distance, and low individualism. Gray's (1988) adapted model suggests that uncertainty avoidance and power distance will intervene in how the IASs will be implemented in Egypt. Therefore, I posited that even though IASs offer alternatives, the privatized companies will prefer to continue to comply with the EUAS required methods.

<table>
<thead>
<tr>
<th>Table 23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary of Findings Related to IAS 4 and IAS 16</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Systematic and consistent allocation of depreciation</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Useful lives reviewed periodically</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Did the company change its depreciation method?</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Depreciation method used</td>
<td>St. line</td>
<td>St. line</td>
<td>St. line</td>
</tr>
<tr>
<td>PPE meet the criteria detailed by the framework</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>PPE classified correctly</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Criteria used to measure PPE</td>
<td>Historical Cost</td>
<td>Historical Cost</td>
<td>Historical Cost</td>
</tr>
<tr>
<td>Does the financial statement disclose:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basis used to determine carrying amount</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Depreciation method</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Useful lives or depreciation rates</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Total depreciation of the period</td>
<td>Yes</td>
<td>Aggregate</td>
<td>No</td>
</tr>
<tr>
<td>Reconciliation between beginning &amp; ending PPE</td>
<td>No</td>
<td>No</td>
<td>Aggregate</td>
</tr>
</tbody>
</table>


From the previous discussion in this section and the interviews that I conducted, it is clear that none of the companies fulfilled the requirements of disclosures related to inventory, PPE, or depreciation as required by IAS 1, IAS 5, IAS 2, IAS 4 and/or IAS 16. This can be attributed to the secretive nature of the Egyptian culture as presented in the previous section.

Also, none of the companies changed their inventory valuation, PPE, or depreciation methods. They continued to comply with EUAS required methods. Based on the interviews that I conducted and the cultural indices that Hofstede provides it is clear that uncertainty avoidance and power distance play a major role in this choice. The company's decision to keep using the EUAS methods can be attributed to the strong uncertainty avoidance and large power distance embedded in the Egyptian culture.

Egyptian managers and accountants do not want to change the accounting methods because change brings with it uncertainty. During my interviews, interviewees made comments such as "why change?", "if it is not broken why fix it", and "we face high uncertainty as it is (because the companies are newly privatized) why make the situation more ambiguous for the investors and ourselves." Also, it was clear that none of the CEO's or the accountants had formally or informally weighed the advantages and/or disadvantages of the different IASs options.

High power distance, which is fundamental in Egyptian society, complicates the situation even more. Egyptian companies did not change managers or employees when

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62 The EUAS requires the use of weighted average for inventory valuation, historical cost for PPE, and straight-line depreciation for depreciation.
they were privatized. These managers and employees are used to the old system, which requires top to bottom communication; orders always came from the top. The irony is that the lower level accountants, who are recently trained, are the ones who know the benefits of moving to LIFO for example in terms of saving tax money. But junior accountants are not accustomed to initiating change, they expect the change to come from the top. At the same time, senior accountants' and top management are unaware of the various benefits that come from different alternatives. Even if they knew, they are not ready to start a wave of changes that might lead to more uncertainty. This problem is magnified because these companies are going through a transition phase. Managers feel the pressure of the media, investors, and the government for them to succeed. None of them are willing to take the initiative to change. The accountants that I interviewed all noted that privatization did not change the communication structure of their organizations, it remains hierarchical. They made comments such as "I don't want to change", "why change" and "I'm not free to change." One of the accountants stated that "we haven't got the directions to do so" when I asked him why they did not change their accounting policies.

The only changes made were in the presentation of PPE. The three companies now report accumulated depreciation as a contra asset, as required by the IAS. The three companies moved from the EUAS to the IASs presentation format after privatization. The companies made this change because of the visibility of the required change. In

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It is important to note that the tax authorities in Egypt do not require the use of moving average. Any of the alternatives introduced by IAS 2 would be acceptable.
addition, when requiring the use of IASs for privatized companies the Egyptian law also stresses that the companies should use this presentation format. In summary, this is a change that is required and is highly visible but at the same time it does not require any major changes in accounting methods and/or procedures.

Moreover, this change has a positive effect on the calculations of working capital. In my analysis of IAS 13 it was obvious that Egyptian managers and accountants care a great deal about showing the highest working capital possible. Prior to privatization the companies included accumulated depreciation as part of the provisions/allowances accounts, which were classified as non-current liabilities. But after privatization, the provisions/allowances accounts were recorded as current liabilities. By removing accumulated depreciation from the provision/allowances accounts the company was able to decrease liabilities in general. Specifically, the company was able to decrease current liabilities and therefore, increase the working capital.

In conclusion, the previous analysis supports the posited proposition. High uncertainty avoidance and strong power distance, embedded in the Egyptian culture, moderated the implementation of the IASs. As a result, none of the companies that I analyzed changed their accounting methods to benefit from the alternatives offered by the IASs.

For a more detailed discussion of this point see the analysis of IAS 13, Presentation of current assets and current liabilities, in the next section.
Standards Related to Conservatism/Optimism

This section contains standards that are mainly related to the companies' presentation of their results of performance. Gray (1988) argues that there is a positive relation between uncertainty avoidance and conservatism and a negative relation between individualism and conservatism. Based on the discussions in chapter II, Egypt has low individualism and high uncertainty avoidance. This indicates that Egyptian managers should be highly conservative in their reporting. Furthermore, the Egyptian laws require compliance between financial and tax accounting. Based on this information one would expect Egyptian managers be conservative in their reporting to save tax outflows.

However, privatization requires that the Egyptian main goal be to attract investments into the emerging stock market (Harik 1997). As a result, companies need to perform better and increase confidence in the stock market. Since the companies in my sample are newly privatized it is acceptable to argue that they aim to portray the company in the best possible form to appeal investors, and add confidence in the Egyptian stock market, even if this will result in losing tax savings. Therefore, I posit that:

*Privatized companies will select accounting methods and techniques that maximize the income of the companies*

There are several ways that accounting methods can be used to make the results of the company look better. These methods include results of operations (income), cash results of operations (cash from operating activities) and presentation of balance sheet (working capital). Based on my analysis it is more meaningful to divide the standards
analysis based on these methods. The analysis of this section will consist of the following standards:

- Standards relating to accrual results of operations (Income)
  - IAS 10, Contingencies and Events Occurring after the Balance Sheet Date
  - IAS 18, Revenue
  - IAS 23, Borrowing Costs
- Standards relating to balance sheet presentation and cash flow statement
  - IAS 13, Presentation of Current Assets and Current Liabilities
  - IAS 7, Cash Flow Statement

*Standards Related to Accrual Results of Operations (Income)*

**IAS 10 (Contingencies and Events occurring after the Balance Sheet Date)**

This standard was initially approved in 1974, revised in 1991, and reformatted in 1994. No substantive changes were made to the original text, in 1994. The standard's main objective is to present adequate disclosure of contingencies and events occurring after the balance sheet date. The standard requires contingent losses to be recognized as both an expense and a liability if the loss is probable and reasonably estimable. If only one of the two conditions is met, then disclosure is required. Conservatism precludes

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65 The standard setters define a contingency as "a condition or situation, the ultimate outcome of which, gain or loss, will be confirmed only on the occurrence, or non occurrence, of one or more uncertain future events" (IASC 1996, 181).

