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STANDARDISATION OF ACCOUNTING
PRACTICES IN THE DEVELOPING COUNTRIES:
THE CASE OF KUWAIT.

by

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A thesis submitted to the

Business School City University

for the degree of Doctor of Philosophy

Volume I
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I dedicate my thesis to my parents, wife, and children.
Acknowledgement

First and foremost, I am deeply grateful to my supervisor, Professor Georges Selim whose experience, inspiration, helpful supervision, constant support and valuable suggestions have benefited me, without which this work would not exist.

My sincere thanks to my wife who has sacrificed a lot and exerted enormous efforts to provide me with the best atmosphere and conditions I needed.

I would like to acknowledge the assistance of Dr. W. Al-Rashed from Kuwait University in the empirical work, and for helpful discussion.

I would like to take this opportunity to thank Dr. S. Al-Rokaibi and Mr. A. Al-Sayyab from Kuwaiti Stock Exchange for providing me with the materials I needed for the empirical study.

I would like also to express my deep thanks to Mr. N. Al-Murray from Kuwait Investment Authority for his invaluable assistance during the questionnaire stage.

Special thanks are extended to Catherine for her invaluable advice and editing during the writing of this thesis.

Finally, I am indebted to the Government of the state of Kuwait for their financial support, and I also extend my thanks to Mr. A. Al-Duwaisan the Cultural Counsellor in the Kuwaiti Embassy in London for his help.
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Abstract

This study examines the causes, nature and consequences of deficiencies in Kuwait accounting; evaluates the accounting guidelines introduced in January 1987; and recommends a new approach for regulating accounting in Kuwait, to remedy the present deficiencies.

After reviewing the theory related to accounting standard-setting, we examine in detail the laws affecting the Kuwaiti accounting profession, and the accounting practices currently employed. It is shown that inadequate, piecemeal regulation, a weak profession, and the lack of a sound theoretical base founded on the characteristics and needs of the local environment, have resulted in ambiguity, and diverse practices. The information provided is therefore not sufficiently reliable and comparable to meet users' needs.

These assertions are supported by presentation and statistical analysis of the findings from an empirical survey of the views of users and preparers of financial information. A number of hypotheses are tested, related to the objectives and nature of financial information, and ways of improving the system.

We recommend greater uniformity in Kuwaiti accounting, and submit detailed proposal for reorganisation of the profession, including the creation of a new independent regulatory body.
Part One: Purpose and Theoretical Background of the Study

Chapter One: Aims and Methodology

Chapter Two: Theories of Accounting Standard-Setting

This study presents a theoretical and empirical survey of accounting regulation and practices in Kuwait. Our aims are to explore the reasons for and nature of any deficiencies and to recommend an improved system of regulation which would ensure that Kuwaiti accounting in future will be able to meet the needs of users. Accordingly, the two chapter in this part lay the theoretical foundation for the study. Chapter one explains in detail the aims of the study, before outlining related hypotheses and describing the methodology employed to test them. The second chapter discusses theories of standard-setting, in order to aid our understanding of the factors that have influenced the present situation in Kuwait, and provide a conceptual basis for any future developments in this area.
Chapter One

Aims and Methodology

1.1 Introduction:

Standardisation of accounting practices has received increasing attention in the world since the early 1970s.\(^{(1)}\) In this period, three major standard setting bodies have been set up. The Accounting Standards Committee (ASC), the standard setting body in the United Kingdom and Ireland, established in 1971, and it was superseded by Accounting Standards Board (ASB) in August 1990. The Financial Accounting Standard Board (FASB), and the International Accounting Standards Committee (IASC) are now 19 years old. Standardisation has thus become the main issue in the accounting field. However, in most of the developing countries, accounting standards do not hold a position of importance. Enthoven stated the reasons for this:

"Various influencing factors such as former colonial practices, legal and tax aspects, and professional and educational conditions have affected accounting in Third World countries".\(^{(2)}\)

It can be added that international accounting literature is of little help to the accounting standards setters in the developing countries.

Most writers -if not all- agree that the main objective of accounting is to provide information to different parties for the purpose of making economic decisions. Well established financial accounting systems can present relevant, timely and
reliable information which is helpful for policy makers, and are an important factor in the pursuit of national goals.

The main objective of accounting standards is to narrow the choice of accounting techniques, so that financial reports are recorded in a general language which is clearly understood by all of the various users.

Accounting regulations have been considered as a method of ensuring the reliability of accounting reports. Harmonisation of the methods by which reports are formed can ensure that accounting regulations are of true value to their users.

The manner of presenting accounting regulation has differed from country to country. In some countries, the accounting profession is leading the promulgation of accounting standards. In other countries, regulation is implemented through government agencies. The status and size of the accounting profession in these countries are the main factors determining who takes the key role in accounting regulation.\(^{(3)}\)

Most writers call attention to the important role of the environmental factors in the development of accounting concepts and techniques. These environmental factors are not the same for all countries, so the accounting techniques in use in different countries also differ.\(^{(4)}\)

As Briston argues:

"the appropriate accounting system for each country will depend upon a wide variety of historical, political, economic and social factors".\(^{(5)}\)

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It has been asserted that differences in environmental circumstances among countries create obstacles to the improvement of international accounting standards.

Muller, for example, states:

"If we accept that (1) economic and business environments are not the same in all countries, and (2) a close interrelationship exists between economic and business environments, and accounting, it follows that a set of generally-accepted accounting principles cannot be useful and meaningful in all situations". (6)

It must be mentioned, however, that the systems used in the developing countries are broad extensions of those in developed countries.

Analysis of accounting systems among countries reveals that no two accounting systems are the same. International accounting literature offers little help in defining the association which may occur between specific environmental factors, and the most appropriate regulatory process for selecting and setting the accounting standards which best comply with local needs. Thus there is a need to propose descriptive and predictive models of the association between factors characterising the environment of accounting reporting functions in a specific developing country, and the mechanism for promulgating accounting standards.

The most preferable model for setting accounting standards can be built and developed after enough evidence has been gathered
as to the relationship between particular environmental variables.

In the case of less developed nations, there is a strong trend to propose that accounting standards should be promulgated by government legislation. Regulation cannot be left to the accounting profession alone, and it needs the support of governmental agencies, as well as other groups concerned with accounting standards.

In most developing countries, accountancy may not be considered as a service developed in response to the needs of its own society.\(^7\)

In general, the accounting profession in the developing countries tends to be weak, and accounting is still in its infancy. There may be no acceptance of the need for a professional association to promulgate standards for accounting and auditing. The professional institutional system may be affected by lack of professional interest, insufficient governmental support, and inadequate help by private and public organisations.

1.2 The Importance of the Research:

Discussion of accounting issues in Kuwait, which has been presented in the international accounting literature, has been confined to a few articles in the international periodicals and some Ph.D. theses in the United Kingdom and United States. These researches and academic works start by emphasising the need for an organised accounting profession in Kuwait, and focus on the weaknesses in accounting practices and regulation.
Moreover, Kuwait has not been included in any of the comparative international surveys. The main reason for this is the absence of a strong professional accounting organisation in Kuwait which could provide the necessary information for such comparative studies.

The accounting profession in Kuwait is still in a rudimentary stage of development. Management and auditors are responsible for selecting the accounting methods and techniques, so most accounting firms choose the techniques which are imported from western countries and some Arab countries, especially Egypt.\(^6\)

It is increasingly recognised that what is desirable for the developed countries - from an accounting perspective - is not necessarily the most desirable for the needs of the developing countries. Therefore the transfer of accounting practices and techniques from other nations, without consideration of their appropriateness to local needs, is likely to be unsuccessful.

The public accounting firms in Kuwait adopt various groups of accepted accounting techniques used in western countries, particularly the United Kingdom and United States. There is a failure to take into account the significant role of environmental factors in the adequacy of the accounting practices and techniques in the country.

Accounting practices in Kuwait are not influenced by law since there is no law in the country which specifies accounting standards and procedures to be used by companies. The Practice of Auditing of Accounts Law (No.6 of 1962) was the first law to
recognise the accounting profession in Kuwait. It required the accountant to comply with the GAAP, and gave the Ministry of Trade and Industry the right to license professional accountants in Kuwait.\(^9\)

There is two others laws which have affected the accounting profession in Kuwait. The first one is Law No.15 of 1960. This law requires companies to appoint an external auditor.\(^{10}\) The other law is Commercial Law (No.2 of 1961), which required that two books of accounts should be maintained by all Kuwaiti companies, and the accountant should use the GAAP which were not specified.\(^{11}\)

In general, the Kuwaiti accounting profession is not well organised, and there has not been enough effort made to resolve this.

1.3 The Purpose of the Study:

The study is basically designed to achieve the following purposes:

(1) To review the previous attempts by different sectors participating in the development of accounting practices in Kuwait.

(2) To examine the accounting practices in Kuwaiti corporations in different industries.

(3) To examine the causes and the nature of the deficiencies in the accounting practices and information disclosures in Kuwaiti corporations, and the obstacles which confronted
the users of the accounting information, as a result of these deficiencies.

(4) To review and evaluate the new accounting guidelines which were introduced in Kuwait in January 1987.

(5) To recommend a new approach for regulating the accounting profession in Kuwait to overcome the present deficiencies.

1.4 Methodology:

1.4.1 Research Methods:

In this study we will investigate whether financial information users have access to appropriate statistics and information prior to their economic decisions; identify the best way to develop the accounting profession in Kuwait; and determine the main characteristics of the proposed accounting system, which are essential to solving the problems and the challenges facing the profession in Kuwait at present.

To realise such goals, several methods were used to gather information for the study. First, it was necessary to start by examining financial information disclosed by Kuwaiti shareholding companies, to inspect the nature and the scope of the financial information disclosed in their reports. In conducting such a study, the more companies' accounts were reviewed, the more interesting the results would be. In this research, all of the Kuwaiti corporations which have been registered by the Kuwaiti Stock Exchange were reviewed.
Second, analysis was made of all legislation and regulating acts which regulate different aspects of the accounting profession, to gain an adequate apprehension of other elements related to the accounting profession, such as education. In so doing, all aspects of accounting system were examined, to ascertain the adequacy of the disclosed information on which investment decisions are based.

Finally a questionnaire was conducted among those concerned, not only to inspect the degree of deficiency in the present accounting profession, but also to obtain their views as to how to overcome it, what are the main obstacles, and the nature of the authority which should be responsible for observing the implementation of the proposed solution.

1.4.2 Data Analysis Techniques:

Statistical analysis was used to analyse the data from the collected questionnaires, and to test the research hypotheses. In addition, computer analysis of the data was undertaken by using the Statistical Package for the Social Sciences (SPSS+).

1.5 Developing the Hypotheses:

1.5.1 Hypotheses concerning the Structural Characteristics' Relationships

1.5.1.1 Hypothesis Concerning the Relationship Between Satisfaction with Meeting of Objectives and Qualitative Characteristics of the Provided Information
1.5.1.1 Hypothesis One:

The first hypothesis reads as follows:

"There is a positive relationship between the respondents' satisfaction with the meeting of objectives and their view of the qualitative characteristics of the information provided in the financial statements."

1.5.1.2 Hypothesis Concerning the Relationship Between Objectives and Financial Reporting:

1.5.1.2.1 Hypothesis Two:

The second hypothesis reads as follows:

"There is a positive relationship between the respondents' view of the degree of influence of the different financial statements on their financial decision-making and their pattern of reading these statements."

1.5.2 Hypotheses Concerning the Structural Characteristics' Interrelationships:

1.5.2.1 Hypotheses Concerning the Interrelationship Between the Qualitative Characteristics:

1.5.2.1.1 Hypothesis Three:

The third hypothesis reads as follows:

"There is a positive relationship between the different scales measuring the qualitative characteristics of the information provided in balance sheet, income statement, and statement of source and application of funds"
1.5.2.1.2 Hypothesis Four:

The fourth hypothesis reads as follows:

"There is a positive relationship between the respondents' view of the qualitative characteristics of the information disclosed in the balance sheet, income statement, and statement of source and application of funds, and their view of the degree of uniformity of such information."

1.5.2.2 Hypothesis Concerning the Interrelationship Between the Financial Reporting:

1.5.2.2.1 Hypothesis five:

The fifth hypothesis reads as follows:

"There is a positive relationship between the respondents' view of the ranking of importance of the different financial statements and their pattern of reading of these statements."

1.5.2.3 Hypothesis Concerning the Interrelationship Between Objectives:

1.5.2.3.1 Hypothesis Six:

The sixth hypothesis reads as follows:

"There is a positive relationship between the different scales measuring the users' satisfaction with the information provided in financial statements."

1.5.2.4 Hypothesis Concerning the Interrelationship Between the Elements of the Financial Statements:

1.5.2.4.1 Hypothesis Seven:

This hypothesis reads as follows:

"There is a positive relationship between the different scales measuring the importance of the
information items disclosed in financial statements to decision making."

1.5.3 Hypotheses Concerning The Effect of the Background Factors:

1.5.3.1 Hypothesis Eight:

This hypothesis reads as follows:

"Respondents with accounting qualifications differ in their assessment of influence of the information provided in different financial statements and reports on financial decisions, compared with those respondents with other qualifications."

1.5.3.2 Hypothesis Nine:

This hypothesis reads as follows:

"Respondents with accounting qualifications differ in their view of the degree of uniformity of the financial statements and reports compared with those respondents with other qualifications."

1.5.3.3 Hypothesis Ten:

This hypothesis reads as follows:

"Respondents with accounting qualifications differ in their ranking of importance of the different financial statements and reports compared with those respondents with other qualifications."

1.5.3.4 Hypothesis Eleven:

This hypothesis reads as follows:

"Respondents with accounting qualifications differ in their pattern of reading of the different financial
statements and reports compared with those respondents with other qualifications."

1.5.4 Hypotheses Concerning the Environmental Factors Relationships:

1.5.4.1 Hypothesis Concerning the Relationship Between Economic Development and Foreign Accounting Methods:

1.5.4.1.1 Hypothesis twelve:

This hypothesis reads as follows:

"There is a positive relationship between the respondents' view of effect of the economic development on different accounting aspects and their view of the effect of foreign accounting methods on these aspects."

1.5.4.2 Hypothesis Concerning the Relationship Between Economic Development and the Accounting Profession:

1.5.4.2.1 Hypothesis thirteen:

Hypothesis thirteen reads as follows.

"There is a positive relationship between the respondents' view of the effect of economic development on different accounting aspects and their evaluation of the present accounting profession."
1.5.5 Hypotheses Concerning the Environmental Factors Interrelationships:

1.5.5.1 Hypothesis Concerning the Interrelationship Between Economic Development:

1.5.5.1.1 Hypothesis Fourteen:

This hypothesis reads as follows:

"There is a positive relationship between the different scales evaluating the association between economic development and the accounting system."

1.5.5.2 Hypothesis Concerning the Interrelationship Between the Accounting Profession:

1.5.5.2.1 Hypothesis Fifteen:

This hypothesis reads as follows:

"There is a positive relationship between the different scales evaluating the present accounting profession."

1.5.6 Hypotheses Concerning the Effect of the Category Factor on the Respondents' View Regarding the Improvement of the Accounting System:

1.5.6.1 Hypothesis Sixteen:

This hypothesis reads as follows:

"Users differ in their evaluation of the performance of the PTC compared with accountants."
1.5.6.2 Hypothesis Seventeen:

This hypothesis reads as follows:

"Users differ in their determination of the degree of contribution of the different parties in advancing the accounting system, compared with the accountants."

1.5.6.3 Hypothesis Eighteen:

This hypothesis reads as follows:

"Users differ in their proposed degree of involvement for the different parties in improving the accounting system, compared with the accountants."

1.5.6.4 Hypothesis Nineteen:

This hypothesis reads as follows:

"Users differ in their preferred structure for improving the accounting system, compared with accountants."

1.5.6.5 Hypothesis Twenty:

This hypothesis reads as follows:

"Users differ in their ranking of the important areas of the accounting system requiring improvement, compared with accountants."
1.5.6.6 Hypothesis Twenty-one:

This hypothesis reads as follows:

"Users differ in their view of the factors which ought to be considered in improving the accounting system, compared with the accountants".

1.6 Outline of the Study:

Chapter (2) examines in detail the different theories of accounting standards setting, concentrating on the following points:

- Are accounting standards necessary?
- Why and how should they be set?
- Who should set the accounting standards (public or private)?
- How should they be enforced?

Chapter (3) discusses in depth the accounting regulation in Kuwait and focuses on the background of the commercial laws affecting the accounting profession. This chapter chronicles the development of accounting in Kuwait from the early part of this century (before and after the discovery of oil) till the promulgation of the three guidelines (Financial Statements, Investment Accounting, and Property Accounting) by the Permanent Technical Committee (PTC) in 1987. The contents of the guidelines and the approach which was adopted by PTC are critically examined in the last section of this chapter.

Chapter (4) starts by defining the different types of business unit in Kuwait. This chapter is concerned with examining the
diversity of accounting practices in the corporations in Kuwait. In the last section, individual differences are discussed.

Chapter (5) highlights the causes, nature and consequences for users, of the deficiencies inherent in the present accounting practices in Kuwait.

Chapter (6) explains the design of the field study. It introduces the population in this study. It presents also the development of the first questionnaire, which is addressed to the first sample (users of financial information). The last part of this chapter is devoted to a discussion of the descriptive empirical findings of the primary investigation.

Chapter (7) presents the development of the second questionnaire which is related to the second sample (the accountants). The last part of this chapter discusses the descriptive empirical findings of the primary investigation.

Chapter (8) is devoted to a discussion of the inferential empirical findings and the results of testing the different hypotheses.

Chapter (9) presents some practical suggestions for regulating the accounting profession in Kuwait which should avoid the weaknesses and deficiencies of past experiences. These are based on the analysis in the previous chapters, and the experience of developed countries.

Chapter (10) includes a summary and the key conclusions and recommendations of the study.
REFERENCES


CHAPTER TWO

A Conceptual Framework for Accounting Standards-Setting

For Kuwait

2.1 Introduction

This chapter follows up the analysis contained in the previous one which described the aims of the study, the methodology to be adopted and to outline the hypothesis to be entertained. The task of evaluating accounting practices in Kuwait, and thus proposing a system which overcome the observed deficiencies, requires a framework within which such task can be fulfilled. This is the subject matter of this chapter. An attempts is made to specify a model of accounting standard-setting for Kuwait, which has wider application to other developing countries.

This section begins with a brief discussion of financial reporting and disclosure and related issues such as diversity, uniformity and comparability. This is followed in the same section by outlining the stages of the model building approach which adopted in the derivation of a relevant model for Kuwait. This forms as an introduction which leads to discussion of some concepts and definition which must be clarified prior to proceeding to the specification of the accounting standard-setting model for Kuwait. Section two covers objectives and nature of accounting information and the level of disclosure, accounting regulation, the definition and objectives of standardization and concludes with the case for and against standardization. Turning to the specification of the conceptual model, section three reviews the accounting policy-making
process and the theoretical approaches. Relevance of such approaches to developing countries emphasizes the effects of environmental factors such as political, social, economic and accounting practices. The importance of such factor is explained in the context of a model showing the elements of financial reporting environment. Inscoping further to focus on Kuwait, it is argued in section four that within an environmental framework, the decision - usefulness approach provides the theoretical underpinning of an accounting standard - setting model for Kuwait. Section five addresses the responsibility for accounting standards-setting with particular focus on regulation by the private and public sectors and government agency regulation. This issue of regulation responsibility is deemed to represent a natural concluding section of this chapter.

2.1.1 Financial Reporting and Disclosure

Whenever a new step is to be taken with regard to the publication of financial statements it is always necessary to decide the extent of information disclosure. In the beginning, accounting activity was confined to record keeping which covered the assets. This later developed into bookkeeping. The so-called "stewardship" function came to represent the first development of accounting. This was followed by the double-entry system, generally attributed to Fra Pacioli. The balance sheet dominated nineteenth century practice, thanks to the emerging concept of creditor protection through accounting as a prime role. A marked change in the situation occurred in the twentieth century, when emphasis shifted from stewardship and mere recording to measurement of the company's managerial
performance related to the funds available. This development increased the importance of a belated development of publishing profit and loss accounts, especially with regard to groups of users who are interested in multistatements.\(^{(1)}\)

The necessity to provide information common to both the owners and management of firms gave rise to the importance of external financial reporting, both in business and in commerce. This has been made even more crucial since business entities are increasingly held by the public. In order to be aware of the operations of a corporate body investors increasingly rely on the external reports of such entities. Because the adequacy of such information was questioned and malpractices were alleged in relation to external reporting, regulation became necessary. This was partially intended to avert incidents such as the 1930's security market mishaps. The system of regulation of corporate disclosure has been mainly concerned with the development of guidelines for financial reporting. Essentially, an independent body has been assigned with the duty to decide the nature of the corporation's disclosures -a duty which has since been shouldered by the firm's management.\(^{(2)}\)

### 2.1.2 Prevalent Diversity & Dissonance

Controversy has generally engulfed the current methods of accounting, among both accounting professionals and others. Discrepancies exist in the practice of various countries. The amounts of particular items in the general financial statements of a corporation are determined by text books and professional handbooks, in ways which may differ from those adopted by most extended expositions of accounting. Again, periodical
surveys have shown that there are variants of textbook and handbook practices in operation, even within the same companies. To give examples of such works, one may cite "Accounting Trends and Techniques", in the USA, and "Survey of Published Accounts (Financial Reporting)", in the UK. The immense diversity of permissible practices (professionally prescribed or included in textbooks) may lead to the existence of a million possible alternatives with regard to the representation of the financial position and profit and loss of firms. It is consequently possible, subject to the exigencies of the given company, to vary the profit and financial position by simply changing the applicable rules.\(^{(3)}\)

**2.1.3 Uniformity of Practice Within and Among Entities:**

It is naturally preferable to choose the best available alternative for the promotion of economic activity. It is important in such a case to maintain uniformity, both within the single firm and among different corporate bodies, though this may be limited to some extent by the practicability of uniform application among various industries. Elements of uniformity include the standard of measurement, the terminology used, and the types of classification adopted. Precision of meanings and definitions is another component of uniformity. In order to be able to compare the results and financial positions of different departments of a corporate body, or different corporations of different industries, creditors, investors and managers need the above mentioned criteria of uniformity. Arbitrary differences in the methods of accounting within the same economic activity, leading to different results, could jeopardise any reasonable handling of
investment resources. One of the benefits of uniformity is the avoidance of bias, be it mathematical or statistical. Such bias, together with the unnecessary existence of a range of accounting options, could encourage undue manipulation of accounting results in order to serve unfair ends.\textsuperscript{(4)}

\subsection*{2.1.4 Uniformity and Comparability}

Uniformity, as described above, could be desired per se. Firms are therefore preferred to have uniform methods of disclosure, classification, measurement concepts and accounting procedures. These should be laid out in a format which is itself uniform. However, some criticism has been leveled against uniformity. It has been argued that it represents an encroachment on the basic managerial freedom of action, that it negatively affects comparability through rigid rules and procedures, and that it would hamper the development of accounting. The advocates of uniformity, on the other hand, assert that the application of uniform accounting methods and practices in different firms facilitates comparison of their results, which would not be possible in the absence of uniformity. Further, they suggest that giving management scope to choose among a wide variety of methods may lead to undesired bias and that the controllers of accounts may gear accounting information to suit their own purposes.\textsuperscript{(5)}

\subsection*{2.1.5 The Model - Building Approach}

Accounting is a quantitative subject, and the accounting profession is concerned with quantitative information. The objective of this study is to conduct a quantitative study of
accounting practices in Kuwait. This involves testing of hypothesis with the purpose of being able to postulate policy recommendation. The model-building approach lends itself readily to such tasks, for the hypothesis testing is best conducted within the framework of a model representation of reality. This approach consists of four stages, as shown in Figure (2.0). Stage one addresses the formal task of model specification which is to be based on selecting the hypothesis to be entertained. This is followed in stage two with the estimation stage in which the main focus is on the collection of data, estimation of parameters and quantification of relationships. This is subjected to verification on theoretical a priori grounds, statistical grounds and other relevant criterion. This evaluative activity forms the subject matter of stage three. The result of acceptance or rejection or partial rejection is determined following such verification. Three flows originate from the first decision box of Figure (2.0). One signifies acceptance and hence proceeding to the next stage, while the other implies outright rejection in the form of non-applicability of the chosen hypothesis. The partial rejection case points to deficiencies in estimation or inadequacy or unreliability of data. In this case the arrow leads to stage two. In the case of acceptance, the application of the model is performed. This includes; though not mutually exclusive; applying the model for analytical, forecasting and policy-making. Such applications - more specifically the analytical purpose - feeds back to the first stage by adding to our
understanding of the phenomenon under-consideration. The process is clearly an iterative one, may be subject to uncertainty, not entirely objective, and provides an important input to decision-making.

2-2 Concepts and Definitions

2.2.1 Objectives and Nature of Accounting Information and the Level of Disclosure

This section attempts to clarify some important concepts which provide the justification for accounting standards setting. Thus, the objectives of financial information are first outlined. This is followed by characterizing the nature of accounting information, which leads to the discussion of the level of disclosure. This, in turn, cannot be separated from the fundamental question of the quality of company financial reports.

It is important to ensure that the users of accounting information receive adequate and accurate statements and reports. This can be made possible by the employment of skilled and experienced professionals who are entrusted with the production of such useful information. The key function is the communication of this information to users, this must be achieved without any distortion which could invalidate the whole accounting activity.⁶

Lee has summarised the function of the accounts as follows:

"The accounting function of company is the mechanism whereby the detail and volume of its business activity is translated into financial accounting terms in order to produce relevant financial statements and reports".⁷

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The role of an accountant may be seen as that of a communicator of information about economic and relevant activities through the recording of words and figures descriptive of his observation. The accuracy of such an abstract presentation depends on the quality of the information given and the skill of the accountant. The underlying goal of the accountant is to communicate the financial and economic situation in a model form of abstractions, and the value of his words and figures must pass this test.\[8\]

The aim of accountants with regard to the financial reports of companies has been summed up by Ross in the following words:

"Our essential service to the public thus boils down to assuring they have the benefit of the best financial statements we can devise, and this in turn boils down to producing the most useful accounting principles that we can and getting them generally accepted".\[9\]

The need for a "generally accepted" body of practices and methods derives from the need to measure the reported information. The financial reports can only be reliable where their preparation is governed by certain rules of communication and standards of measurement.

Financial information is greatly needed in the case of public limited companies which fundamentally operates on the "going concern" principle, and the divorce of management from ownership. This necessitates that the shareholders be protected against possible unscrupulous practices by managers to the detriment of the investors' interests. Such protection may be provided through the regular publication of financial information which reflects the performance and condition of the company's
The publication is effected by filing legally prescribed information with the Registrar of Companies on an annual basis. The information is thus accessible to members of the public, and official bodies who are interested in the given corporate activities.\(^{[10]}\)

The reported financial information relating to a company benefits both the managers and the external parties who have interests in the company. Managers may use such statements to set pricing and dividends policies, while shareholders and debenture holders may use them to assess the profitability and financial standing of the company. This applies to both existing and potential investors and lenders, who need to have knowledge of the investment potential and the credit-worthiness of the corporate body, respectively. Government departments make use of the published financial information of companies for taxation purposes. Again, employees of the company could equally benefit from such information, for the purposes of assessing employment prospects and collective bargaining.

Whether or not all these parties find the same information equally useful is a debatable matter. However, there is an increasing tendency to provide various users with the same financial statements, which suggests a shared level of comparability. The process of economic decision making must benefit from the reported accounting information. In order to maintain a logical relationship between the financial information and the economic activity it is attempting to represent, the nature of the economic decisions involved must be identified.\(^{[11]}\)
Firms are responsible for the preparation and publication of accounting information which will be accessible to users at a nominal or no cost. However, the company itself may benefit from this practice, because of potential trade in its securities made available through publicity. The company will ultimately obtain capital funds as a result, while the shareholder will enjoy having his shares getting into the stock market.

The allocation of resources within the economy and the investor's selection of portfolios are both affected by the nature and extent of the published financial information. This demonstrates the socio-economic relevance of accounting information, and hence raises the question of the level of disclosure.

There is much debate on the amount of financial information which should be disclosed. The demands of empirical research and surveys have promoted academics to encourage more and more company information to be disclosed. The arguments for increased disclosure are as follows:

- It enhances the economy through the optimisation of decision making as a result of increasingly available information.
- It minimises the chances of the company being subjected to takeovers, by making available more information which bears on 'opportunity cost', in relation to the current value of the company's assets.
- More disclosure can be asked for by management, in order to demonstrate their good performance.
Disclosure of the procedures followed in running the business in a company have overall social implications, since national wealth and public services are provided by business enterprises.

This, however, does not mean that there are no disadvantages associated with increased disclosure. It could be argued that, company rivals may benefit from too much information, and the users of financial information can be confused by voluminous data. There is also no doubt that the more information which is to be produced, the greater the cost involved. Moreover, additional information may be abused by some sectors of the population. Given the advantages and disadvantages of increased disclosure, what is relevant in this context is to be able to determine the extent to increasing the level of disclosure improves the quality of financial reports.

For the quality of financial reports to be improved they need to satisfy the following tests:  

- **Relevance**: in addition to describing economic factors, financial information should also influence the actions and decisions of its potential users.

- **Significance**: as far as the factors described are concerned, financial information should be sufficiently significant to make it relevant in the sense described above.

- **Fairness**: this requires utmost neutrality and objectivity in reporting the information.
- **Intelligibility**: potential users must be able to understand the reported information, no matter how complex accounting statements are supposed to be.

- **Comparability**: the information must be realistically comparable with similar or previous information. The users' decisions which such information is designed to influence, necessarily include drawing comparisons between alternative positions and situations. Methodological consistency is equally important in this regard.

- **Promptness**: the information must be an accurate representation of the economic situation at the time of reporting. This requires timely measurement and communication of such information.

- **Completeness**: the user should not be given incomplete information which, as such, prevents him/her from making reasonable assessment of management stewardship or drawing sound economic conclusions.

- **Reliability**: This test can be satisfied through having information of such good quality as to invite dependence thereon by potential users. Responsible auditing and/or credible reporting can lead to reliable accounting information being presented.

### 2.2.2 Accounting Regulation and Standardization

The events which affect the financial position and affairs of a company are translated by its accountants into a financial report, thereby rendering the activity into a communication process,
intended to inform the users of accounts of the message to be communicated. The company follows a set of policies which govern this communication process. These policies affect two areas: (a) the amount of information to be disclosed, and (b) the valuation method to be adopted, and the mode of presentation. The company's accounting policies themselves are -in most countries- governed by accounting standards, namely, officially or privately prescribed rules governing financial reporting. They cover both methodology and degree of disclosure.\(^{15}\)

Professionally-designed accounting standards serve both the companies and the public at large. As these standards determine, in part, the information process, they influence many economic decisions which affect the whole society. One example of the significance of the accounting standards is their contribution in deciding the duty to report profits or losses among various public and private corporations. Profits or losses reported may differ according to under which the reports are prepared.

The financial reports of companies may determine the level of investment in these companies individually. They may also influence decisions by individual management in relation to starting up or closing down a business.

Accounting information also plays a part in the formulation of theories applicable to the explanation of corporate functioning. All these areas of decision making and theory construction can be affected by any changes which may take place in the accounting standards. The creation and distribution of wealth and well-being in the society will consequently be affected.\(^{16}\)
It is by the setting of professional accounting standards that the accounting profession responds to the public need for accounting information of higher quality. Such standards must therefore promote the quality of published accounting information, and must be seen by the public to do so. When this is achieved, then general acceptability of the relevant standards is more likely to be gained. The involvement of all parties concerned with accounts is thus essential to the enhancement and effectiveness of the accounting process.