66 The standard specifically excludes four subjects that may result in contingencies that are excluded from this standard:

1. liabilities of life assurance companies arising from policies issued
2. obligations under retirement benefits plans (IAS 19, Retirement Benefit Costs)
3. commitments arising from long-term lease contracts (IAS 17, Accounting for Leases)
4. taxes on income (IAS 12, Accounting for Taxes on Income)
recognition of contingent gains, although such gains may be disclosed if probable. The following are the required disclosures:

(1) the nature of the contingency
(2) the uncertain factor that may affect the future outcome
(3) an estimate of the financial effect, or a statement that such an estimate cannot be made

In the case of events that occur after the balance sheet date the standard setters differentiate between two situations. The first situation deals with events that occur after the balance sheet date and provide additional evidence to assist with amounts relating to conditions existing at the balance sheet date or indicate problems with the going concern of the firm. The standard requires that the assets and liabilities be adjusted to reflect the new information. The second case is if the events occurring after the balance sheet date do not affect the condition of assets and liabilities at the balance sheet date, but the non-disclosure will affect the ability of the users to make proper evaluations. Then, the assets and liabilities need not be adjusted but the new information should be disclosed to make investors aware of it. The standard also requires that dividends declared after the balance sheet date but before the approval of the financial statements be disclosed and retained earnings adjusted if appropriate.

In 1994 and 1995, based on the EUAS, the three companies created several liability accounts to reflect expected contingencies. The EUAS, as amended in 1994, also requires disclosure of the nature of contingencies. However, none of the companies in this study complied with these disclosure requirements.

One of the important contingencies that Company 1 accumulates is the liability to complete utilities for property sold. Prior to 1997 the company accumulated 50% of the
estimated utilities cost. After privatization the company disclosed that it changed the rate to 35%. This change increased profit (before tax) by 14.5 million. This change had dramatic effect on the income statement, especially if compared to the prior year's income statement. Table 24 contains the analysis of the income statement of Company 1 for 1996 and 1997 before and after the change in the liability's percentage.

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1997 (using 35%)</th>
<th>1997 (using 50%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit</td>
<td>43 million</td>
<td>59 million</td>
<td>41.50 million</td>
</tr>
<tr>
<td>Operating Income</td>
<td>48 million</td>
<td>41 million</td>
<td>23.50 million</td>
</tr>
</tbody>
</table>

From the previous analysis it is clear that the change in the utilities liability accumulation percentage was aimed at maximizing profit, in 1997. Without this change in estimates, the results of operation of 1997 would have been a lot worse than the results of 1996. Furthermore, neither company provided any disclosures to account for how these provisions/allowances were calculated. Table 25 presents a summary of the findings related to the implementation of IAS 10 by the three companies in 1997.

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67 One comment that needs addressing is if the companies aim to maximize working capital then why did they move the provisions/allowances to long-term liability accounts. From my interviews, I was told that the companies did not want to change unless change was strongly needed. Since the movement of these accounts was not needed they were not done.
<table>
<thead>
<tr>
<th>Standard Requirement</th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss contingencies recognized as expenses and liabilities</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Contingencies adequately disclosed</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

**IAS 18 (Revenues)**

This standard was revised in 1993 and is applicable for financial statements covering periods beginning on or after January 1, 1995. The main objective of this standard is to determine the timing of recognition of revenue. This standard applies to revenues from, sale of goods, rendering of services, and the use by others of a company's assets that results in interest, royalties, and/or dividends. The standard limits the concept of revenues to inflows generated by the ordinary activities of a company.

Revenue should be recognized at the fair value of the consideration received. The standard also specifies that the following five conditions must be met before revenue can be recognized:

1. the significant risks have been transferred to the buyer (mostly through transfer of title)
2. The seller does not retain control over the goods
3. Revenue can be readily measured
4. It is probable that the economic benefits will flow to the seller
5. The costs can be readily measured

In the case when a company renders services and the revenue is readily measurable, the company is supposed to recognize revenue based on the percentage of completion of the
service. If the outcome of a transaction is not readily measurable, the company is required to recognize revenue based on the extent of the expenses that are recoverable.

The standard also provides a basis for accounting for revenues arising from interest, royalties, and dividends. These revenues should be recognized if it is probable that the economic benefits from the transaction will flow to the company, and revenue amounts are readily measurable. Interest revenue should be recognized on a time proportion basis that takes into account the effective yield on the assets. Royalty revenue should be recognized on an accrual basis in accordance with the relevant agreement. Finally, dividend revenue should be recognized when they have been declared. The standard requires three main disclosures:

(a) Revenue recognition criteria used
(b) Each significant category of revenue
(c) Revenues related to goods and services

In 1994 and 1995, the three companies did not provide any disclosure relating to the methods and policies concerning recognition of revenue. They all provided a detailed breakdown of revenues, as required by the EUAS. In this instance the EUAS requires more details than the IASs.

In 1996, Company 1 distinguished between revenues from sales and revenues from interest, dividends, and real estate. The company did not disclose the policies and/or methods relating to the recognition of revenues. In 1997, the company's statements were more informative. The company showed the liabilities to complete utilities as a separate line item subtracted from revenue. Second, the company disclosed that the revenue recognition criteria used was as follows:
Sales of land and buildings are recorded when they are actually delivered to the customers and based on the contracts. In case of installment sales, the profits and the interest related to these profits are recorded in the income statement based on the amount that is collected during the year.

As a general rule, IAS 18 requires that revenue from the sale of goods be recognized when the transfer of risk occurs. In addition, IAS 18 allows the use of the installment method when there is a high risk about collectability. Since the company does not report that major problems with collections exist, it should not have used the installment method. One explanation for the company's policy can be related to the idea of income smoothing. The company is involved with the construction of large apartment complexes that require a long time to finish. At the same time, the company usually starts and ends major projects as a batch. If the company uses the method required by IAS 18 (recognize revenue when units are sold), it would result in fluctuations in revenue between years. However, by tying the revenue recognition to the cash collected from customers, the company can present a more favorable revenue stream. Two of the three CFO's I interviewed told me that one of the main goals that they make sure is reached is to decrease the variability of income as much as possible. Moreover, they believed that privatization required them to show large increases in their income every year. The second incentive to smooth income is related to taxes. If the company recognizes all of the profits of a certain project at once, then it will have to pay all the taxes that are related to those profits.

68 I was able to support my conclusion that the company does not face major collection problems through: (1) interviews, (2) aging schedules in the subsidiary ledger, and (3) the insignificant size of the allowance for bad debts accounts.
to this profit. Since the company does not get paid the entire amount at once, they would have cash outflow while cash inflows would occur over a long period of time.

In 1996 and 1997, Company 2 and 3 did not disclose the accounting policies adopted for recognition of revenue. The companies distinguished between revenues from sales of goods, revenues from financial investments, revenues from interests, and other revenues. Neither company provided any breakdown for the extraordinary revenues that were reported, as required by the standard. Table 26 contains the summary of implementations of IAS 18 for the three companies in 1997.

<table>
<thead>
<tr>
<th>Table 26</th>
<th>Summary of Findings Related to IAS 18</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Comp1</td>
</tr>
<tr>
<td>Method of revenue recognition</td>
<td>Installment</td>
</tr>
<tr>
<td>Method accepted by IAS</td>
<td>Specific situations</td>
</tr>
<tr>
<td>Interest revenue accounted for correctly</td>
<td>Yes</td>
</tr>
<tr>
<td>Dividend revenue accounted for correctly</td>
<td>Yes</td>
</tr>
<tr>
<td>Revenue recognition policy disclosed</td>
<td>Yes</td>
</tr>
<tr>
<td>Categories of revenue recognized individually</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Although company 2 and 3 did not disclose their policy of recording profits on installments, I learned from the interviews that they followed the same policy that Company 1 uses. Therefore, I will not repeat the same discussion.

The extraordinary revenues constituted 13% of net income.
IAS 23 (Borrowing Cost)

This standard was originally introduced in 1984 and revised in 1993. It is effective for financial statements covering periods beginning on or after January 1, 1995. The standard benchmark treatment requires the immediate expensing of interest in the period in which they are incurred. The standard also requires that financial statements disclose the accounting policy used to account for borrowing costs. The alternative accepted treatment allows the capitalization of interest that is directly attributable to productive assets. The standard requires that interest expense be netted against any investment income from the temporary investment of these borrowings. The capitalized borrowing costs should be calculated by applying a weighted average of the borrowing costs, applicable to the borrowing of the enterprise that is outstanding during the period. The financial statements should disclose the following:

(a) the accounting policy adopted for borrowing costs
(b) the amount of borrowing costs capitalized during the period
(c) the capitalization rate used to determine the amount of borrowing costs eligible for capitalization

In 1994 and 1995, none of the three companies disclosed the accounting policies that relate to interest. The EUAS allows two alternatives when reporting borrowing costs. Interest may be expensed as incurred or it may be reported by using a straight-line formula, which results in reporting constant amounts of interest for every period.  

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71 This alternative was added to the EUAS by code 965 in 1990.
72 The formula is Recorded Interest = (Total interest/useful life of the loan).
In 1996, Company 1 disclosed that interest incurred on loans related to construction projects was capitalized as part of the costs of the project during construction. After the completion of the project, interest on the loans is expensed. This disclosure appeared only in the 1996 report; the 1997 had no disclosure related to interest costs.

In 1996 and 1997, Company 2 also disclosed that the interest is capitalized as part of the projects that the loan are taken to complete. Company 3 did not provide disclosure relating to the interest costs, but the CFO of the company informed me that they follow the same method as Company 1 and Company 2. Table 27 contains the summary of implementation of IAS 23 for the three companies for 1997.

<table>
<thead>
<tr>
<th>Method of recognizing borrowing cost</th>
<th>Comp1</th>
<th>Comp2</th>
<th>Comp3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adequate disclosures provided</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

Table 27

Summary of Findings Related to IAS 23

As discussed earlier Gray (1988) argues that there is a positive relation between uncertainty avoidance and conservatism and a negative relation between individualism and conservatism. Since Egypt has low individualism and high uncertainty avoidance (as shown in Chapter II), Egyptian managers should be highly conservative in their reporting. Furthermore, the required compliance between financial and tax accounting pressure the managers to be conservative in their reporting to save tax outflows.
However, privatization necessitates that Egyptians set attracting investments into the emerging stock market, as their main goal. Therefore, it is acceptable to argue that the main aim of the companies in my sample should be to attract investors, and add confidence in the Egyptian stock market, even if this will result in losing tax savings. Therefore, I posit that the companies will choose accounting methods and techniques that increase income.

From the previous discussion and the interviews that I conducted it is clear that the companies were flexible in their implementations of IAS 10, IAS 18 and IAS 23. As a result of the opposing pressures that the companies face, they seem to use a mixed strategy in their implementation of the standards. All three companies' strategies are directed towards smoothing accounting income and minimizing cash outflows from taxes. Also, none of the companies met the disclosure requirements of the standards.

My analysis of IAS 10 and IAS 23, indicate that the companies aim to increase reported income. In case of IAS 23, the three companies decided to capitalize borrowing costs (alternative treatment accepted by the standard), which results in a higher income, over expensing it (benchmark treatment). In case of IAS 10, Company 1 financial statements clearly indicate that the company sought to increase reported income after privatization, by decreasing its estimated expenses, even at the expense of sacrificing a cash outflow in taxes. The companies are under a lot of pressure from the media,

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73 The first pressure is from tax and culture, which pressure companies to report the lowest income. The second pressures results from fact that they are newly privatized companies pressure the companies to try and report the highest income.

74 The only exception is Company 1 in 1994. Since I’ve already discussed the reasons for the higher disclosure level in Company 1 while analyzing IAS 1 and IAS 5, I will not repeat this discussion here.
investors, and the government to show that privatization has increased efficiency. Since accounting profit is seen as a measure of management efficiency, all three companies have utilized income maximization strategies when possible.

However, the incentive to maximize reported profit reported income has been dampened by the compliance requirement. All three companies use the installment sales method to recognize revenue from sales to match inflows from cash collections from customers to tax outflows. The analysis of IAS 18 (revenues) indicates that the companies were very reluctant in presenting any information about their extraordinary items, or to accelerate revenue recognition by use of the sales method. The companies report profit from installment sales based on the amount that is collected. Even though, IAS 18 allows the use of installment sales it limits the use of this method of revenue recognition to situations when there is a significant risk related to collectability.

The companies' practice can be better understood when related to Egypt's requirements of tax and financial accounting compliance. As indicated by the interviews, the tax laws have a very strong effect on the choice of policy in this case. Companies have to pay taxes on all the profit that they report and they try to match cash inflows from customers with cash outflows to the government. Therefore, the companies would rather defer recognizing profit until they actually receive it. If the companies follow the IAS requirements they would have to pay large amounts in cash for taxes when they do not

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79 Company 1 discloses this fact and I found out that the other two companies follow the same practice through interviews.
have enough liquidity. This might jeopardize the whole privatization process because it will greatly affect the liquidity situation of the companies.

In conclusion, due to opposing pressures the three companies are using a mixed strategy when reporting income. They understand the importance of portraying that privatization results in better performance efficiency. Therefore, they report higher income through contingency policy and capitalization of interest. However, they also try to smooth income and to match cash collections to cash payments to the government through the use of the installment sales method.