2.2.3 Definition and Objectives of Standardisation

No agreed definition of "standardisation" exists within the accounting literature, and various approaches are held by different writers. The definition given by Bromwich describes accounting standards as

"...uniform rules for external financial reporting applicable either to all or to a certain class of entity. These rules seek to prescribe the preferred accounting treatment from the available set of methods for treating a given accounting problem".

According to Littleton's formula:

"A standard is an agreed upon criterion of what is proper practice in a given situation; a basis for comparison and judgement; a point of departure when variation is justifiable by the circumstances and reported as such. Standards are not designed to confine practice within rigid limits but rather to serve as guideposts to truth, honesty and fair dealing. They are not accidental but intentional in origin, they are expected to be expressive of the deliberately chosen policies of the highest types of businessmen and the most experienced accountants, they direct a high but attainable level of performance, without
precluding clearly justifiable departures and variations in the procedures employed”.

The element of uniformity is included in the definition given by Edey\(^{(20)}\), within the broad term, of “standard requirements”. However, he limited the domain of his definition to external financial reporting. His definition also does not suggest that uniformity is always included in, or comes as a result of, the application of standards. Four types of standards are suggested by Edey. The first type is the disclosure of accounting policies, i.e. methods and assumptions. The second type deals with the maintenance of some level of uniformity in the accounting presentation. The third type involves paying specific attention to a specific item of accounting, or to follow the specific disclosure approach, not a general one. This rule becomes more important as the degree of uncertainty regarding the specific item increases. The final type involves decisions (either express or implicit) as to the definition of, for example, income and how it shall be divided according to periods, or the way to assess liabilities (thereby enabling the determination of net shareholders’ equity).

Standardised accounting is defined by Enthoven\(^{(21)}\) as:

“...the uniform treatment of information in accounting. This in itself, however, can apply to either the whole system of accounting, the methods of classification of accounts (charts of accounts), or the application of standards, principles and reporting”.

Linkage has therefore been made by Enthoven between uniformity and standardised accounting. This applies to the totality of accounting practice, as well as to any segment thereof.
Elaborating on the required level of uniformity, Merino and Coe\textsuperscript{(22)} put forward four degrees of uniformity: strong, moderate-strong, moderate-weak and weak uniformity. Strong uniformity exists where every accounting event is governed by prescribed rules. The moderate-strong uniformity is concerned with general uniformity in using accounting principles. Such principles are themselves individually governed by certain rules which are excluded from application only where it is quite impossible to attain uniformity. The third form of uniformity, the moderate-weak, allows choice to be made by the firm from a limited number of accounting methods and procedures. However, such choice is to be justified by the economic and technological environment of the firm. Finally, the weak type of uniformity is similar to the moderate-weak, with the exception that the firm's choice is justifiable by managerial discretion alone.

Merino and Coe limit their discussion of these four types of uniformity, to the field of financial reporting. They are not applicable to any other area of accounting.

A purposive view of uniformity is held by Al-Hashim\textsuperscript{(23)} He believes in the possibility to identify uniformity without special scrutiny into the particular area of accounting where such uniformity is applied, and regardless of the goals relating to its application. To Al-Hashim:

"Purposive uniformity is a system of accounting control in which the interpretation of economic events and the prescription of accounting methods and reports are purposive to definitive user needs".
According to Choi and Mueller\textsuperscript{[24]}, a number of uniform accounting systems can be grouped within three main lines. In what they call the business approach, uniformity is determined according to the nature of the business and its environment (e.g. industrial, commercial, etc). It is only through extensive application against the background of the relevant environment and users' demands for data that the business approach system of uniformity arises. Secondly, the economic approach system is biased towards macro-economic demands, as opposed to technical considerations. The example given is the uniform accounting system applied in Hitler's Germany. Thirdly, there is the academic approach. This (also called the technical approach) is characterised as being analytical, general and theoretical. Its analytical nature stems from the fact that the basic conventions of double-entry form the basis for uniformity. The approach is general because specific characteristics of accounting procedures in the whole industry are given direct consideration. Finally, it is a theoretical approach, since it is concerned with the establishment of links between similar accounts, with a view to consistent treatment. The Schmalenbich chart of accounts for Germany is an example of this.

The criteria for uniformity in the case of the inductive-deductive approach to accounting are designated in accordance with the accounts user's preferences. Investors and directors are given prime importance. However, the accounting rules are to be applied with consistency, and resources claims are to be measured in a like manner.
A descriptive process is at the centre of market theories. It is directed towards reproducing the effect generated on prices and amount of sales by the dissemination of accounting data in an organised securities market. This theory also assesses the impact of markets in the deployment of resources and choice of portfolios.\(^{(25)}\)

There are further factors which need be considered where accounting policies are to be set. One element is that the active participants in the economic environment do not rely exclusively on accounting data in their resort to financial information. Consequently, other sources of financial information should be considered when designing accounting policies. Such secondary information could be less expensive and more readily available. The costs and benefits of the accounting information also deserve consideration. It is not only the direct costs of production and presentation of accounts which matter, but also indirect negative effects which could be sustained by individual or corporate recipients as a result of adopting certain accounting policies. As far as the benefits are concerned, they go beyond the arena of direct decision making to some positive effects which occur as a result of relying on accounting information.\(^{(26)}\)

Accounting standards have been described as endeavouring to minimise the scope for choice in accounting.\(^{(27)}\) Another description holds standards as serving the function of uniformity in the areas of measurement and communication.

The published accounting data tend to minimise uncertainty and increase the users' understanding of the relevant affairs in the business. This increases users' protection from hazardous
investment or financial decisions. In other words, reported accounting information serves the dual purposes of curbing undue flexibility in accounting, and maximising uniformity of measurement of accounting data, thereby enhancing comparability, to the benefit of users. The whole process leads to a fairer investment environment as a result of the relative equality among users, who can compare the economic situations in various companies.\(^{(28)}\)

The quality of reported accounting information should be improved by accounting standards. The main positive effect should then be to enhance the credibility of such accounting data in order to ensure its utilisation.\(^{(29)}\)

Rules governing accounting interpretation, translation and communication are included in every body of accounting standards. Communication relates to the reporting through disclosure and presentation. The nature of the report is determined by its objective, which is to provide potential users of accounts with information relating to the periodic financial statements in the business entity.\(^{(30)}\)

Accounting practice and legal rules allow various options, which the accounting standards are there to minimise. However, it is the law which can give standards the necessary sanction and strength, to ensure that they are complied with. The protection of accounts users, which is the prime objective of accounting standards, requires their confidence in the accounting information. This is another way of reducing the degree of flexibility and of introducing essential and effectual uniformity.\(^{(31)}\) The ultimate aim is to enable users to make comparisons
among different periods within the corporation or among different corporate entities.\textsuperscript{(32)} This will provide the necessary protection to the users of accounting information.\textsuperscript{(33)}

\textbf{2.2.4 Arguments For and Against Accounting Standards:}

Advocates of accounting standards put forward a number of points, as follows:

(1) It is argued that accounting standards provide a system for harmonising rules for the individual practitioners.\textsuperscript{(78)} They also enable them to measure the validity of accounting reports and to prepare them with relative ease.\textsuperscript{(79)}

Without the existence of accounting standards, it is quite possible for a number of accounting professionals presented with basic information about certain economic activities to prepare different sets of accounts, representing the position of the given concern. Two factors may be held responsible for such discrepancies. The first is the involvement of subjective measures, such as estimates and predictions, in the process of accounting. The second factor is the existence of principles that lead to various results when applied by the accounting practitioners.\textsuperscript{(80)} It is also possible for accountants to see standards as a measure of their proper conduct, in so far as they follow them. The directors of a corporate body would find it difficult to impose upon accountants any accounting policy which is not compatible with the relevant standards.\textsuperscript{(81)}

According to McMonnies\textsuperscript{(82)}, both shareholders and accounting practitioners benefit from an accounting policy.
The former benefit by receiving better reports, and the latter in a variety of ways, particularly the following:

(i) A party dealing with an auditor or an accountant may be convinced that a suggested piece of innovative accounting may be severely criticised by the whole profession.

(ii) It could be of possible evidential value in a court of law.

(iii) Time and effort which would otherwise be spent in thinking and theorising can be saved.

The application of accounting standards is also thought of as a means towards the achievement of uniformity and rationality. Theories in the field are more likely to develop among the various participants, through debate and discussion. The establishment of accounting methods and procedures would generate uniformity, which would ensure stability in practice\(^{83}\). As a natural consequence, the domain of theory would be more active, since the accounting profession would not be preoccupied to the same extent with practical issues.

It is quite possible, argues Ross\(^{84}\), that the source of financial information may be deserted by users if the lack of uniformity results in increasing uncertainty and decreasing credibility and reliability. Accountants would then be redundant as far as the reporting of financial information is concerned. Following this, demands of public interest can prompt government to intervene in order to find a solution
for the ensuing crisis of confidence in an important function of the accounting profession.\(^{85}\)

(2) To claim that accounting standards are not needed could only be natural if financial statements to be reported were exclusively related to the corporate body in question. The reality, however, is different, since different business concerns are subjected to comparison in securities markets. Investors and creditors depend on such comparison of their decisions and actions. Accordingly, there should be some governing set of principles to prevent interested corporations from formulating rules to enhance their market standing.\(^{86}\) So long as the users need consistency and comparability of financial statements, there should be some consistent means of providing such statements. Even if absolute uniformity is not attained, it is useful to limit undesirable diversity of methods and procedures.\(^{87}\)

The need for a generally acceptable body of accounting, which would enable users to examine financial information, and make comparisons, and would facilitate rational exercise of choice and decision-making, has not been satisfactorily met\(^{88}\). Traditional accounting practice is unsatisfactory; for example, greatly misleading statements have been revealed by some accounting press (among other sources). Law suits, official inquiries, successful takeover bids and even the total collapse of some enterprises, have all demonstrated cases of gross deficiencies in accounting practices, mostly in the valuation of assets. A number of incidents have been revealed where a revaluation or
devaluation of assets has been effected unexpectedly and in substantial proportions\textsuperscript{(69)}.

In relation to income calculation, shifts in asset prices are another explanation for increment of wealth for an accounting period, in addition to net revenues. Reported financial positions of companies have sometimes been proved to differ from their realities. Examples of this may be seen in cases of sudden collapse of companies whose financial statements show every sign of prosperity, or the demonstration of greater or smaller amounts of assets, compared to those revealed in the account books. Same companies borrow sums which are quite unrealistic in the light of their book assets. These discrepancies have actually misled many shareholders and investors and caused them huge financial losses. Where appropriate, the accounting firms responsible are often brought to justice for recovery of damages resulting from misleading accounting statements.\textsuperscript{(90)}

Attempts have been made to improve the situation. A call has been made, for example, for a limited number of accounting practices. A reduced number of options within a framework of standards would minimise the reduction in the value of reported information and provide a suitable environment for professional regulatory measures to operate.

No good argument can be made in support of diversity, so long as that would exacerbate the accounting deficiencies highlighted above. The existence of diversity would damage
comparability and realistic presentation of performance and asset evaluation. It would also negatively affect comprehensibility and manageability of financial data, thereby reducing their potential use. \(^{(91)}\)

Investors need a consistent system of reporting within a single corporation, as well as between different business concerns. In the latter case, the user of the financial reports, is enabled to choose among different enterprises. For better performance evaluation and sound allocation of resources, it is also necessary to have uniformity between different firms, since this will boost comparability. Accounting data will be cheaper, according to May and Sundem\(^{(92)}\) in the presence of uniform accounting systems. Uniformity facilitates comprehension by the user of accounts, since only a minimum number of accounting systems are there to be dealt with. Again, less advice will be sought by such users as a result of their increased awareness of the prevailing accounting system. Even where advice is sought, it could be offered at a cheaper price than if there was no uniformity, because in the latter case, the advising analyst would need to spend more time and effort to accomplish his task (which would involve comparing between different accounts using different systems).

\(^{(3)}\) Comparable accounting data are essential to planners in a centrally planned economy, for overall control of such economy. Two major objectives are served by a national plan in a planned economy. The first is the acceleration of the mechanism whereby new projects are implemented. The
second is the specification of all development objectives. To accomplish both of these ends, planners must have comparable accounting figures. As far as the first objective is concerned, such figures help them to determine the right project for investment purposes. In making their decision, planners will have to refer to data in different points of time and weigh the costs and benefits of every project. Standardisation of relevant data in the case of a planned economy is crucial to the success of this process of choice making.

In developing countries, where resources are scarce, it is possible to minimise costs by avoiding the establishment of accounting systems for individual entities and by building, instead, a uniform accounting system. Such a standard system could cover a whole sector of the economy, or an industry, or even the whole economy in the country.

Where uniformity is lacking it would be difficult indeed for planners to interpret aggregated accounts, since every entity’s accounts will be framed on a different basis. Nor can such planners attain any satisfactory level of comparison among different corporate bodies, or be able to allocate resources in any appropriate manner.

In the case of a market economy it is important for investors to be able to compare the position and performance of different entities, a task which is best achieved through the existence of a uniform accounting system which will enable comparability. For a variety of reasons, uniformity could also serve governments. Through
the ability to compare different accounts, governments can decide the destination of their corporate or sectoral subsidies. These subsidies are made on the basis of both macro and micro analysis of the economy, and they resemble resource allocation.

(4) For the purposes of policy efficiency it is necessary for management to be able to conduct interim comparisons, and this is made possible in an environment where management can test the position and performance of its own firm against that of other entities. Undesirable contingencies with regard to operation or structure can be detected by management if it is possible for it to draw comparison among different accounting data. The benefit of this process of detection that it becomes possible to plan for overcoming shortcomings and conduct partial or total corrective adjustments in the firm. [95]

Critics of accounting standards forward a number of arguments against the same. These are as follows:

(1) Critics of standardisation believe that the users and suppliers of accounting data are both strongly interested in seeing trade and business taking place, and this is made possible by easy flow of information. Consumers of accounting data need them for the proper conduct of their decision-making process, while the suppliers would like to offer such information as is likely to attract resources from potential investors. Management and accounts users have, therefore, a strong incentive to maintain the availability of reliable information in the absence of regulation.[96] The
market mechanism, according to regulation critics, would operate against firms which tend to provide information which consumers would regard as insufficient, unreliable, useless or in breach of generally accepted standards.

Users may be motivated in two ways as part of their information trading activity. After conducting their speculations on the basis of the obtained information, users would then disseminate the data back into the market in order to realise expected results and gains in terms of upward price movements. Secondly, the relationship between managers and shareholders has been taken by some writers as one of agency\(^{(97)}\). It follows, among other things, that common interest exists which places an incentive for management and shareholders to have audited financial information disclosed. The management of a firm, which represents the agent in the analogy of the agency theory, has far more information on the position and performance of the firm. The position of the shareholder (the principal) is inferior as far as such information is concerned, and he is thereby removed from direct observation of managerial conduct.