*Standards Related to the Presentation of Balance Sheet and Cash Flow Statement*

Gray's (1988) adapted model suggests that environmental factors of a country impact how IASs are implemented. Uncertainty avoidance and the poor economic situation in the Egyptian society make the Egyptian people more concerned with short run economic effects. Therefore, Egyptians are very sensitive to changes in current assets and liabilities. Also, the media, government, and investors place enormous pressures on newly privatized companies to present the positive effects of privatization. Therefore, I posit that the accountants in this study will use accounting classifications to portray a better picture of their companies. Specifically, the companies will use the classifications of assets and liabilities to show higher working capital, and classifications of the cash flow statement to show higher net cash flows from operations. In this section I consider IAS 13 (Presentation of Current assets and Current Liabilities) and IAS 7 (Cash Flow Statements).
IAS 13 (Presentation of Current Assets and Current Liabilities)

This standard was originally approved in 1979, revised in 1991 and reformatted in 1994. The standard's main objective is to introduce methods of presenting current assets and current liabilities. The standard also addresses the basis of valuation of current assets and current liabilities. The International Accounting Standard Committee (IASC) acknowledges that there are opposing views relating to the purpose and meaning of the distinction between current and non-current items. In general, the standard requires the classification of assets as current if they are expected to be liquidated within one year, or within the normal operating cycle of the company, whichever is longer. Liabilities are classified as current if they are payable at demand or are expected to liquidate within one year.

In 1994 and 1995, Company 1 classified assets and liabilities as fixed and/or current, but Company 2 and Company 3 did not. Company 2 and Company 3 classified assets under major headings like PPE, projects under construction, inventory,...

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76 One view is that "current" is a measure of the company's liquidity (short run ability of the company to continue in business without getting into financial difficulty. The other view is that "current" is a representation of the enterprise assets that are in continuous circulation (assets or liabilities that are consumed or settled within the normal operating cycle of the firm).

77 Among the items that should be included in current assets are the following accounts: (1) Unrestricted cash and bank balances available for current operations, (2) Securities not intended to be retained and capable of being readily realized, (3) Trade and other receivables expected to be realized within one year of the balance sheets, (4) Inventories, (5) Advance payments for the purchase of current assets, and (6) Expense payments that are expected to be used within one year from the balance sheet date.

78 The fixed assets included PPE and projects under construction. The current assets included inventory (finished goods and work in process), real estate investments, financial investments, accounts receivables, cash and bank accounts, and other debit accounts. The other debits included accounts like suppliers with debit balance (prepaid accounts) and interest recoverable on bank deposits. The company also divided the liabilities into long term liabilities and current liabilities. The long-term liabilities were mainly long-term loans from banks. Current liabilities included suppliers, dividends payable, and different credit balances (insurance owed, tax payable and social insurance owed). Current liabilities also included an account labeled other liabilities, which included unearned revenues, and liabilities for completion of utilities.
investments, other debit accounts, and cash and bank accounts. They classified liabilities under major headings, like capital, reserves, retained earnings, provisions, long term loans, bank loans, and other credit accounts. None of the companies disclosed the breakdown of the assets and liabilities accounts. 79

In 1996 and 1997, the three companies classified assets and liabilities as long-term or current. 80 However, there were many misclassifications in these accounts. In 1997, most of the misclassifications in Company 1 resulted in the classification of long-term assets as current assets. For example, the local lending account, disclosed as being long-term loans to employees, was classified as current. Also, the company classified real estate investments as current assets. The real estate investment account consisted of investments in land that is kept for future use and land that is owned by the company after property on the land is sold. Based on the IASs classifications these accounts should be classified as long-term assets.

The most significant misclassification was in accounts receivable, which accounts for approximately 50% of total assets. In 1997, Company 1 classified all accounts receivable as current assets. The company sells apartments on credit, which extends over several years. The customers pay installments and interest each year. Therefore, accounts receivable should be classified as long-term assets. Only the amount that the company

79 The EUAS does not include a specific definition for current assets and current liabilities but still some companies use that format.
80 In 1997, the long-term assets of Company 1 consisted of PPE, projects under construction, and long-term investments. Current assets were consisted of inventory, local lending, real estate investment, net accounts receivables, net suppliers accounts with debit balances (prepaid), other debit balances, and cash and bank balances. Long-term liabilities consisted of long term loans from the bank. Current liability accounts included provisions/allowances, suppliers, liabilities to complete utilities, unearned revenues, dividends payable, and other credit accounts.
expects to collect during the next period should be classified as current. If the
misclassification is corrected current accounts receivable would decrease to
approximately 100 million,\(^{81}\) decreasing total current assets to approximately 440 million.
Also, Company 1 misclassified some of the provisions/allowances as current liabilities.
The correction of these misclassifications would decrease total current liabilities to
approximately 465 million. It is important to note that these misclassifications seem to
oppose the company's desire to increase working capital. However, I learned from my
interviews that provisions/allowances were recorded as current liabilities under the
EUAS. Therefore, the accountants did not want to change their classifications unless it
was absolutely necessary. This supports the analysis in the uniformity section of this
chapter.

The previous analyses have a significant effect on the company's 1997 reported
working capital. The correction of the prior misclassifications result in a negative
working capital of 25 million,\(^{82}\) compared to the 50 million, positive working capital, that
the company reported, in 1997.\(^{83}\)

In 1996 and 1997, Company 2 classified real estate investments and financial
investments as current assets. These investments amounted to approximately 45 million
and 73 million in 1996 and 1997 respectively. As mentioned in the analysis of Company
1, the real estate investments should not be reported as current because they are

\(^{81}\) This number is approximate and is based on the actual collections during the year as a percentage of the
accounts receivable. The previous analysis is based on data from the ledgers of the company.
\(^{82}\) The negative working capital is a result of subtracting the corrected current liabilities (460 million) from
the corrected current assets (440 million).
\(^{83}\) The working capital is calculated as current assets of 760 million minus 710 million in current liabilities.
investments in land that is kept for future projects or land that is owned while the property on it is sold. Also, in 1997, 18 million of the financial investments were long-term investments that the company held in two specific companies. The book value of these investments did not change over the four years of my analysis. Table 28 contains the correction of the misclassifications of Company 2 in 1997. The correction of the above misclassifications would result in negative working capital.

<table>
<thead>
<tr>
<th>Table 28</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 2 Correction of Misclassification for 1997</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>1997</strong></td>
</tr>
<tr>
<td>Reported working capital</td>
</tr>
<tr>
<td>Subtract: Real estate investments (long term portion)</td>
</tr>
<tr>
<td>Subtract: Financial investments (long-term portion)</td>
</tr>
<tr>
<td>Corrected Working Capital</td>
</tr>
</tbody>
</table>

In 1997, Company 3 misclassified real estate investments as current assets. An unpublished management report supports this conclusion. The report disclosed that working capital was 61 million (as reported in the financial statements), in 1996 and 30 million (which is 40 million lower than the amount reported in the published balance sheet), in 1997. The main difference between the unpublished report and the published figures is the 40 million of real estate investments that the company misclassified as a current asset. Table 28 contains a summary of the findings relating to the implementation of IAS 13 by the three companies in 1997.
In summary, the three companies misclassified several long-term assets as short-term assets. As a result, the published working capitals of the three companies were inflated. As discussed in Chapter II, Egyptians have high uncertainty avoidance, which makes them more focused on the short run than the long run. The managers understand this and use accounting classifications to inflate working capital. One of the CFOs that I interviewed explained it by saying "working capital is one of the most important numbers in the balance sheet because we are companies that depend on our own." Another CFO stated that given the Egyptian way of thinking, he is convinced that current assets are the focus of the Egyptian investors. As he puts it "Egyptians always look under their feet, they do not know how to look to the future."