This situation gives rise to a "moral hazard", or a possibility for management (the agent) to commit fraudulent or other misconduct which would jeopardise the financial interests of the shareholder (the principal). This problem could be solved through the implementation of certain incentive schemes (e.g. profit sharing, share options, etc.) which
would tend to guarantee that the aims of management are compatible with those of the shareholders.\(^{(98)}\)

(2) It is believed that standardisation would reduce accounting to mechanical practice with very little room for the exercise of professional judgement and skill\(^{(99)}\). Excepted from this are the more subjective areas of accounting, such as allocation and valuation, which cannot be the subject of rigid regulation. Professional judgement could also be blocked in cases where such judgement is needed to decide whether or not a certain standard may be departed from in the given circumstances. The conservative nature of the accounting profession would cause standardisation to be a rigid system which blocks change and development through continual reviews.\(^{(100)}\)

(3) Standardisation may induce users to believe that financial statements are immune from errors. Standardisation may give users a false sense of security, by persuading them to think that the produced financial data are infallible. Weaknesses in a standardised system may arise from initial acts of compromise by the setting committees, or through the lack of appropriate review. These shortcomings may be avoided or removed by providing for adequate research-based review preferably conducted by independent entities. Unnecessary compromises should be avoided by making specific provision for this purpose.\(^{(101)}\)

(4) The requirements embodied in accounting standards to disclose the procedures and practices used in producing the financial statements are increasingly growing. They have
the effect of increased the amount of reported information, and its complexity. It is doubtful whether the additional data would positively affect the behaviour of the user and his views about the relevant corporation.\(^{102}\)

Some critics of uniformity put forward an argument based on cost-effectiveness. They see uniformity as depending on unified but over-detailed manuals which embody standard codes of practice. These are expected to include a series of instructions covering items required to be dealt with in preparing the accounts. Examples are: elements of cost relating to fixed assets and inventories, debit and credit items, modes of determining the market value, etc.\(^{103}\)

(5) Critics of uniformity argue that standards fetter the management's right to manage the firm, and consequently reject this source of restriction. The choice of the appropriate accounting methods, they argue, must be within the jurisdiction of management. The imposition of standards on management would hamper intelligibility and prudence in the conduct of management. Two points are put forward by those critics in this regard. First, that so long as diversification exists in the business, it is necessary to allow management full discretion to choose the most suitable accounting method for the entity concerned. Diversity of business activities presupposes diversified accounting principles and practices, and it is only management which can best select the right method for the given activity. Secondly, for the standards to be generally accepted by all management, it is necessary to obtain a near consensus
through prior consultation with all relevant parties\textsuperscript{(104)}. This is because the levels of management vary greatly between different firms. However, other critics\textsuperscript{(105)} of standardisation are sceptical about entrusting management with the task of choosing the correct accounting method to be applied, or even of preparing adequate financial statements. They argue that management is biased and tends not to reflect reality, but to serve managerial interests.

\textbf{(6).} Different industries and different business environments require different qualities of accounting services. In fact, the rules in action generate rigidity because of their bureaucratic nature\textsuperscript{(106)}. Standardisation is not compatible with the reality of diverse business circumstances. The possibility of successful standardisation is therefore questioned, except as regards certain broad areas where similarities do exist between different entities or different types of business.

It is not possible to support the idea that accounting diversity is a result of the desire to express real life situations (e.g., differences between business activities). This is because such accounting diversity (e.g. with regard to inventory pricing) has been traced in situations where no sufficiently significant differences exist between the relevant firms. In order to show the intended profit figures some nationalised industries in the UK have introduced different accounting practices.\textsuperscript{(107)}
(7) It has been argued by critics of uniformity that priority must be given to the reflection of the real economic position through consistent accounting. They also argue that such consistency is best served by applying diverse accounting practices and methods. Comparability based on uniformity cannot be a substitute for such a function; it rather causes distortion of reality.\(^{108}\) The reality of business does not invite the superficial uniformity attempted by applying similar methods to diverse business activities. McCosh\(^{109}\) argues that consistency is more important than uniformity. However, diversity is not without its deficiencies, such as those related to inter-firm comparison and the construction of national accounts.

(8) It is argued that the environment of diversity makes possible experimentation with a variety of practices, principles and procedures which could in some cases be even better than unified models. This will lead to innovation and creativity, unlike in the case of uniformity, which leads to the opposite situation of rigidity and stagnation. However, Spacek\(^{110}\) believes that this is not true, since diversity conceals irregularities, the removal of which represent real and sound development. According to him, experimentation is not prevented by restricting alternative methods of accounting, and advocates of the contrary view cannot substantiate their allegations.
2.3 Specification of a Conceptual Accounting Standard- Setting Model for Kuwait

2.3.1 The Accounting Policy - Making Process

Following May and Sundem (1976) there are four groups of elements in the accounting policy-making process. Three represent groups of actors interacting in the markets. These are: Policy-makers; which in turn is divided into accounting and non-accounting policy-makers; firms and auditors, and individuals represented by decision-makers. The process describing their interaction is shown in Figure (2.1). Accounting practices are selected by accounting policy-makers, and are applied in business firms and used by auditors in carrying out their verifying and ratifying duties. Audit opinions and other information are used by individual decision-makers in various activities which generate, through markets, individual cost and benefits. The latter, in turn, feedback into individual decision-makers. Perception of costs and benefits, preferences by individuals, public policy are not the only influence on individual policy-makers. Knowledge of accounting alternatives plays an important role. Accounting policies are chosen by resorting to a choice rule, thereby turning the process full circle. It is not clear how policy makers choose between alternatives, or how the choice is, in any case, to be made. Neither is there any justification that a priori explanation is valid. In fact many interpretations exist, each one of which places different emphasis on the elements of the policy-making process. Some on the effects of economic events, others on the usefulness to decision-makers, or on the agency responsibility, or as a product
of political action or in the context of social welfare. These and others are discussed in the next section.

2.3.2 Review of the Theoretical Approaches

2.3.2.1 Economic Reporting

Under this approach, the effects of economic events are subjected to objective scrutiny. There is an underlying assumption here that the users of accounts demand the reporting of accounting income and asset values, which demand is then met.\(^{(35)}\) The reporting of the economic reality of the enterprise is seen as a response to the requirements of the potential users of accounts.\(^{(36)}\) However, the approach clearly ignores the decision-making process on the part of such users, and their associated demands. The advocates of the approach see the latter process as affecting human behaviour and refrain from becoming involved in such a political domain. They argue for neutrality, which they consider necessary for the credibility of the accounting process.\(^{(37)}\)

2.3.2.2 Serving User's Decision-making:

This approach puts the user's activity in focus. It consequently concerns itself with the behavioural aspects relating to the user's decision-making process. This process is influenced by the accounting information, which should comply with normative tests (e.g. comparability, relevance, reliability, etc.) to the extent of enabling the user to reach appropriate decisions.\(^{(38)}\) The approach therefore puts emphasis on the normative criteria, aiming to facilitate impartial policy making.\(^{(39)}\) Foremost among these normative criteria are the relevance and reliability of the
accounting information. As far as policy issues are concerned, relevance is crucial, because decisions cannot be based on irrelevant information, however reliable it may be. Next, however, comes reliability of the data. Relevant information should depict what it is meant to represent. In this regard, reliability could overlap with neutrality in that information is not prepared with the conscious aim of influencing the user, but rather, to provide objective data.

2.3.2.3 The Information Supplier Orientation Approach:

This approach is based on the agency theory applicable to corporations, which denotes - among other things - that owners are to be supplied with data by management. According to the agency theory, effort is made by individuals for the purpose of enhancing their utility. Jensen and Meekling define the agency relationship as being:

"a contract under which one or more persons (the principal [s]) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent".

In the case of a corporate enterprise, the management is considered as playing the role of an agent for the supplier of capital, who is also the principal. The agent (or management) is scrutinised by the principal (the supplier of capital) who expects the best of services (provision of appropriate financial information).

There are three elements of cost included in this agency relationship, which result from the divergence between the
manager's interest and that of the shareholders. They are as follows: First, costs arising from monitoring effort intended to check the agent's performance. This affects the prices of securities negatively. Secondly, there is the cost incurred by the agent to protect the principal's interest. This is called bonding cost, and it promotes the price of securities. Thirdly, the agent also incurs some residual loss as a consequence of discounting the securities in the firm to meet divergence between the actions of management and those of the shareholders. The costs of maintaining the agency relationship may be kept low, thereby sustaining the relationship by keeping low the cost of providing financial information to be used by the shareholders for monitoring purposes. The ultimate result is the satisfaction of both principal and agent.

Because the supplier orientation approach is concerned with the shareholders' desire to supervise the actions of management, it differs from the user orientation which endeavours to facilitate decision-making on the part of the investing user.

The supporters of the agency theory consider the prime function of accounting policy-makers to be the making and maintenance of financial market rules, together with the necessary system for the sanctioning of any deviation or breach of such rules.

The static and descriptive nature of the agency theory prevents the promotion of change. Some writers (e.g. Tinker, 1982) criticise the agency theory as being socially and politically unacceptable, because of its emphasis on the utility-maximising behaviour of managers and investors.
2.3.2.4 The Political Approach:

This approach is clearly in disagreement with the contention that accounting issues can best be tackled through a conceptual framework.\(^{[51]}\) Such a framework is strongly advocated by writers closely related to the accounting policy-making process (e.g. Kirk, 1981; Stamp, 1982; Macve, 1981).\(^{[52]}\) As early as the first half of the 1970s, the political approach found solid support by Horngren\(^{[53]}\) (1972, 73). He writes that:

"The setting of accounting standards is as much a product of political action as of flawless logic or empirical findings. Why? Because the setting of standards is a social decision. Standards place restrictions on behaviour, therefore, they must be accepted by the affected parties. Acceptance may be forced or voluntary or some of both".

Recent accounting literature shows increasing interest in the concept of the political dimension of professional accounting standards. Standard-setting is viewed as largely political by Gerboth\(^{[54]}\) and Horngren.\(^{[55]}\) The accounting rule-making process is even seen (by Gerboth) as not only inevitable, but just. When decision process depends on public confidence the critical issues are not technical, they are political.

Past experience, both in the UK and the USA, reflects the existence of politicisation in standard setting. This is especially true of highly debated accounting standards.

Watts and Zimmerman\(^{[56]}\), discuss the important concept of political costs. They contend that interference by political bodies and groupings into the large companies' field of action tends to result in costs being increased by such companies.
The expression, "political" dimension has been discussed by Burggraaff\textsuperscript{(57)} who points out two possible interpretations. The first rests on the involvement of political parties, bodies or pressure groups, in such a way as to serve the political cause of any such body. The second interpretation is illustrated by the case where an issue arises within the private sector and two or more groups have differing perceptions of the issue and of the appropriate solution. Burggraaff justifies interference into the field of accounting by political parties so long as financial statements and other similar information invite power issues which inevitably affect national and foreign interests. It is certainly understandable why interested parties may take steps to secure their influence on rules governing the preparation and presentation of accounting information. This influence is exerciseable so long as there are alternative options which are equally applicable in a given situation.

According to Hope\textsuperscript{(58)}, the political dimension comes into play so long as the public demands information and is represented by political entities. The gaining of public confidence is a function which affects the political, rather than the technical elements of accounting. Consequently, social decisions are to be made by accountants, so far as regulation is concerned.

Gerboth\textsuperscript{(59)} sees the accounting regulation process as a kind of political exercise. He takes it a step further by suggesting that accounting -at least at that level- be equated with other political institutions as far as policy-making is concerned. Some other writers (particularly Demski,\textsuperscript{(60)} 1973; Cushing,\textsuperscript{(61)} 1977 and Bromwich,\textsuperscript{(62)} 1980) suggest a necessary link between polity and
policy-making, although this is generally not put in express terms. Their approach maintains that social policy is sensitive to individual choice in any democratic/capitalist society (May and Sundem, 1976).

If the policy-making process in the field of accounting is viewed as a political process, it follows that a framework is necessary whereby augmentation is achieved. Interested groups and parties who are likely to be affected by the process need to be given consultative or representational access thereto.

There is also the social welfare approach which emanates from the political approach. It deals with the assessments made by policy makers, with a view to probing the causal relationship between accounting policies and user groups. Such examination also makes it possible to consider the effect of such policies on the economy as a whole. This approach is related back to the realisation of economic relevance of accounting in the 1970s. It has been submitted by some writers (May and Sundem) that the betterment of overall social welfare, as against the promotion of party or group interests, should be the prime target of accounting policies. They have thereby indicated in general terms the role to be played by financial reporting.

2.3.2.5 The Economic Consequence Approach:

It is necessary to predict and expressly consider the consequences of any policy option upon all groups, individuals or other parties who are likely to be affected by it. It is equally important to account for individuals' preferences with regard to such consequences. This is necessitated by the political process
of establishing disclosure requirement, and is maintained with reference to the economic consequences of accounting standards.\(^{66}\)

As long as accounting rules stimulate certain economic effects, it is quite logical that such effects be catered for when laying down these accounting rules. For accounting regulators to do so, implies a wider extra-technical role which invites other considerations (Rappaport,\(^{67}\) 1977).

An inquiry into the administrative work involved in standards setting in the UK has been conducted by the ASC/ASB. However, no direct attempt has been made to determine on what basis accounting alternatives are chosen. ED 29 includes the only reference to the economic consequences of accounting standards. This came in relation to leases, in which case the ASC/ASB acknowledged the relevance of such consequences.\(^{68}\)

From the above position held by the ASC/ASB it can be deduced that it gives priority to the application of technical criteria, compared to the significance of economic consequences, in the area of standards-setting. Even when economic consequences are considered, this is done only as a check on decisions which are made on the basis of technical criteria.

The ASC/ASB position is very conservative compared to that of the FASB in the USA. As early as 1976, the FASB encouraged and paid for research on the subject of economic consequences of accounting standards, especially in relation to securities markets and managerial attitudes. The results of the research, however, did not proceed to the stage of affecting the standards setting
process through measures taken as a result of analysis of economic consequences. This has been the case, despite the fact that the FASB-sponsored research has identified some economic effects resulting from accounting regulation.

2.3.3 Accounting Standard - Setting Models for Developing Countries

Available empirical evidence indicates that the financial information disclosed in business reports falls considerably short in both quantity and quality of that needed for development planning in such countries.

The main reason for this is the fact that financial reporting is generally at a low level of development in most developing countries. As a result, financial information disclosed has little relevance to investment decisions. Investors question the reliability of disclosed financial information and in many cases do not regard it as an effective factor in the economic decision making process.

For historic and economic reasons accounting in developing countries is not yet sufficiently established or mature to provide relevant, timely, and reliable financial information that can satisfy users' needs. In other words, accounting information produced in developing countries lacks most of the required qualitative characteristics of accounting information, compared with that disclosed in developed countries. The status of the profession is described by many analysts as being embryonic, and therefore, to a great extent it is subject to the influence of developed countries' better established accounting systems.
Whereas in developed countries, accounting has evolved slowly, regulated by the profession itself, the urgent need for economic and cultural development is motivating legislators in developing countries to intervene to regulate accounting profession. Thus the accounting profession will have a legislative advantage in standard-setting and provision for enforcement.

In this situation, developing countries need an orderly and carefully considered approach for accounting development, to enable the national accounting system to realise its full potential contribution to economic development. From what has been said here, one can assume that in the prevailing environment of developing countries, the authoritative body for legislation and enforcement of accounting standards seems to be appropriate.

In view of this, it may seem desirable on a priori grounds to recommend the establishment of an authoritative body commissioned to set accounting standard. Such a body should be state-oriented in terms of formation and regulation, empowered with full authority to function efficiently, and independently in terms of standard-setting.

This body may act as a centre of a standard-setting process in which all parties concerned can participate in the sub-committees formed by the body. Such participation will undoubtedly assure this body of full compliance and co-operation from accounting firms and individual accountants. Its status as a governmental agency would also give the body adequate power to issue guidelines and enforce accounting standards.
However, being a governmental agency does not in any way mean that it can function alone. The input of the accounting profession derived from active participation, is vital. Furthermore, co-operative participation of the private sector in the continuous process of follow-up and review is also to be desired.

The less than satisfactory status of financial reporting in developing countries can be attributed to the fact that accounting is greatly influenced by the social, political and economic forces which characterize the environment in which it functions. Figure (2.2) shows the main elements which make up the financial reporting environment and their relationships. It is clear that the changing social, political and economic conditions influence both the groups in financial reporting as well as the accounting theories. Given the demand for particular kinds of disclosure by those interested groups, it follows that the changing environmental conditions indirectly affect parties who determine disclosure whether financial report preparers or policy-makers. There is also an indirect effect on accounting theories through the demand for specific theories. There is also a feedback from accounting theories to the changing social, political and economic conditions. Figure (2.2) also shows that there are two groups responsible for the amount and level of disclosure. Financial report preparers represented by the management who has the primary responsibility for financial reporting. In the absence of regulation, they prepare reports in response to market circumstances, and in accordance with the rules, regulations and principles which have developed over time. The other group is represented by policy-makers. They act as regulators by imposing disclosure requirements on preparers.
Governments impose legal requirements, while stock exchanges relate trading to minimum disclosures. Professional bodies also stipulate requirements in the form of accounting standards.