**IAS 7 (Cash Flow Statement)**

This standard became effective for financial statements covering periods beginning on or after January 1, 1994. The objective of this standard is to provide information about the cash flow of the company to allow users of the financial statements to assess the ability of the company to generate cash. The standard requires companies to
prepare a cash flow statement and to present it as an integral part of all reported financial statements. The standard requires that the cash flow statement be divided into operating, investing, and financing activities.

The standard permits the use of either the direct or indirect method to compute operational cash flows.\(^4\) Also, the standard allows for some cash flows to be reported on a net basis.\(^5\) The standard requires that cash flows from foreign currency transactions and foreign subsidiaries be recorded using the exchange rate applicable at the date of the cash flow. Cash flows from extraordinary items, interest and dividend received and paid must be disclosed and classified separately as either operating, investing, or financing activities, in a consistent manner. Also, cash flows arising from taxes on income should be separately disclosed and classified as cash flows from operating activities.\(^5\) The standard requires separate disclosure of cash flows from acquisitions and disposals from subsidiaries or other business units (as investing activities) and significant cash and cash equivalents that are not available for use by the company. The disclosure should be accompanied by a commentary from management.

\(^4\) The direct method discloses major classes of gross cash receipts and gross cash payments. The indirect method adjusts net profit/loss for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments and items of income or expense associated with investing or financing cash flows" (IASC 1996, 120).

\(^5\) The standard reports the following as examples of cash flows that can be reported on a net basis:
- Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the company
- Cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short
- Cash receipts and payments for the acceptance and repayment of deposits with fixed maturity date
- The placement of deposits with and withdrawal of deposits from other financial institutions
- Cash advances and loans made to customers and the repayment of those advances and loans

\(^6\) The cash flow from taxes can also be classified as investing or financing activities if the taxes can be directly related with financing or investing activities.
In 1994 and 1995, none of the three companies presented a cash flow statement, except Company 1, which provided a direct cash flow statement for 1995. Although, this was pre-privatization, the company included the cash flow statement because in 1994 the EUAS issued a statement requiring companies to provide a cash flow statement as an integral part of the financial statements. During 1996 and 1997, the three companies provided direct cash flow statements. However, none of the companies included comparative figures as required by the standard. Also, the cash flow statements had classification problems.

During 1997, Company 1 and Company 2 cash flow statements contained misclassifications that inflated net cash flow from operations. Company 1 misclassified two investing activities and reported them as operating activities, overstating net operating cash flow by 45 million. The misclassifications in Company 2 cash flow statement inflated net cash flow from operations by 28.5 million. The correction of the misclassifications would decrease net operating cash flow of Company 1 and Company 2 to approximately 57 million and 0.1 million respectively. These amounts are lower than the working capital published by both companies in 1996.

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87 The head of the accounting department of Company 1 informed me that they started to prepare a cash flow statement in 1995 in preparation for their privatization in 1996.
88 The first cash flow (80 million) came from the sale of stock that Company 1 owned in Company 3. Also, Company 1 paid 35 million to acquire almost 100% of the stocks of company XYZ. The net effect was 45 million overstatement (80 million - 35 million).
89 The company included collections from sale of financial investments (1.4 million) as operating activities, and payments to complete projects (27 million) as investing activities. The correction of these misclassifications would mean that the company should classify collections from sale of financial investments as an investing activity (decreasing operating cash flow by 1.4 million) and cash payments for completing projects as an operating activity (decreasing operating cash flow by 27 million). The net effect would be a 28.4 million decrease in the net cash flow from operating activities.
90 In 1996 the working capital for Company 1 and Company 2 were 61 million and 28.5 million respectively.
Company 3 had a significant discrepancy between the reported end cash balance, in 1996, and the beginning balance for 1997. Table 31 includes the reported beginning and ending cash balances for Company 3 for 1996 and 1997.

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning cash flow</strong></td>
<td>31 million</td>
<td>70 million</td>
</tr>
<tr>
<td><strong>End cash flow</strong></td>
<td>260 million</td>
<td>43 million</td>
</tr>
<tr>
<td><strong>Difference between ending cash in 1996 and beginning cash in 1997</strong></td>
<td></td>
<td>190 million</td>
</tr>
</tbody>
</table>

The company does not disclose any information about the discrepancy in the financial statements. One reason for the decrease in liquidity that is mentioned in the management letter in one sentence, and is supported by the interviews, is the payment of debts owed to the governmental holding company. There are two factors that may have together led to the company’s flexibility in reconciliation of the statements. First, the company did not want to report explicitly its relation to the governmental holding company to avoid the requirements of related parties and consolidation standards. Second, the company did not want to report a sharp decrease in cash because of cultural reasons. The Egyptian investors are new at the investing game and as discussed earlier they tend to try to avoid uncertainty. Therefore, the company wanted to avoid showing a
sharp decrease in cash. \footnote{I also analyzed the 1996 balance sheet. In 1996, the company had a large sum of cash injected into it by the governmental holding company. This is shown as a debit to cash and a credit to a liability account. One explanation might be that the governmental holding company wanted to show that Company 3 is highly liquid to encourage investors to invest in the company when its stock was first sold in the stock market. In 1997, when Company 3 repaid the cash, the company did not want to show a drastic decrease in cash so as not to disturb the market.} Table 32 contains a summary of the findings related to the implementation of IAS 7 (Cash Flow Statements) in the three companies in 1997.

<table>
<thead>
<tr>
<th>Summary of Findings Related to IAS 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comp1</td>
</tr>
<tr>
<td>Cash flow statement divided into three parts</td>
</tr>
<tr>
<td>Accounts classified correctly</td>
</tr>
<tr>
<td>Format of cash flow statement</td>
</tr>
<tr>
<td>Interest classified is classified as</td>
</tr>
<tr>
<td>Dividends classified is classified as</td>
</tr>
<tr>
<td>Taxes classified correctly as operating activities?</td>
</tr>
<tr>
<td>Adequate disclosures</td>
</tr>
<tr>
<td>Significant cash amounts that are not available for use by the company disclosed</td>
</tr>
<tr>
<td>Disclosures accompanied by a commentary from management</td>
</tr>
</tbody>
</table>

In summary, the misclassifications in the cash flow statements resulted mainly in overstating 1997 net cash flows from operations, especially if it was lower than 1996 amounts.
Since the companies are newly privatized managers feel that it would be disturbing to stockholders if the companies reported lower net operating cash flow in 1997 than in 1996. The general feeling in the Egyptian market is that these companies should perform a lot better after privatization. To meet such high expectations the managers try and show that the companies' liquidity is increasing. Given the high uncertainty avoidance of the Egyptians a drop in net operating cash flow would be highly disturbing.