Accounting for environmental factors means that the choice of an accounting standard can be influenced by a series of factors, some of them of an environmental nature, e.g. current accounting practice, the economic environment and international regulation.\(^{69}\) Another five sources of influence relate to interest groups which can benefit by affecting the standards setters' decision-making. No individual source of influence can be assumed to be entirely independent, nor can the different circles of influencing bodies and/or individuals be taken as completely free from interdependence or some kind of overlapping.

**Current Accounting Practice:**

The current practice clearly imposes a measure of influence on accounting regulation. It probably forms the basis for the initiation of any standard setting process to be taken up by the relevant committee. This tendency is open to criticism, however, since sometimes the new standards turn out to be mere codification of dominant accounting practices. This could hamper the development of accounting rules. The tendency seems to suppress innovation in standard-setting, and stress rigidity in the face of change.

**Economic Factors:**

The measurement and reporting of economic events and changing elements are functions to be achieved by accounting
statements. Such a connection between the economy and accounting necessarily means that changes in the business world and the economic factors to result in corresponding changes taking place in the structure of accounting reports, as well as in their substance. If certain economic effects are foreseen to ensue from the application of a given accounting standard, then management, government and other interested groups will direct their lobbying process and manoeuvring behaviour in such a way as to serve their interests.

**International Regulation:**

Global practice can equally influence the process of standard setting. The source of influence in this case is the international body of various accounting systems, regulations and practical experience.

**Auditors:**

Due to their important role in the regulation process, auditors who may also be members of professional institutes are likely to stimulate managerial acceptance of a certain accounting standard. Disagreement with management on some standards may lead them to qualify their audit report. To assess the level of influence exercised by auditors on accounting standards, it is crucial to look into the nature of the relationship between such auditors and the corporate body. By rendering advice to management, auditors may pass on their views on policy issues which affect the accounting process. The auditors' interests may be in line with those of the managers, despite the fact that the former are supposed to be acting for and on behalf of their
appointees, i.e. the shareholders. For example, both managers and auditors may share an interest in not complying with an increased disclosure policy, the former because of reluctance to reveal sensitive information, the latter because the extra work involved increases the risk of auditing error, with the penalties this may incur.

**Company Management:**

It is part of the legal responsibility of managers to produce accounting statements. Since the information contained in such statements may have particular repercussions, managers find it in their interest to influence the substance of standards which committees are to prepare. This may take place where, for example, management judge that competitive decisions by other concerns may be affected if a certain piece of information is disclosed. Another example is where the application of a certain policy will affect the shareholders' assessment of the feasibility and profitability of their investments. In both of these cases, the management conviction will tend to secure the application of such accounting standards as to prevent the occurrence of the undesirable results.

The greater the level of disclosure, the greater insight is likely to be obtained into the management's methods of working. It is not unexpected, therefore, that management would tend to minimise the level of disclosure, in order to allow more room for their discretionary power in running the business. Because they exercise control over the process of producing statements, managers are expected to exercise some influence on the
regulation process, in order to secure favourable accounting standards.

**Users Of Accounts:**

Various types of interest in the accounting information are exercised by different bodies and individuals who use such information. These include creditors, shareholders, employees, etc. It is an expressed view of standard setting bodies that the recipients of accounting information shall be assisted in their decision-making process through the production of appropriate accounting statements. It is likely, therefore, that the users of accounting information may constitute the most important source of influence.

**Academics:**

Scholars and other participants in the academic field of accounting influence the standard setting process. This may take place as a result of theory formulation or the conduct of empirical research both of which form sources of information in the process of standard-setting. Furthermore, academic research has recently placed increased emphasis on inquiries into the process of choice in the setting of accounting standards. This brings academics into a more influential role than the traditional provision of information to help standard setters make their decisions.
2.4 A Decision-Usefulness Framework for Accounting Standards-Setting in Kuwait

The structure of the Kuwait economy represents a challenge to development economics in that the economy of Kuwait does not fit in easily to any of the traditional broad classifications of either "developed" or "underdeveloped". The rapidity of change during the oil boom era has contributed to the blurring of this distinction. Kuwait's economy combines extreme features of both classifications.

On the one hand, the economy is characterized by rising capital surplus. Until recently, no country in the world has proceeded with development with such a speed as in Kuwait, with the rate of growth averaging approximately 7.7%, with one of the highest per capital income, one of the highest savings ratio, and a consistently favourable balance of payments position. All these are indicators of a developed economy. On the other hand, there are striking features of under development. These include the inadequate indigenous supply of technical manpower and labour, the total reliance on imports of capital and consumer goods, and the over-dependence of the economy on a single resource; namely oil. The country is also characterized by a narrow market which is due to the numerical size of the population and the sophisticated tastes of Kuwaitis brought about by affluence.

The dual nature of Kuwait's economy makes a selection of an appropriate theoretical framework, whether such theory is to deal with the economy at large or with some aspect of the economic environment and other related matters. Such framework should have the overriding property of being flexible.
and lends itself to a pragmatic approach seeking a desirable and logical menu encompassing elements from various theoretical approach. The decision usefulness approach appears to satisfy this requirement relative to other approaches, as it links the financial information to be reported to the decisions and its usefulness to such decisions allowing for the duality of the economy. The information may or may not be economic in nature, and where two perspectives may be distinguished. The decision-models perspective emphasizes the information needs of such models, whilst the other decision-makers perspectives focuses on the information needs of decision-makers.

The decision-usefulness approach calls into question the validity of traditional accounting practices. It involves both a priori and empirical research. In the former the main task centres on developing the objectives of accounting and upon which financial reporting is determined. As to the latter, positive models attempting to provide a true representing of reality without sacrificing manageability. Obviously, the empirical model may be used - in fact is almost always used - to verify and test a priori reasoning at the individual and agree at level. One of the main advantages of normative decision models, whose information requirement represent the main emphasis of a priori research, is that they may provide a standard of reference for the evaluation of actual decision models. However, a priori research has faced serious criticisms. The neglect of groups other than investors is certainly a drawback despite attempts to analyze the information needs of other groups. But the main criticism relates to the piecemeal nature of this approach for while it may be addressed to particular decision or decision makers or
accounting issues, still it is unlikely to provide comprehensive answers to a variety of accounting problems. To remedy this deficiency, theoretical frameworks have been created by accounting policy makers, significant among them is the FASB conceptual framework.

This FASB have designed the most ambitious program to develop a constitution, coherent system of interrelated objectives and fundamentals that can lead to consistent standards that prescribe the nature, function and limits of financial accounting and financial statements. The ultimate aim of this approach is to enhance the credibility of accounting information by replacing the ad hoc nature of the conventional approach of accounting by a body of standards which are more internally self-consistent. This approach consists of the following components:

1. A statement of the objectives of financial reporting.
2. A specification of the characteristics that financial information must posses to qualify for inclusion in a financial report. These characteristics provide criteria for choosing among alternative accounting methods.
3. A set of definitions of the elements of financial statements.
4. A specification of the criteria for deciding when to recognize the various elements of financial statements.
5. A set of measurement rules.
6. A set of guidelines for the presentation and disclosure of the elements and other information that is useful in fulfilling the objectives of financial reporting.
Figure (2.3) illustrates the FASB conceptual framework for financial reporting.

The FASB framework offers several benefits. With a framework, the standard setter is in a position to evaluate the usefulness of alternative approaches, resulting in a body of standards having the desirable property of consistency. Additionally, it has the effect of reducing personal biases and political pressures. Against these benefits, some argue that the FASB framework takes a social perspective and their generality is conditional on the presence of the elements of such approach. For this reason and in order to avoid any such biases, a priori reasoning should be subjected to empirical testing which assist policy-makers in their policy choices. Referring to the model building approach outlined previously, there are three purposes or types of empirical research, which are not mutually exclusive. Applied to accounting, there is the economic consequences research which examines the potential and actual effects of accounting alternatives. There is also, the predictive properties of reported accounting numbers, which considers whether accounting numbers have the desirable properties of predicting the future performance of companies. Finally, there is the behavioral - as compared with the economic consequences or the predictive properties - which examines the behaviour of individual decision makers. This normally relies on survey data collected by such questionnaires as may be appropriate to help explain and predict human behavior. It is in the combined a priori and empirical format that the decision-usefulness conceptual framework is adopted and adapted to Kuwait. Field survey is chosen relying on
questionnaires for the collection and analysis of data concerning behavior.

2.5 Conclusion:

As far as a market economy is concerned it is possible to point out one particular weakness in the arguments of the critics of uniformity. This is equating uniformity with rigidity, which is not the case so long as there cannot be total similarity between any two firms. Resulting from this very weakness, those critics also equate flexibility with diversity, almost using the terms synonymously. A flexible approach is one which takes into consideration those areas of real life which call for specific handling. It by no means resembles the current practice of diversity, which is simply extreme laxity in choosing accounting methods. Diversity can no more be equated with flexibility than uniformity with rigidity.

A further weakness in the case of the critics of uniformity lies in their advocation of diversity on the basis of a very shaky assumption. They think that an optimality of behaviour is maintained by management, even as regards dealings involving other parties, when they select an accounting method. This is an implied assumption of altruism on the part of management, which is certainly not the case on all occasions. Diversity is rather based, on most occasions, on a pursuit of a dysfunctional attitude by the management of the corporation.

Due to the high costs of processing new accounting data or, in some cases, the impossibility of doing so in almost all segments of the environment, it would be inappropriate to encourage
diversity, because so doing would prevent such segments from enjoying the practical benefits of accounting data. There remains the question of responsibility for accounting standards-setting.

It is very important to stipulate in clear terms who is to be responsible for the formulation, application and monitoring of accounting standards. Various types of responsibility should equally be defined. This is in order to meet the demands of the important role played by accounting standards in the field of corporate financial reporting.

The production of disclosed accounting information, as well as its quality, is the legal responsibility of management. Should the management also be responsible for the laying down of rules governing the measurement and reporting of accounting information, then a conflict of interest will be inevitable. The protection of public interest is also a duty of the government. Although it is possible to back this protection by legal sanctions, it would be undesirable to codify accounting standards and thereby introduce rigidity into a system which is expected to be continuously developing.

Although the duty of the accountant is to apply accounting standards, it is not inconceivable that he may also be entrusted with the duty to formulate such standards. This kind of practice has created many problems through history, and the accountancy profession is to be held responsible for any negative development that may arise in consequence of this approach.

The effect of the accounting profession with regard to accounting standards ends with their formulation, and does not
extend to the power to enforce these on the management of companies. However, individual member accountants who breach the professional code of practice will suffer certain sanctions imposed by the profession. No sanctioned enforcement of standards can be imposed other than by government.

There is an assumption that to bestow on the private sector the duty to formulate accounting standards would serve public interest. This assumption is a basic concept behind what may be called the private sector approach. One of the arguments put forward by the advocates of this approach is the multifarious composition of the private sector, as regards both the direct participants and financing parties. The diversity of interests involved is seen as a supporting attribute.

Those who are against the private sector approach\(^{(71)}\) argue along the following lines:

(i) There is no enforcing power to back the role of the private sector.

(ii) Corporations and public accounting firms exercise some influence on the private sector of which they are part. Consequently, it is not possible for the private sector, under such dependency, to respond to the public interest.

(iii) Where the private sector demonstrates response, it does so very slowly, although the issues generating such response may be of crucial importance.

It has been contended that private sector standard setting is affected by two problems\(^{(72)}\). One of these is the difficulty of
establishing the source of binding rules which govern various people, both inside and outside the private sector. The other problem relates to the intention to reach consensus, which would strengthen the authority of the standard-setting body, and hence its power to issue binding rules.

(i) **Standards Setters Authority**: The power of standard setters to enforce rules depends on the nature of the authority which they enjoy, which differs from one country or region to another. It can be said that the mandate given to standard setters in Continental Europe is quite negligible while their Canadian and Australian counterparts enjoy considerable authority.

(ii) **Consensus Seeking**: The political atmosphere in which standard setters happen to operate is likely to arouse controversy whenever divergent opinions exist. Consensus is sought by standard setters in order to avoid this condition, which they perceive as threatening. Voluntary acceptance of standards by accounting practitioners has been intensely worked for by private sector agencies. The co-operation which follows consensus by influential bodies would serve to preserve the survival of the standard setting body.

Much controversy has surrounded regulation by the public sector of any activity. However, such regulation has become quite legitimate.\(^{(73)}\)
Some given general principles have been regarded as criteria against which to test the effectiveness of regulation. The following are endorsed by Elliot and Schuetze:

(i) Regulation should not conflict with the general law or constitutional rights.

(ii) No foreseeable social damage should be made likely by regulation.

(iii) Regulation should be in harmony with public interest.

(iv) So long as the purpose of regulation can be achieved by the private sector, then the public sector must not be assigned that task.

(v) It should not be the responsibility of the party assigned with regulation to ensure the implementation of such regulation.

(vi) Regulation should not oust the task of the law by being designed for the purpose of preventing legal infringements\(^{74}\).

The following arguments are offered in support of regulation by the public sector:

(i) Public interest is better served when regulation is effected by the public sector. This occurs through the avoidance of preparer bias and by offsetting the economic limitations of investors seeking adequate information.
(ii) Greater legitimacy and enforceability are enjoyed by the public sector, as opposed to the private sector. This is because it is openly supported by statute.

(iii) The objectives of the private sector may sometimes conflict with public interest, a circumstance which necessitates monitoring and control. This has been held to legitimise relevant intervention by government.

However, those who oppose regulation by the public sector argue as follows:

(I) Regulation by government imposes costly burdens on corporate bodies.

(ii) The officials are biased towards increasing the revenue of the bureaucratic structure.

(iii) Government regulation would mean the politicisation of the standard setting process, thereby giving the chance to special interest groupings to gain lobbying power within the government system. However, some believe that pressure groups can play an important role in checking and scrutinising the systems.

(iv) To standardise accounting measurement, it is not necessary to enforce regulation using governmental capacity, which by definition includes policing and other powers. It is also believed that such an approach would hamper free research and experimentation in the field of accounting policy.
Governments' reluctance to allow the securities industries to be self-regulated have resulted in the creation of government agencies to do that job. The courts often define the mandate of such agencies, while the legislative body gives it the necessary support. The previous argument in favour of regulation through the legislature is therefore also relevant here. Accounting regulation is only a part of the responsibility of a governmental agency such as the Security Exchange Commission (SEC). This enables the agency to take a much wider perspective than if it were to confine itself to standard-setting alone. Qualified professionals are employed, and thus technical expertise is guaranteed.

These agencies are preferred to legislative bodies, since not only can they promulgate the necessary rules, but also they are backed by essential technical knowledge. Where an overall legislative change is needed to reform accounting reports through the legislature, much cost is entailed in terms of government subsidies and taxation procedures. In contrast, regulation through agencies is far less costly and more efficient. More independence is demonstrated by a governmental agency than by a self-regulatory one, since the latter is largely a representation of the entities to be regulated. It is also in a position to be more accountable to the public than private agencies.

The system of agency regulation is, however, open to some criticisms. A greater part of the activities carried out by a regulatory agency may be seen as based on wide discretionary powers exercised by the working staff. This may result from
lack of statutory details, which is largely inevitable, since legislation cannot lay down in full, all the principles necessary for the agency's operation. According to Benston, the SEC in the USA has often served its own best interest in the accounting field.\(^{77}\)
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Part Two: Accounting in Kuwait

Chapter Three : Accounting Regulation in Kuwait
Chapter Four : Accounting Practices of Kuwaiti Business Entities
Chapter Five : Deficiencies in Kuwaiti Accounting

Having in the previous part outlined the nature and scope of this study, and explored some relevant concepts, we are now in a position to begin our survey of the present situation of Kuwaiti Accounting. This part, represents the side of the Kuwaiti study, is divided into three chapters. Chapter three explains the sources and nature of regulation currently applicable to Kuwaiti Accounting, while chapter four discusses the accounting practices of Kuwaiti Firms. On the basis of these chapters, chapter five draws attention to the defects which the researcher believes exist in the present system. The three chapters of this part thus serve as an introduction and complement to the empirical research presented in part three.
CHAPTER THREE

Accounting Regulation in Kuwait

3.1 Introduction:

In Chapter Two, an attempt was made to characterize the conceptual framework which forms the foundation of the theoretical underpinning of this study. Reference was also made to the model-building approach as the vehicle through which and according to which the theoretical hypothesis to be entertained is subjected to rigorous empirical analysis. Such analysis ascertains the validity or otherwise of the a priori reasoning - appropriately theorized - and once verified and accepted it is carried forward to its ultimate uses.

The conceptual framework sought appropriate in the case of Kuwait begins with the recognition that accounting is greatly influenced by the social, political and economic forces which characterize the environment in which it functions. In fact such factors help explain the less than satisfactory status of financial reporting in developing countries. Groups interested in financial reports such as shareholders, creditors, financial analysts, management, auditors, employees, government ... etc. are all influenced by changing environmental conditions, which also affect accounting theories. Given such environmental constraints the specific theoretical approach chosen for Kuwait focuses on the decision-usefulness reasoning for financial reporting and accounting standard-setting in Kuwait. This means that one expects the status of accounting practice to reflect the environment in its intrinsic and changeable features. This
necessitates a review to cover accounting practices in Kuwait. The purpose is to collate information on accounting regulation in Kuwait as a prelude to drawing inferences as to the suitability, and efficiency of such system. In the context of the model-building approach this task represents a step towards the completion of the specification stage. To evaluate the deficiencies of the prevailing regulations, the criterion used for such evaluation is based on how useful such system to decision-makers which emphasizes the decision-usefulness approach. This dual task represent the subject matter of this chapter and the next two chapters.

The promulgation of financial accounting standards is essential if the accounting profession is to develop and cope with the immense boom in the business field. Such standards enable the measuring of the effect of activities on the enterprise and the results thereof. These will then be communicated to the users of the accounts.

The national economy as a whole will certainly be negatively affected by the absence of proper standards of financial accounting. Comparison, for example will be impeded, as a result of different measurement bases. Consequently, it will be difficult to decide upon various investment or business alternatives. Inappropriate accounting measurement devices may be used as a result of the inadequacy of existing ones.

The general trend in the Kuwaiti national economy has recently been towards the establishment of shareholding companies. People are increasingly investing in such companies and accounting standards has thus become increasingly necessary.
This is especially so since ownership is being separated from management in these enterprises. Communication of reliable information to the shareholders is therefore an essential prerequisite for their decision-making, both as regards existing or new investments and the supervision of the activities of management boards. Future investors, as distinct from existing owners of shares, will be equally concerned about the establishment of accounting standards. Existing and potential creditors are also affected. The responsibility for the provision of adequate information for the benefit of all these users lies on the management and legal accountants, who in turn are in need of proper standards to enable them to deliver the goods.

No appropriate body of accounting standards has as yet been made available for Kuwaiti accounting practitioners. This has made it almost impossible for the Kuwaiti accountants to discharge their duties in the proper manner. Thus, a variety of approaches have been adopted to similar situations, and where opinions differ, there is little guidance to resolve the confusion.

Although Kuwait is in great need of uniform accounting principles, these are not yet defined, nor is there the capacity to do so. The development of Kuwaiti accounting experience in this regard will now be discussed in this chapter.

3.2 Historical and Environmental Outlook:

Kuwait comprises some 16,000 square kilometres, accommodating 1.7m people, 60% of whom are Non-Kuwaitis according to the 1985 census. It is located at the north western side of the Arabian Gulf, south and south east of Iraq, and north
and north east of Saudi Arabia. Traditionally, the local economy was based on fishing, and on trade with the Indian sub-continent, East Africa and other countries accessible by sea.

The Al-Sabah family who rule Kuwait on an hereditary basis, originally migrated from Najd in the northern part of the Arabian peninsula. The British protection of Kuwait since 1899 was ended in 1961. The 50-member elected National Assembly was suspended in 1986. The government consists of a council of ministers assisting the Prime Minister, the head of government. Islam forms the foundation of the constitutional, legal, economic and social life in the country.

3.2.1 The Discovery of Oil:

In 1938, oil was discovered in commercial quantities and from 1946, exportation of oil opened up a new phase in Kuwaiti's economic history. Kuwait became a founder member of the Oil Producing and Exporting Countries (OPEC). The booming oil industry since the 1940's enabled Kuwait to prosper and it attracted migration of skilled, professional and other labour elements from the countries in the region\(^1\). Huge government spending took place, especially in the field of construction for residential and public usage.

In terms of crude oil reserves, Kuwait ranks second among OPEC member countries, with 67 bn barrels. Kuwait now enjoys some of the highest growth rates in the world, but the country is still a developing economy, with the remarkable dominance of oil over other sectors.
A landmark in the story of Kuwait was the establishment in 1931, of the Kuwait Oil Company (KOC), by two foreign oil concessionaires (BP& GULF) in 1931. Oil exportation actually started only after the Second World War, in 1946, with the UK being the first market. The Kuwaiti government assumed control over the production of oil in 1976. Since 1980, production has been under the agency of Kuwait Petroleum Corporation (KPC). Four years later, the entire hydrocarbons sector was extended to KPC. This was followed in 1983 by the discovery of Burgan oil field which is the largest field ever discovered in Kuwait.

The government increased KPC's capital from KD 1 bn at its inception to KD 2.5 bn, and a law was enacted which had the effect of placing the Corporation at the heart of the Kuwait oil sector structure, both in terms of diverse activities and power, which were previously handled by separate government agencies.

The government's Five Year Plan announced in fiscal year 1985/86 comprised the broad development objectives of raising productivity to generate savings; drawing a balance between nationals and expatriates, and developing the labour force in general. Other guidelines in the plan included the direction of oil revenue to achieve industrial diversification, overseas investment, Arab economic development, domestic long-term saving and the establishment of a strong social service in Kuwait. Investment accounted for KD 7.5 bn of the plan resources, 84% of which were to go to the public sector, with a special emphasis on housing -an area which, together with many other socio-economic utilities, receives handsome government subsidy. The
subsidisation policy is, however, being slowed down due to present declining oil income.

3.2.2 Foreign Investment:

Although foreign investment is favoured by the Kuwaiti government, the law allows it to exist only through national participation or sponsorship. Joint ventures and locally sponsored branches are the most common instruments of foreign investment in Kuwait. Registration with the Ministry of Commerce and Industry is required in the case of branch offices. The government provides incentives in the form of concessions to attract investments in approved industries. Such concessions relate to taxes, credit through the Industrial Bank of Kuwait, customs duties, etc.

The development areas in Kuwait do not absorb its oil revenues. The surplus therefore goes towards investment abroad. The government must, by law, contribute 10% of oil revenues to the Revenue Fund for Future Generations (RFFG), which is considered a long-term investment to provide for the country when oil reserves are depleted.

Kuwait Investment Office, the nation's RFFG, and the state-owned KPC have penetrated the fabric of western basic industry. Perhaps Kuwait's most spectacular investment to date is the holding of 9.9% of British Petroleum (the world's third-largest oil company)\(^2\). In 1981, Kuwait invested $2.5 bn to acquire a huge oil company in California, USA, namely Santa Fe International Corporation. The following year Kuwait acquired almost a quarter of the Holchst petrochemical enterprise of
West Germany. In 1983 it purchased Gulf Oil in Europe, comprising oil refineries in Denmark and the Netherlands, together with a network of 1,500 service stations. This was followed in 1985 with the acquisition of a further 1,400 petrol stations, 75% of an oil refinery in Milan and three aviation centres based in Italy. Kuwait also owns one fifth of the West German mining concern, Metallgesellschaft, 14% of Daimler-Benz car manufacturer and has remarkable share holdings in a number of UK insurance companies and banks. Kuwaiti capital has also penetrated equity markets in the US, UK and Europe, the dealings often made through US banks, resulting in a significant presence of Kuwaiti capital in the giant industrials of the West.

3.2.3 Trade Policy:

Kuwaiti trade restrictions are minimal and may almost all be attributed to the Islamic orientation of the country. Apart from prohibited drugs, foods and other items the traditional openness of the Kuwaiti economy characterises its trade.

3.2.4 International Links:

As an Arab, Muslim country which produces oil, Kuwait is a member of the Organisation of Islamic Conference, the Arab League, OPEC, the Organisation of Arab Petroleum Exporting Countries, the United Nations, and the Gulf Co-operative Council (GCC). It is also affiliated to the World Bank, the International Monetary Fund, the Arab Monetary Fund and the Islamic Development Fund. For almost a quarter of a century, Kuwait has provided credit for Third World countries. By 1984, this
amounted to a sum of $4.23 bn, spread over 279 transactions and sixty countries, half of the total going to non-Arab countries. The agency through which this was extended was the Kuwaiti Fund for Arab Economic Development (KFAED), set up in 1962.

### 3.3 Development of Accounting in Kuwait:

#### 3.3.1 Accounting Before the Discovery of Oil:

No corporate trade existed in Kuwait prior to the discovery of oil. Fishing, pearling and other activities prevailing at the time were conducted either by individuals or in co-operative groups. Because of mutual confidence within the trading community, no written agreements were used, let alone accounting books or financial statements of any form. A simple recording practice existed, however, whereby each individual commodity was recorded with its cost and sales price. This was called "Alsawafi".

#### 3.3.2 Accounting after the Discovery of Oil:

Oil was discovered in Kuwait in 1938 and since the mid-1940's has been exported. The ensuing capital generation, rapidly increasing investment and economic growth, necessitated the establishment and development of an accounting profession. The presence of expatriate practitioners with varying accounting backgrounds presented an additional challenge in this regard.

Private investment has been boosted by the existence of development activities and public expenditure in general and provided an ample market for contracting to implement public projects. This is another factor which accelerated the demand for accounting in oil-rich Kuwait.
According to Malallah, the year 1946 witnessed the establishment of the first accounting firm in Kuwait\(^{[3]}\), with British companies introducing the first auditors in the country, as they did in Iraq, Palestine and Egypt.\(^{[4]}\)

Concentrated ownership during the earlier stages of Kuwaiti development debarred the swift introduction of public accounting in Kuwait. The absence of high income taxes, coupled with the simple business structure, provided insufficient incentive for the development of accounting.

Following the flow of oil income specialised companies started to appear in order to meet demands for banking, shipping, travelling and other services. The foreign banking sector was obviously less risky than a fresh local start in the field and consequently, the Ottoman Bank (the British Bank for the Middle East) was established in the early 1940's. In order to meet the accounting requirements of these new companies, experts had to be brought from overseas accounting firms. A Kuwaiti money market had its roots after the establishment in September 1952 of the first Kuwaiti-owned and Kuwaiti-run banking company, the Kuwait National Bank, with a capital of 13,000,000 Indian Rupees (IR), shares in which were offered to the public. Two years later, the National Kuwaiti Cinema Company was set up, with capital of IR 8,762,400. This was followed in 1957 by the establishment of the Kuwaiti Oil Tankers company, with capital of IR 76,684,000 and a 53% government stake.

Soon after this mushrooming of corporate activity, the Kuwaiti government decided to handle the regulation of shareholding
companies and the emerging stock market\(^{(5)}\). The implementation of the decision started with the passing of the Commercial Companies Act (CCA) No.15/1960 which applied to both simple partnerships and corporate entities.

During the seven years that followed the promulgation of the 1960 Act, no less than 13 companies with a total capital of KD 35.8 m were formed. Their shares were made available for public subscription.

### 3.3.3 Promulgation of the Commercial Regulations:

Before 1960, according to Al-Mosawi, Indian Commercial laws were resorted to in Kuwait as far as accounting matters were concerned.\(^{(6)}\) The first Kuwaiti legal provisions relating to accounting are found in the CCA of 1960 (Articles 161-163). This was followed by two consecutive legislations; Law No.2/1961 and Law No.6/1962, which have now been replaced by Laws Nos.68/1980 and 5/1981 respectively\(^{(7)}\). The first attempt to regulate the auditing of companies in Kuwait was made through the 1962 legislation, since the 1961 law dealt merely with the organisation of commerce in general.

The relevant laws did not define what they referred to as "accounting principles". Section 15 of the 1962 legislation for example, directed auditors to audit "... the accounts of companies, individuals and institutions in the light of generally accepted accounting principles", but with no guidelines as to how "generally accepted accounting principles" could be ascertained. Section 16 rendered the auditor responsible for
violation of "acceptable principles of his profession", but again
gave no helpful definition whatsoever.

3.3.3.1 Commercial Companies Act (Law No.15 of 1960):

The relevant provisions of this pioneering legislation may be very
briefly outlined as follows: The general assembly of the company
is required to nominate a registered accountant to act as auditor
who shall be authorised to inspect the books of the corporation
and be given any further information which in his opinion is
necessary to enable him carry out his duty. Certain areas are
specifically required to be covered by the Auditor's report. The
Law requires the report to reveal whether or not;

- the auditor has been given access to all necessary
  information and explanations;
- a true and fair view of the entity's financial performance is
  reflected and the relevant companies laws complied with;
- proper books are maintained by the company;
- the accepted practices were followed to conduct an
  inventory of the assets;
- the Board of Directors report is in harmony with the
  company's books;
- the articles and memorandum of association of the company
  and the relevant commercial company law are observed by
  the company, both as regards its financial position and
  commercial activities.

The correctness of the information included in the report must
be ascertained by the auditor. A company is required to set aside
from its gross profits, an annual basis, a reserve sufficient to
compensate for the depreciation of assets. How much is needed is to be decided by the director, or specified in the articles of association of the company. A minimum of 10% out of net profits is further required (Article 167) to be set aside as a statutory reserve.

Law No.15/1960 includes, in Schedule (C) thereto, a detailed layout for the company's balance sheet and profit and loss account, together with brief prescription of some of the accounting practices which must be followed.

3.3.3.2 Commercial Law:

The commercial Law (No.2/1961), as mentioned before, has been replaced by Law No.68/1980. The law provides that every company shall maintain proper accounting books suitable to the type of business conducted by the enterprise (Articles 26-33). A minimum requirement of every company is to keep a daily journal and an inventory book. The first is to include a record of all financial operations and expenditure on a daily basis, the second to include details of the stock at the end of the year, together with a copy of the annual balance sheet if not recorded elsewhere. Both books are required to be pre-numbered and stamped by the Ministry of Justice, to which they must be presented within two months of the end of the accounting period. Such detailed requirements impeded any move towards the introduction of advanced accounting systems or technology. This also delayed the process of communication.

The law seems to lay more emphasis on form than substance in terms of accounting principles and guidelines. The individual
accountant has thus been left on his own to fill this substantial gap, relying on his own background and experience. The resulting diversity impedes the reliability of the accounts and statements.

3.3.3.3 The Practice of Auditing of Accounts Law:

Law No. 6/1962 has been replaced by Law No. 5/1981, and it deals with the licensing of professional accountants by the Ministry of Commerce and Industry (MCI). Intending auditing practitioners are required by this law to have their names entered in the Register of Auditors with the said Ministry.

(A) Auditing Qualifications:

Any Kuwaiti citizen not less than 25 years of age, of good character, who has attained a university degree in accounting followed by five years experience and has passed the MCI-organised professional examination, may be eligible to be registered as an accounts auditor. However, seven years of experience are required where the auditor intends to audit in the fields of banking, insurance companies and financial institutions.

Non-Kuwaitis could, under the 1962 law, apply for a five year licence which might be renewed upon its expiry. This has not been the case since January 1986, according to Law No. 5/1981 which limited the right to Kuwaitis.