Currently, Company 1 and the tax authority are disputing the type of taxes that the company needs to pay on the profits from selling the stocks from the financial investments. The government argues that these profits should be taxed an extra amount under the capital gain tax. Company 1 argues that these profits are part of how the company uses excess cash from operating activities, like depositing in a savings account, and they should not pay the extra tax. The management feels that classifying these profits as operating activities supports their argument.

In summary, prior to privatization none of the three companies provided a cash flow statement. All three companies provided direct cash flow statements after privatization, as required by the IAS 7. The three companies' used the direct method for presenting the cash flow statement because the Capital Market Authority (CMA) requires it. All the cash flow statements had misclassifications that overstated net cash from operations. The importance of the operating section in the cash flow statement can be tied directly to the Egyptians high uncertainty avoidance and focus on short term and liquidity. For Egyptians, cash from operations is one of the most important parts of the
activities of the company because they are repetitive and tangible. Egyptian investors would like to see cash from operations as high as possible.

Gray's (1988) adapted model suggests that environmental variables moderate how IASs are implemented in Egypt. The uncertainty avoidance that is embedded in the Egyptian culture, the fact that privatization is still at an embryonic stage in Egypt, and Egyptian tax laws have significant effects on how IAS 13 and IAS 7 are implemented. The uncertainty avoidance and the poor economic situation in Egypt makes the Egyptians more concerned with short run effects and liquidity. Also, the fact that the privatization program is still in a pioneering stage puts tremendous pressures on the newly privatized companies. These companies are expected to benefit from privatization. The Egyptians expect these benefits to be reflected in the financial statements of these companies. Therefore, I posited that the three companies in this study will use accounting numbers to portray their performance in the best picture possible.

As expected, the three companies used accounting to portray themselves as being more liquid. The companies misclassified long term assets as current assets inflating working capital. Also, the companies' misclassified their cash flow statement accounts overstating net cash flow from operations.

The interviews that I conducted support the previous arguments. The three CEOs mentioned the media and investors scrutiny in several occasions. They were also very open in describing the strong pressures that they face to show that their companies have benefited from privatization. One of the CEO's said, "we have always claimed that our relation with the government was the main factor that hinders our performance. Now that
we are privatized we better prove to them that we can make it." The same pressure was also clear in my interviews with the accounting heads of these companies. They all noted that there is extra political and social pressure that is put on their companies to succeed. One of the accountants indicated that they had to show increasing profits or they would be in trouble. The key is that they do not only have to show profits but they also have to show 'increasing' profits from year to year, at least until the privatization program establishes itself as a success. Comments like "we are closely watched" and we are "expected to increase our results of operations dramatically after privatization" were repeated several times during the interviews.

It is important to note that these companies are at the beginning of a new era under private ownership, and are expected to perform exceptionally well in comparison to the previous era. Therefore, the main goal of these companies is to present results that show that they performed better after privatization. This idea is even more important because the management of the companies did not change. Therefore, the managers have an extra incentive to show the public that they are excellent managers and that the old bureaucratic system is the reason that their companies performed so poorly prior to privatization. The managers want to show that their companies performed a lot better once the burden of the government control is removed even if the removal is only partial.

**Standards Relating to Selective Implementation**

This section focuses on three standards that I expected to be hard to implement in Egypt due to the Egyptian socioeconomic situation. Gray's (1988) adapted model argues
that it is important to consider the surrounding culture when studying accounting. The
collectivist nature of the Egyptian culture may conflict with the more individualistic,
profit maximization focus of the IASC. Also, the Egyptian tax requirements and the way
business is conducted in Egypt may intervene in whether individual IASs are
implemented or not. I posit that:

*IASs will be selectively implemented in Egypt*

In this section I consider the following standards

- IAS 22, Business Consolidations
- IAS 24, Related Party Disclosures
- IAS 27, Consolidated Financial Statements

**IAS 22 (Business Consolidations), IAS 24 (Related Party Disclosures), and IAS 27
(Consolidated Financial Statements)**

IAS 22 was originally approved in 1983 and revised in 1993. The standard is
effective for financial statements covering periods beginning on or after January 1, 1995.
The standard introduces the required accounting treatment for business combination, and
differentiates between the nature (a) acquisition and (b) uniting of interests.\(^{92}\)

*Acquisitions occur when a company obtains control over the net assets and
operations of another company, acquiring half or more than half of the voting stocks of
that company. Other means of acquisitions occur when the acquirer obtains power (a) by
virtue of agreement with other investors, (b) under a statute, and/or (c) to remove the

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\(^{92}\) Uniting of interest occurs when there is a mutual sharing of risk and benefits by two companies that
occur through the exchange of substantially equal number of voting shares. I will not discuss this part of the
standard because this relationship is unheard of in Egypt. The closest to this arrangement is a joint venture
in Egypt. None of the companies in this study had any joint ventures.
majority of the board of directors. The standard requires that an acquisition of another company be accounted for using the purchase method of accounting. The acquirer should incorporate the results of operations of the acquiree into the income statement, and recognize the assets, liabilities, and any goodwill resulting from the acquisition in the balance sheet. The acquisition should be accounted for at cost and the acquirer can either include minority interest in his/her presentation of the acquired assets or liabilities or as a separate line item. The standard also presents detailed requirements of how to determine the fair value of the acquired assets and liabilities. The standard requires the acquirer to amortize goodwill over its useful life, not to exceed five years.\textsuperscript{93} The standard requires a set of disclosures to accompany the acquisition.

IAS 24 was originally approved in 1984 and was revised in 1991 and reformatted in 1994. This standard presents the rules of presentation and disclosure of related parties transactions. The standard considers the following as related parties:

(a) Companies that control, or are controlled, by the reporting enterprise. This includes holding companies and subsidiaries.
(b) Associates
(c) Individuals that own voting power that gives them significant influence, and close members of the family of such individuals\textsuperscript{94}
(d) Key management personnel
(e) Other companies which any person in (c) and/or (d) own significant interest

The standard acknowledges the presence of a variety of methods to value related party transactions.\textsuperscript{95} The standard also requires that related party relationships be disclosed when control exists, even if there have been no transactions between the related

\textsuperscript{93} The standard allows the acquirer a longer amortization period, up to 20 years, if it can be justified.
\textsuperscript{94} The close members of the family of the individual are the people that may be expected to influence, or be influenced by, that person in dealing with the enterprise.
\textsuperscript{95} For example, the comparable uncontrolled price method, and the cost-plus method.
parties. When transactions occur between related parties, additional disclosures are required including (1) the nature of the relation with the related party, (2) the type of the transaction, and (3) the elements of the transaction that are needed to understand the transaction.