(B) Rights and Duties of the Auditor:

A registered auditor has the right to audit the accounts of individual businesses, companies and institutions. He/she is
required to keep a file for every entity he audits, wherein all the relevant documents must be kept. The auditor is not eligible to be appointed chairman of the board of directors, a delegate member therein, a director, or an employee, nor can he be a shareholder in the same company. He can neither be a partner in a firm where he audits the accounts, a partner's partner or employee, a delegate member in the firm's board or an employee therein. A relative of the person responsible for the management or the accounts of the firm -up to the fourth degree of relationship- is not eligible to be appointed as auditor for that firm. The auditor is debarred from taking any appointment which is not compatible with his duties as auditor and in particular he may not carry on non-accounting consultancy, promotion of companies, preparation of final accounting reports and balance sheets. The auditor is also prohibited from commercial advertising of his services.

(C) Sanctions:

The breach by an auditor of the 1962 law or the principles of the profession, gross negligence, or the commission of a non-ethical or dishonourable act, will entail disciplinary penalties and measures ranging from mere warning or reprimanding and suspension for up to three years, to removal of the defaulting auditor's name from the Register, thereby denying him the right to practice.
3.4 The Recent Position:

3.4.1 The First Permanent Technical Committee (PTC):

On 28.6.1981 a PTC for the setting of accounting standards was constituted by Ministerial resolution No.57/1981. It was intended by the Ministry that committee would exist for a period of three years. The five-man committee included three members from the Ministry of Commerce and Industry, a member of the Kuwaiti Accounting and Auditing Society and a university lecturer. The resolution outlined the objectives of the committee, which included the following:

- Laying down of a professional code of practice for auditors;
- The establishment of mandatory accounting standards;
- The specification of the minimum information to be disclosed in financial statements;
- Conducting regular review of the accounting standards; and
- The carrying out of studies and research for the purpose of developing the accounting profession.

The resolution allowed for the committee to consult with other experts for the proper conduct of its duties. The findings and results of the committee's work were to be delivered to the Ministry in the form of recommendations.

Between July 1981 and May 1984, the PTC held a series of meetings which were mostly focused on procedural matters, but throughout its period of activity, not a single accounting standard was promulgated. A major reason for this failure could possibly be the crisis in the Souk Al-Manakh (the unofficial stock market), which occurred in the middle of the committee
period, resulting in the involvement of its members in the government attempts to tackle the problem. That this was so evident from a ministerial statement summarising the activities of the committee which was issued upon the constitution of the Second PTC. Most of the tasks enumerated were directly related to the stock exchange crisis. Other reasons include the negative attitude of government bureaucracy and the fact that none of the committee members were working for it full-time.

3.4.2 The Second PTC:

The second committee was set up on 8.3.1986, two years after the expiry of the first. Membership was increased to seven with a deputy minister as Chairman, three members from the accounting department of Kuwait University, two MCI officials and one official from the Kuwaiti stock exchange. The same original objectives of the first committee applied to the second one, which held its first meeting on 16.4.1986. Soon thereafter it issued three broad accounting guidelines to be applied by companies as from 31.12.1986. These covered the areas of financial statements, investment accounting and property accounting. The following is an exposition of the accounting standards included in the three guides.

3.4.2- (1) The Financial Statements:

This guide aims to specify all the information which must be disclosed in the financial statements, comprising the balance sheet, the profit and loss account and the retained earnings. It does not suggest a specific manner of presentation. A number of forms and classifications of financial information are included
and ranked according to the relative importance of every item and its effect on the financial information of most industrial, commercial and financial companies.

The guide starts by pointing out the necessity to disclose the material information needed to explain the financial statements; the disclosure of the name of the company, the city, the date of the accounting report and the period covered, with a summary of the nature of the activities carried on by the company and the currency used; the summing up of amounts and classification of items so far as it is necessary, with important items separately disclosed, the disclosure of material statements numerically and comparing them with the previous accounting period.

The guide then mentions the items to be disclosed in the report. The assets are to be divided into long term and current assets, the latter to include cash, current investments, debit and stock. Long term assets should be divided into the following: fixed assets (including land, buildings, machinery, equipment, accumulated depreciation and other classifications); non-fixed long-term assets which include long term investments in subsidiaries, associates and other investments; long term debit, goodwill, patents, trademarks and prepaid expenses. Liabilities are to be divided into current liabilities, long term liabilities and other liabilities. The current liabilities should disclose bank loans, the current part of long term loans, creditors, income taxes (if any), profit distribution and accrued expenses. The long term liabilities should include secured loans, unsecured loans, loans from subsidiaries and associates. "Other" liabilities should include important items relating to provisions and claims, for
examples, pension provision and due taxes (if any). The guide then mentions the items which must be disclosed in shareholders equity. These are to be divided into two: capital (including the number and values of authorised and issued shares, unpaid capital and the nominal value of shares); other rights, namely issuing premium, surplus resulting from revaluation, provisions and retained earnings.

The next item covered by the guide is the disclosure of information relating to the profit and loss account. This includes sales, depreciation, provisions, administrative and general costs, credit interest, investment returns, debit interests, income taxes (if any), unusual costs and revenues, important transactions of subsidiaries, and net profit. The method of distribution of net profit should be disclosed taking into account the statutory reserve of 10%, the allowance for the Kuwait Foundation for the Advancement of Sciences, and any other reserves under the companies law or the memorandum and articles of the company. The remuneration of the members of the board of directors, as specified by law or the company constitution shall also be taken into account.

The guide also points out the necessity to observe the dates of the fiscal year as provided in the company constitution, and to mention any deviation therefrom as regards the balance sheet or the profit and loss account. A supplement to the guide includes two examples, one of an industrial company and the other of an investment one. It is worth mentioning here, before turning to comment on the guide, that it is based on a previous proposal made to the MCI in 1984 which was intended to apply to
companies for accounts periods ending on 31.12.1984. The same proposal remained intact to form the guide, with not the slightest change.

**Comments on the First Guide:**

1. In the introductory part of the guide, it is mentioned that it sets out the minimum disclosure requirements. Nevertheless the guide omits to mention the need to disclose data which are, regarded, in the UK and the USA for example, as crucial for disclosure. These are not even mentioned within the explanatory examples. This applies to both financial and non-financial information. Examples of crucial financial data not required for disclosure by the guide include the following: research and development costs; a summary of the most important financial statistics for a period of five to ten years; securities and pledged assets received by the company from its debtors and the market price of such assets; supplementary tables for depreciation in fixed assets divided according to the types of asset included and showing the cost, depreciation rate, accumulated depreciation, net book value; the market value of the securities; the numbers of ordinary and preference shares and the value of each type; details of goods in stock (raw materials, work in progress, finished goods); a table for the maturity of debts and the method of calculating the value of provision for doubtful debts; indicators on the profitability of shares compared with last year (such indicators to include the earnings per share, dividends per share, dividend cover, etc .......). The guide is also silent as to
crucial non-financial data. Examples of this include the names of the members of the board of directors, their qualifications, staff indemnity schemes, future projects of the company, etc.

2. In the opening paragraph of the guide, it is stated that "the aim of this guide is to mention the data that should be disclosed in the financial statements and any other clarifications or information that form part of the financial statements". The clarifications mentioned thereafter included those relating to the general balance sheet, the profit and loss account and the distribution of profits. No mention has been made of the statement of changes in the financial position, the statement of current cost, the statement of value added and other statements now regarded as important and complementary to the balance sheet and the profit and loss account, without which the true financial position of the company may not be ascertained.

3. Some parts of the guide are ambiguous and as such allow for more than one interpretation. One example is that the guide states under "Important Notes" that, "it is necessary to disclose all important material data in order to render the financial data clear and intelligible". This requirement is vague and uncertain, since what is "important" to one accountant is not necessarily so to another. A second example is to be found in the explanatory supplement to the guide Article 2(a) which provides that the accounts included there have been prepared in accordance with the
accounting principles in investment companies, but no
definition is given of these "accounting principles". Again,
under Article 2(b) the guide, equally ambiguously, states
"investment in the above subsidiary companies is disclosed
in accordance with accepted accounting principles". Such
statements, which appeared in the 1962 law and other
legislation intended to regulate the accounting profession
have been repeatedly criticised. A third example of the
ambiguities included in the guide is that it reads under the
paragraph First-3 "the amounts and classification of items
must be summed up as far as that is necessary". The word
necessary opens the door for many different interpretations
as different accountants will each have their own
assessment of the situation.

4. The guide is inconsistent. An accounting principle is
mentioned for example, followed by a measurement method
which conflicts with that principle. In the explanatory
supplement, for example, Article 2(a) on "Accounting
Convention", the financial statements have been prepared
on the basis of historical cost, but under Article 2(g) it is
mentioned that "goods shall be evaluated at cost or net
purchase value whichever is less". The company is then left
to chose the proper method for the measurement of cost. It
must be noted at this juncture, that other methods for the
measurement of cost do exist which do not come under the
general principle of historical cost, such as LIFO or the
average method.
In the second explanatory example, one principle, namely the Accrual Basis, is mentioned as the basis for the calculation of investment revenue. It is known that such business is risky and the principle of conservatism is better applied than any other differential principle. It may be better, for example, to adopt the cash basis instead of the accrual basis, or specifying an item of doubtful cash revenue.

3.4.2- (2) The Investment Accounting Guide:

This second guide discusses the evaluation of investments which are to be listed as part of the financial statements of all types of enterprises, together with related clarifications.

First some definitions are offered in the guide, including the following terms, by way of example: investment, short term investment, long term investment, the fair value, the market value, and marketable. Types of investment discussed in the guide thereafter include banking and insurance where the evaluation of the enterprise is highly dependent on the success of investment. Other types of investment depend on utilising surplus capital, and maintaining relations with other enterprises.

The guide also discusses the cost of investment and states that it should include the acquisition costs, such as brokers' commissions. Where the investment has been acquired through shares or any other security, the cost of acquiring the investment will then be the market value of such securities, not the nominal value thereof. If the basis of acquiring the investment is the exchange of assets in the enterprise, the investment cost will be the market value of the exchanged asset.
The guide then discusses the method of calculating interest and profit dividends on the investment.

The guide goes on to discuss the classification of investments in the financial statements. The short-term (current) investments are to be entered as current assets and the long-term investments as long-term assets. This is in relation to enterprises which distinguish between the two types of investments in their statements. Enterprises which do not adopt such distinction are required to do so for the purposes of evaluating these investments.

Concerning the book value of investments the guide directs that investments which are classified as current assets shall be entered in the general balance sheet at the cost price or market price, whichever is lower. The difference between cost and market prices is to be taken as a provision on the profit and loss account. Only in investment companies and banks may the market price be used. The unrealised balance of profit and loss is to be entered as a separate item with the shareholders equity. Investments which are classifiable as long-term assets are to be entered in the balance sheet at cost, except with regard to investments in shares with the main objective of long term commercial growth. In the latter case, such investments are to be entered at the cost or market price, whichever is lower. Shares, the issue of which has been the result of a decision by the board of directors, may however be entered at cost, but the market price must be mentioned in such cases.
The guide then directs that concerning the sales of investments, the difference between the net sales return and the cost is to be entered in the profit and loss account.

In cases of reclassification of investments, the guide directs that where the reclassification is from long-term to short-term, it should be effected at cost or book value, whichever is lower. However, where short-term investments are entered by the enterprise at market value, then the same shall apply to the reclassification. Where the reclassification is from short-term to long-term investment, it is to be effected at the cost or market value, whichever is lower. The following items are directed by the guide to be entered in the profit and loss account:

a. Investment revenues resulting from interest and dividends, profit and loss on investment sales and provisions accumulating as a result of decline in market prices below the cost value of short-term investments.

b. Long-term investments permanent decline. The guide requires clarifications on investments to be entered in the financial statements.

**Comments on the Second Guide:**

1. The guide provides that "in cases of non-marketable investments an alternative method of evaluation shall be applied thereon". This laxity and ambiguity about such an alternative method is undesirable and may lead to abuses.

2. The "market value" has been defined in the guide as the amount received as a result of the sale of the investment at a stock exchange. The Kuwait Stock Exchange has been cited
as an example, but no details are given as to the qualifications or characteristics of such market. The existing Kuwaiti market suffers from a number of shortcomings such as the absence of financial and other essential information, the lack of exchange principles and competitiveness, etc. These are left undiscussed by the guide. Such circumstances prevent the existence of a fair and equitable market value in the true sense of the phrase.

3. Article(9) on clarification's states that "the following clarifications are to be entered in the financial statements". The wording of the article fails to make these clarifications mandatory, despite their crucial importance. They include, for example, investment revenues, the market value of investments, the classification of investments, the management's evaluation of the fair value, the method of evaluating the book value of investments, and so on. The guide is only persuasive in this regard, having used the word "suitable", instead of an expression of compulsion, such as is used regarding all other accounting principles mentioned in the guide, include some which are less important than the clarifications under Article(9).

3.4.2 - (3) The Property Accounting Guide:

This guide deals with land and buildings accounting, including the disclosure of clarifications. First, the guide offers definitions relating to land, fixed buildings, commercial land and buildings, investment land and buildings, land for development, land for acquisition by the Government, and market price.
On the classification of properties, the guide declares that companies acquire property either because the nature of their business requires them to do so for their activities or else because of an intention to trade in property as a main objective. The guide directs that a distinction should be made in financial statements between short-term (current) and long-term assets. It also directs that property acquired for the purpose of trading for profit should be entered in the financial statements of companies, so long as such property is expected to be sold within one year. The entry is required to be made under the current assets. Property acquired for the purposes of investment is to be entered under long-term assets, while property which is used as demanded by the nature of business is to be entered as a fixed non-current asset.

On costing, the guide directs that the cost of the property shall consist of the purchase price plus any amounts directly spent on the property, whether before or after acquisition. Properties owned for trading therein are to be entered at their cost or market price, whichever is lower. Investment properties are to be entered at their cost or realisable value, whichever is lower.

No property shall be treated as sold or otherwise exchanged unless the vendor or purchaser has committed himself with an exchange agreement, delivery has been officially registered with the appropriate government department and the purchaser has either paid the price or arranged a bank guarantee for the payment thereof. In the case of cash payment, the purchaser must have paid at least 20% of the total price of the property.
The guide requires certain statements to appear in the profit and loss account. These include property revenue, profit and loss from the sale of property, provision for decline in market prices, permanent decline in the property as long-term investment, and profit and loss on disposal of property. The guide then states the important clarifications to be shown in financial statements, which include the method of evaluating the book value of the property, amounts collected as property revenue, encumbrances and pledges imposed upon the property, the classification of properties and the body responsible for evaluating the property.

Comments on the Third Guide:

1. An obvious weakness of this guide is its repetitiveness. Many of the disclosure requirements are mentioned in more than one place. For example, in Article(5) the guide states that where property is sold, the difference between the book value and the realised value of the sold property is to be entered into the profit and loss account. The same appears under Article 6(2). Secondly, in Article(4) the guide mentions that where there is a decline in the net book value as a result of revaluation this shall be transferred to the profit and loss account. Article(6) repeats the same requirement. Thirdly, Article(5) states that where property of no expected return is disposed of, the resulting profit or loss shall be entered in the profit and loss account. Again, the same is repeated in Article(6). Further instances of repetition in the guide include the statement in the introductory parts of certain accounting principles and
subsequently repeated verbatim in the main part of the
given article (see for example Article(5) and the first three
paragraphs in particular).

2. A number of ambiguous and uncertain words and phrases
are used. For example, concerning the expenses that should
be made part of the cost of the property, the guide
mentions in two places that "no additional or inactive costs
shall be included in the cost of property". No definition is
given of the words additional and inactive, nor does the
guide specify who shall decide whether or not such costs
are additional or inactive. Moreover, guide fails to provide
examples of such costs. A second example is found in Article
4(3) which describes some enterprises which consume the
cost of long term property at equal instalments over the
production period. Thereafter the guide remains silent as to
the consequences of this description and whether or not
what has been described is desirable. Thirdly, on the subject
of property book value, under Article(4), two methods have
been specified to be followed in entering the value of
property classified as a long-term asset, namely the cost
value and evaluation. However, no conjunction (e.g. "and",
"or") has been used between the two methods, leaving the
accountant with a problem of deciding whether it is
acceptable to choose one of these methods, or whether both
are required to be used.