IAS 27 was introduced in 1988, reviewed in 1991 and reformatted in 1994. The standard contains criteria for the presentation and preparation of consolidated financial statements for a group of companies under common control. A parent company that issues consolidated financial statements should consolidate all subsidiaries. The consolidated financial statements must be prepared by adding the financial statements of the parent and the subsidiaries on a line by line basis. Intra-group balances and transactions should be eliminated in full. Consolidated financial statements should be prepared using uniform accounting policies for similar transactions. If impractical, the parent company must disclose the accounting policies used and the proportions of their use. Minority interests should be presented separate from the liabilities and the parent stockholder’s equity. The standard requires the parent company to disclose the following:

(1) a list of significant subsidiaries including the names, the origin, and proportion of ownership or voting stock, if different.
(2) reasons for not consolidating a subsidiary.
(3) the methods used for accounting for subsidiaries.

The EUAS did not require any special treatment or disclosures for consolidation or insider trading. During 1994 and 1995 none of the three companies disclosed any information related to these subjects.

Based on my interviews, in Company 1, I discovered that several of the key management personnel have made huge profits from trading in the stocks of Company 1
in 1996 and 1997. The company should have applied the requirements of IAS 24 to these activities. However, insider-trading laws in Egypt are not completely developed and understood yet given the emerging stage of the stock market in Egypt. Also, given the state of how business is done and the general ethical standards that are applied in Egypt, insider trading is seen as an acceptable practice. Corruption and insider dealings still may be the norm; bribery continues to be viewed as a way of doing business. The problems stem from the fact that financial affairs of families in Egypt are treated as more cohesive than in developed countries. As a result, it is usually accepted for a father, uncle, or any other relative to buy stock in the name of another relative, if the relative's position might be affected by the transaction. In this type of atmosphere, related parties transactions are not viewed negatively.

In 1997, the company bought 90% of the stocks of company XYZ, which means that Company 1 should apply IAS 22, IAS 24 and IAS 27 in reporting. Company 1 disclosed the purchase, but the disclosure only reflected the number of share bought. The disclosure did not report the percentage of ownership or the degree of control. Also, Company 1 did not present a consolidated financial statement, as required by the standards. When I examined the subsidiary ledger of Company 1, I found several transactions between Company 1 and company XYZ that were not disclosed. Also, Company 1 did not disclose any of its dealings with the governmental holding company that still holds 25% ownership in Company 1.

Company 2 and Company 3 did not have any activities that would make their financial statements fall under IAS 22 or IAS 27. But, the companies' statements should
have met the requirements of IAS 24. This is especially true in the case of the activities and exchanges that occur between Company 2 and Company 3 and the governmental holding company. Table 33 contains a summary of the findings related to the implementation of IAS 22, IAS 24 and IAS 27 by the three companies in 1997.

<table>
<thead>
<tr>
<th>Summary of Findings related to IAS 22, IAS 24, and IAS 27</th>
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<tr>
<td>Comp1</td>
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<tr>
<td>IAS 22 applied correctly&lt;sup&gt;96&lt;/sup&gt;</td>
</tr>
<tr>
<td>Related party relations disclosed</td>
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<td>Consolidated financial statements prepared</td>
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Based on the previous discussion and the interviews that I conducted none of the companies met the requirements of IAS 22, IAS 24, and IAS 27. This attitude coincides with the fact that insider-trading laws in Egypt are not complete yet and are not fully accepted or understood by the public. The way business is done in Egypt magnifies the problem of implementation of these standards even more. Corruption and insider dealings still may be the norm; many people accept bribery as a way of doing business. In this atmosphere it is very hard to control the information that is exchanged among related parties.

<sup>96</sup> I decided to present this as an aggregate question instead of a detailed list because the standard is not applied completely.
The high collectivist nature of the Egyptian society coupled with the close family ties in Egypt hinders the implementation of these standards. Financial affairs of families in Egypt are treated as more cohesive than in developed countries. In Egypt, if a person's position makes a certain stock transaction sensitive it is accepted for one of his/her relatives to buy the stock for him/her. During the interviews, the CFOs of the companies that I analyzed had negative comments in relation to the ability of the government to enforce the insider trading laws in Egypt. All the people that I met including the personnel in the CMA believe that it will be very hard to implement the insider trading laws in Egypt due to the extended family relations that are present in Egypt. One of the three CFOs that I met stated that the only way to implement the insiders trading rules in Egypt is to "change the Egyptian people, and bring in new people that are more individualistic."

Another CEO told me that they intentionally do not want to disclose related party transactions because many of their contracts are with the government, which still owns a large share of their company. Management did not want to remind the public of their affiliation with the government. They want to give the impression that they are a private sector company.

All the accounting managers that I interviewed did not feel that consolidated financial statements would result in an accurate reflection of their company's status. Their intuition is based on the fact that they buy these companies based on political directions and not economic directions. As one of the CEO's told me "we are directed to buy the shares of these companies when there is no demand on them." In other terms, they create
demand for the shares and at the same time they wait until the investors start buying the shares and then they sell them for a profit.

The effects of the Egyptian tax laws and their conflict with the standard have a strong effect on the companies' implementation of these standards. As discussed earlier, the Egyptian tax laws do not have provisions for filing consolidated financial statements. The Egyptian tax code prohibits consolidated reporting and requires each company to present its financial statements individually (Price Waterhouse 1996). Egyptian laws require compliance between tax and financial accounting. As a result, the companies decided not to implement the IASs in favor of meeting the requirements of the tax laws. Moreover, one of the CEO's that I met stated that he does not believe that Egyptian investors are sophisticated enough to understand consolidated financial statements.

The analyses of IAS 22, IAS 24, IAS 27, and several standards that were analyzed in the earlier sections, indicate that companies were very selective in their implementation of the IASs. Companies' decisions to implement or not to implement a standard were strongly affected by the socioeconomic environment. Tax laws and cultural factors were some of the most important factors that companies refer to when deciding whether to implement or not to implement standards. Also, companies understand that they have to attract capital and increase the confidence in the Egyptian market. Therefore, companies were more inclined to implement standards that show an increase in their efficiency. In summary, environmental factors that are embedded in the Egyptian society strongly affect companies' decisions to implement individual standards.
CHAPTER V

CONCLUSIONS, CONTRIBUTIONS, AND FUTURE RESEARCH

Conclusions

The main purpose of this study was to examine the implementation of International Accounting Standards (IASs) in the financial statements of three newly privatized companies in Egypt. I predicted that the Egyptian culture and socioeconomic factors would intervene in how the IASs are implemented in the financial statements of these companies. Specifically, I posited that the disclosure level in the financial statements of these companies would be lower than the IASs requirements because of the high propensity for secrecy embedded in the Egyptian culture. I also posited that although IASs offer alternatives, privatized companies would not change their accounting methods because of the high uncertainty avoidance and strong power distance relationships that exist in Egypt. Also, I argued that the pressure to show the positive effects of privatization would overcome the propensity to save taxes, leading the companies to use income-maximizing accounting methods. Finally, I argued that the companies in this study would be selective in their decisions as to whether or not to implement individual IASs.
The analysis of the financial statements and the interviews suggest that culture and socioeconomic factors had a significant effect on the implementation of IASs in the companies analyzed in this study. The three companies were selective in their choice of the standards that they applied. Decisions to implement or not to implement were strongly affected by the Egyptian cultural and socioeconomic factors. None of the companies implemented the insider-trading standard because it conflicted with the collectivist nature of the Egyptian society and with the way business is conducted in Egypt. Also, the consolidation standards were not implemented, which can probably be attributed to the fact that the Egyptian tax code does not allow consolidated reporting.

The results suggest that the propensity for secrecy that is embedded in the Egyptian culture override the IASs disclosure requirements. As a result, the companies' disclosure levels were considerably lower than the IASs requirements. Also, the high uncertainty avoidance and the strong power distance, inherent in the Egyptian culture, deterred companies from taking advantage of the alternatives allowed by the IASs. None of the companies changed their accounting methods. They continued using the accounting methods that were prescribed by the Egyptian Unified Accounting System (EUAS).

97 IAS 22 (Business Consolidations), IAS 24 (Related Party Disclosures), and IAS 27 (Consolidated Financial Statements) are used to analyze the companies' decisions to implement/not to implement standards.
98 IAS 1 (Presentation of Financial Statements), IAS 5 (Information to be Disclosed in the Financial Statements), IAS 8 (Profit or Loss for the Period, Fundamental Changes in Accounting Policies), IAS 21 (The Effect of Changes in Foreign Currency Rates), and IAS 25 (Accounting for Investments), are the titles of the standards used in the analysis of the effect of secrecy on disclosure.
99 IAS 2 (Inventories), IAS 4 (Depreciation), IAS 16 (Property, Plant and Equipment), are the titles of the standards used in the analysis of the degree of uniformity of the accounting methods used.
In terms of income reporting, the three companies faced opposing pressures. Since these companies are newly privatized, the media, government, and investors expect them to perform better than during the pre-privatization period. Pressures exist to portray the positive benefits of privatization that create incentives for the companies to use income-maximizing reporting methods. However, Egyptian laws that require tax and financial accounting compliance make income-minimizing accounting reporting methods attractive. As expected, the companies in this study used mixed strategies combining income-maximizing and income-minimizing accounting methods.

The pressure to appear more liquid after privatization also led to significant deviations from IASs recommended classifications. In the balance sheet, all three companies overstated working capital by misclassifying long-term assets as current. They also overstated net cash flows from operations by misclassifying investing cash flows as operation cash flows.

In conclusion, the companies' decisions to implement or not to implement IASs were strongly affected by the culture and socioeconomic factors. All three companies complied with the IASs when they did not conflict with local culture or socioeconomic factors, but deviated when conflicts existed. The disclosure level in the financial statements of the three companies was considerably lower than the IASs requirements because disclosure conflicts with the Egyptian propensity for secrecy. Also, the three companies continued to use the accounting methods prescribed by the EUAS because of

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100 IAS 10, Contingencies and Events Occurring after the Balance Sheet, IAS 18 (Revenue), IAS 23 (Borrowing Costs), are the standards used to analyze the income reporting methods used.
101 IAS 13 (Presentation of Current Assets and Current Liabilities) and IAS 7 (Cash Flow Statement) are the standards used to analyze the classification of accounts.
the high uncertainty avoidance and high power distance that are inherent in the Egyptian society. In terms of income reporting, the companies used mixed strategies to meet opposing pressures that they face. Also, the companies deviated from IASs classification requirements to appear more liquid after privatization. In summary, the culture and socioeconomic factors strongly intervened in the implementation of IASs in the financial statements of the three companies analyzed in this study.

Contributions

Prior research focused on developed countries or combined developed and developing countries. The study directs the attention of the International Accounting Committee (IASC) and the international accounting society to the problems that face developing countries when they adopt IASs, by offering insights into the implementation of IASs in three newly privatized Egyptian companies.

Prior empirical research focused on the adoption of IASs or concentrated on the implementation of a few IASs. This study extends previous research by analyzing the implementation of all relevant IASs in the financial statements of three companies. This method of examination allows a more comprehensive analysis of the implementation process.

This study also adapts Gray's (1988) model to fit the Egyptian situation, by adding accounting importation to the model. The adapted framework is more appropriate for countries that import the western oriented IASs without allowing society time to adapt to the changes. Bernard (1991, 50) reports that "Egyptian accounting is at the top of
Arabic sophistication." Moreover, he states that "Egypt which has had its own regulations since the turn of the century has served as the model which is most emulated throughout the region (Middle East)" (Bernard 1991, 93). As a result, the transformation in the Egyptian economy will be reflected in other Arab and Middle Eastern countries. This framework can be used as a guideline for future research that focuses on countries that go through the same process in the Arab world.

Future Research

This study focuses on the financial statements of three companies in the infrastructure sector of the Egyptian society. Other sectors of the Egyptian society may face different forces and pressures. Also, this study only considered the sale of State Owned Enterprises (SOEs) through the stock exchange. The Egyptian government uses other methods for privatization of SOEs. Future research is needed to expand the scope of this study to cover more companies and industries. Added to that, future studies should examine the effect of IASs on companies that are privatized by other means than the stock exchange. Also, more research needs to be conducted to compare the implementation of IASs in other developing countries to the Egyptian experience. This research should examine whether all the developing countries face the same problems when implementing IASs or are these problems only unique to Egypt.

Although Gray's (1988) adapted model highlights the dual effects of accounting, this study only considers the effect of IASs on accounting practice and accounting subculture. I do not attempt to examine the effects of the implementation of IASs on the
Egyptian culture because that adaptation is a long-term phenomenon. A law decreed the adoption of the IAS; Egyptian society was not given time to adapt to the changes. The effects of adoption and implementation of IASs on the Egyptian culture will not be clear for some time. Future research needs to be conducted to examine how the Egyptian culture will change as a result of the adoption and implementation of IASs.

The International Accounting Standard Committee (IASC) efforts to harmonize accounting financial practice has wide spread support from the accounting profession (Coopers and Lybrand (International) 1991) (Ernst and Whinney 1986) and the academic world (Wyatt 1989; Nobes and Parkers 1991). The IASC and its supporters argue that harmonization facilitates the growth of equity markets and promote economic development. The results of this study suggest that the IASC harmonization efforts cannot be successful unless the IASC abandons the concept of 'one size fits all' standards and acknowledges the importance of local culture and socioeconomic factors present in individual countries. Future research is needed to assess the viability of the IASC harmonization efforts. Also, more research is needed to find ways to make the IASs more sensitive to local cultures and socioeconomic factors of local countries.
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Ernst and Whinney. 1986. *International Accounting Standards: Synopses, Multinational Comparison and Disclosure Checklist.*