3. A review of the balance sheets of Kuwaiti companies reveals
that some companies use only the historical cost method for
the evaluation of property, and when such assets depreciate
in a specific period of time, the value of the property becomes nominal (KD 1.00). This approach is frequently used in order to create secret reserves. The guide, however, does not deal with this issue by, say, directing the relevant companies to re-evaluate the property in question. By allowing free choice to the companies on the matter, the guide fails to avoid the possible harm done to the disclosure of financial information.

3.4.3 General Comments on the PTC:

1. There is a lack of clear objectives and conceptual framework. The specification of objectives and conceptual framework is essential for the task of establishing accounting standards and methods. However, the committee seems to fail in this regard like other committees in most countries. The difficulty of getting users to understand and accept accounting standards which are developed in the absence of prior financial objectives has been outlined by Hauworth, among others. He stated that, it makes a considerable difference whether the main objective of the standard setters is to assist economic decision makers by providing them with necessary information, or simply to provide a true and fair view of the financial position of the company."^{8}\)

Ignoring the important direct relation between the standards and the objectives will render the developed standards either irrelevant or completely useless. Because of their importance, accounting standards should be closely related to the main national objectives. This may
only be attained if the standard setters start with the fundamental task of setting the primary accounting objectives. The PTC did not do this, nor did it identify the potential users of accounting information, what sort of information they need, or how it may be made available to them.

For the developed accounting standards to be mutually compatible, it is necessary that they be developed within a conceptual framework which should embody the financial accounting concepts.

2. The intelligibility and acceptability of the accounting standards by intended users and accountants are prerequisites for such standards to be observed and followed. Financial accounting, falling within the realm of social sciences, as opposed to natural sciences, needs to be generally acceptable among the concerned parties. The development of accounting standards in Kuwait was not associated with adequate discussion and feedback, let alone general acceptance by users and preparers of accounts. In November 1986, the PTC prepared standards were ready and declared to be in force as from the end of the following month (31.12.1986). Users and preparers therefore had only one month for reflection before the standards were made binding by a ministerial resolution in January. This was so, despite the fact that the guide itself states that "...ample time shall be allowed between the date of issuing the resolution and the date of laying down the principles to be applied".
3. With the exception of a handful of leading accounting firms, little has been known about the three guides (discussed here) in Kuwait. Copies were sent to those few firms by the PTC, asking for their opinions. Numerous other concerned parties, such as other accountants and auditors, academies, investors, creditors and other users of financial information, were excluded. Two main reasons have contributed to the low level of publicity of the three guides. First, there was no draft stage nor a trial period which could have exposed the committee's work for reflection by all concerned parties. This is contrary to the practice Chambers recognised as being widely followed by accounting standards committees, namely, the publication of accounting standards among the professional circles at the draft stages⁹. To elaborate, the relevant steps include a consideration of the draft papers by a senior professional committee, then an "exposure draft" is widely promulgated, with an invitation to comment on the included draft standards, after a deadline has been set for the same. The resulting feedback may then stimulate amendments by the originating committee. The senior professional committee will then publish the final document for application by the relevant parties. Such an elaborate process is apt to guarantee a wide-based scrutiny which counteracts any damaging elements or influences.

The second reason behind the comparative lack of publicity of the PTC's work is the absence of a professional accounting magazine. This could have provided a widely
circulated medium, sufficient to bring the draft standards to the knowledge of potential commentators.

4. The comments mentioned above on the three guides prepared by the PTC reveal some formal as well as substantial shortcomings therein. The guides have, for example, been silent as to certain important issues; they contain inconsistencies, repetitive in places, and ambiguously worded. One major reason for this is the relatively short period of time allowed for the PTC's work. The PTC, having been constituted in March 1986, started work by the end of September, when the second meeting was held (the first, an informational are being in April). The whole process was therefore been completed in only three months, including the preparation, primary discussion, circulation to some accounting firms, discussion on the basis of the feedback and finally issuing the guides in the form of a ministerial resolution. This is in sharp contrast with the time spent in preparing accounting standards elsewhere; in some cases, according to Chambers, it has extended to a few years, with more resources and patience being directed to the achievement of the mission.\(^{(10)}\)

5. The PTC did not adequately refer to the relevant sectors in preparing the three guides. No specialised subcommittees were constituted by the PTC to make extensive investigations and research on various topics. All the work was confined to the PTC which had few qualified
members, and lacked experience of the kind of work in which the PTC was involved.

Such shortcomings need be avoided in the future if standards setting in Kuwait is to be based on solid grounds. Professional consultation should be widened and consensus reached beyond the limited scope of the PTC membership. Foreign expertise should also be consulted in the process.

6. The PTC exerted little effort to set the standards included in the three guides. This becomes clear when such guides are compared with the standards issued by the International Accounting Standards Committee (IASC). The PTC seems to have relied heavily on International Standards. Some standards have been very clearly followed, even as regards the wording.

Three statements in the PTC guides may be cited as relevant examples of the above weakness. The first guide, which deals with the disclosure of financial statements, seems to be directly derived from IAS No.5 discussing the same issue. The second guide resembles IAS No.25 with regard to the requirements relating to accounting for investments. The property accounting guide, the third and final one, closely relates to IAS No.25 on investment and IAS No.16 on accounting for property, plant and equipment.
3.5 Conclusion:

There are persuasive indications that a move has taken place toward the adoption of sound accounting practices in Kuwait. However, such movements are far from being comprehensive. Any reform which may be conducted in the field, however, must tackle the demands of the profession and all the concerned parties, including the government bodies, investors, financial analysts and the like. For the accounting standards to be successful in achieving their purpose, such standards must stem from a consistent body of accounting theory. Such a theoretical base should itself be founded on the national economic background and realities, as well as being appropriate to the Kuwaiti legal and cultural heritage. If this is achieved, the intended standards will derive their coherence and integrity from a theoretical base of harmonious objectives and basic concepts outlining the scope, role and nature of accounting. Further qualitative enhancement of the Kuwaiti accounting standards requires consideration of the following:

1. As a prerequisite of standard setting, there should be wide-based reference to various sources of expertise and concern in the accounting field.

2. The PTC must publish its work with explanatory comments for useful scrutiny.

3. Research should be encouraged and directed towards the consideration of a possible theoretical basis for the potential accounting standards in the country.
4. The absence of such a theoretical framework in a process of standard setting may result in the production of inconsistent standards which will not, therefore, lead to the attainment of any generally desired accounting objectives.

5. The observance of the developed accounting standards should be backed by a sanctions system. This may be effected, not only by commanding companies and accounts preparers to comply with these standards, but also by encouraging users to be sufficiently critical, and even to reject inadequate financial reports. Pressure from below, i.e. effective scrutiny by the users, could therefore encourage compliance with the accounting standards.
References


10. Ibid, p.86.
4.1 Introduction:

In Chapter one it was stated that the purpose of the study is to examine the accounting practices in Kuwait and to examine the causes and the nature of the deficiencies in the accounting practices and information disclosures in Kuwaiti Corporations. Obstacles confronting the users of the accounting information as a result of these deficiencies are also to be identified. Following the analysis of the accounting regulation in Kuwait in the previous chapter, attention is now focused on business entities in fulfilment to the purpose of the study. This chapter marks the beginning of the field survey work, and thus signals the start of the estimation stage - albeit restricted to data collection at this stage - within the framework of the model-building approach. Though discussing the various types of business units in Kuwait which cover: Solidarity Companies, Limited Partnership, Limited Liability Company, Joint Venture, and Shareholding Companies, the subject matter of the survey is limited. It deals with information reporting practices as revealed in the annual reports of all of the listed shareholding companies comprising public and a few closed shareholding companies whose shares are tradeable in the Kuwait Stock Exchange. Other entities are excluded from the population due to unavailability of financial reports for entities other than shareholding companies. As will be mentioned later, on 42 shareholding companies are included and their reports are examined for three financial years only as information for subsequent years is not available, due to
destruction of data during the Iraqi invasion. This small sample limits the usefulness of the results particularly in view of the growth in business entities associated with the Oil Boom of the 1970s.

Following the 1970 rise in oil prices, Kuwait witnessed remarkable economic growth. Government expenditure leaped in order to meet the requirements of development projects, including agriculture and the construction of roads, airports, hospitals and housing schemes. The objective was the advancement of living standards of Kuwaiti people.

The boom in commercial activities had to be accommodated by a matching business structure, and this gave rise to numerous entities within the business sector. The form of finance in these entities varied: ranging from proprietorial and investor capital to finance by the financial institutions. This expansion of business activity has led to recognition of a need for better and more uniform accounting policies, and for higher standards of reporting.

At this point, it would be useful to define the current position in a number of basic accounting areas. Commercial legislation in Kuwait has not yet been put in a harmonious format. However, by Amiri decrees, the types of bodies legally acceptable for the conduct of business have been defined in some detail. Bodies with shareholdings are required to file their annual accounts with government departments, but no common accounting policies or standards are readily recognised or required to be followed.
A business in Kuwait will base its accounting policies and procedures on, or sometimes even adopt, those which are applied by the home country of its professional accountant, adviser or financial manager.

No "Generally Accepted Accounting Standards" have been legislated for, despite the use of this expression in practice. For a higher degree of confidence by the user, there should be some consistent use of uniform accounting policies.

4.2 Type of Business Unit:

Decree No. 15 of 1960 recognises certain forms of business entities. They are as follows:

(1) Solidarity company.
(2) Limited partnership (simple and by shares).
(3) Limited liability company.
(4) Joint venture.
(5) Shareholding company (closed and public).

The Commercial Companies Law (1960) recognises these forms of business entity. Registration is required at the Ministry of Commerce and Industry, with the exception of joint ventures. There are also sole traders who run a considerable number of family businesses.

Following are the main features of the principal forms of businesses is recognised by the law:
4.2.1 Solidarity Company:

This form, which may also be called a general partnership, is an association of two or more partners who assume joint liability in the enterprise to the full extent of their entire assets as regards the partnership debts (S.4).\(^1\) The law requires that at least one partner be a Kuwaiti national, holding (alone or together with other Kuwaiti partners) not less than 51% of the partnership capital (S.5)

A winding up of the solidarity company must take place in any of the following circumstances (S.24):

1- The expiry of its fixed term.
2- The completion of the business for which it was formed.
3- Where no profit would be yielded by the partnership as a result of loss of all or a major part of the partnership property.
4- Where it is declared bankrupt.
5- Where a member is declared bankrupt or placed under interdiction.
6- Where winding up has been unanimously agreed by the members.
7- Where a judicial judgement for the winding up of the firm has been issued.

There is no statutory duty as to auditing or filing of financial statements with the Ministry of Commerce and Industry.
4-2-2 Limited Partnership:

Two types of limited partnerships may be distinguished (S.43):

a- Simple limited partnership, and
b- Partnership limited by shares.

a- Simple Limited Partnership:

This consists of general partners (solidarity members), and limited liability partners (sleeping members) (S.42). The general partner's liability for the debts of the partnership extends to the whole of his assets. At least one general partner must be Kuwaiti, and Kuwaiti capital must form at least 51% of the total capital. The liability of a limited member for the partnership debts is limited to the amount of his capital contribution.

The general members' names must form part of the partnership name. Where there is only one solidarity member, the name of the partnership should be followed with the words "and partners". The inclusion in the firm's name of a limited member's name makes him fully liable for partnership debts incurred in good faith and his position becomes, for that purpose, similar to the position of a general member (S.45).

b- Partnership Limited by Shares:

This comprises two types of partners: general and limited members. The firm's capital is divided into negotiable shares of equal value (S.49).

The liability of a limited member is similar to that of a shareholder in a shareholding company. The managerial tasks
and the extent of liability of members are similar to the position as to simple limited partnerships. However, in a partnership limited by shares, a supervisory board of three should be formed from the shareholders or otherwise (S.51). One or more general members are bestowed with the power to manage and their names should appear in the memorandum and articles of association, together with limits of their powers (S.50). Their liability is equivalent to that of a shareholding company's founders and directors.

The words, "partnership limited by shares", must appear on all the partnerships contracts, invoices, papers and publications (S.54).

A limited partnership has no statutory duty to submit to audit, nor a requirement to file financial statements with the Ministry of Commerce and Industry.

4.2.3 Limited Liability Company:

This is a fixed capital commercial company with no less than a KD 7500 capital divided into non-negotiable shares (S.189). The total amount of capital is required to be paid in full, in cash or other assets valued at their fair market value.

A legal reserve is required by law, which may be used to ensure payment of a cash dividend up to 5% in years when profits are insufficient to warrant a dividend of this size (S.167).

At least two founders are required to form a limited liability company. The number of shareholders may not be less than two, and not more than thirty (S.185). At least one member must be
Kuwaiti, holding -alone or with other Kuwaiti members- not less than 51% of the shares (S.197). The founders of the limited liability company determine its duration, which is not restricted by law.

The founder must, either in person or by proxy, sign a memorandum of association, a certified copy of which is filed in the Commercial Register, together with the application for registration.

The company management is normally conducted by one person or more, but they need not be Kuwaiti nationals or members of a company they manage (S.201). The managers are jointly and separately liable to the company, the members, and to third parties dealing with the company for illegal acts, violations of the memorandum of association or any managerial error (S.204).

No legal requirement exists as to format or disclosure of financial statements in the case of a limited liability company. In practice, most such companies follow US or UK modes of presentation, but with fewer explanatory notes.

The law does not require consolidated financial statements, and these are not prepared in practice. There is no legal stipulation as to the valuation principles to be followed by business entities, but the commercial companies law requires the auditor of a limited liability company to make a statement in his report as to whether or not a true and fair view is disclosed by the financial statements of the company. The law does not require separate financial statements for tax purposes.
Kuwaiti law neither demands nor prohibit inflation accounting and this has not been adopted in practice. Auditing of financial statements in the case of a limited liability company is required by law, and these must then be filed annually with the Ministry of Commerce and Industry. There is no further requirement as to publication, e.g. in a newspaper.

The rule governing winding up and liquidation is as follows: where a limited liability company loses half or more of its capital, a general meeting must be called by the managers to decide whether or not to dissolve the company (S.216). The relevant resolution to dissolve the company must be passed by members holding three quarters of the capital before it can be carried out.

4.2.4 Joint Venture:

A joint venture is formed of two or more persons, but third parties are not aware of such an association (S.56). As a result of this, a third party may only claim against the joint venture member who has been dealing with him. This is because the association has no legal personality. Nor is it subject to disclosure rules (e.g. filing statements, etc.) with which other companies must comply. Again, there are no statutory audit requirements. The rule is different, however, in the case of foreign corporate participation, where audit is usually required for the purposes of income tax.
4.2.5 Shareholding Company:

Two types of shareholding company may be distinguished:

a- Public Shareholding:

These are equivalent to joint stock companies which offer their shares for public subscription. The number of promoters should not be less than five persons who are Kuwaiti nationals (S.70). However, where the project in question needs foreign capital or expertise, foreigners may be allowed to participate in the formation of this type of company, with the exception of banks and insurance companies (S.68). The holding of at least 51% of the capital share by Kuwaiti nationals is again a requirement.

A minimum of 10% of the share capital must be subscribed by the promoters; they, like other subscribers, must pay 20% of the price of their shares on subscription (S.81). The balance must be paid within five years from the date of incorporation.

b- Closed Shareholding Company:

This type differs from the previous one in that it can not offer its shares for public subscription (S.94).

Disclosure Requirement:

As to the rules governing financial statements, schedule C of the Commercial Companies Law No. 15 of 1960 describes the disclosure requirements and the manner of presentation of the balance sheet, and profit and loss account of shareholding companies. It should be mentioned here that the presentation required is out dated and difficult to follow in practice.
Consequently, most shareholding companies opt out and follow modes of presentation similar to those adopted in the US and UK.

Under (Schedule C) a great number of details are required on the face of the balance sheet, and the profit and loss account, but very little is required with regard to notes and the disclosure of accounting policies.

Regarding valuation principles, financial statements for tax purposes, and inflation accounting, the situation is the same as that for limited liability companies, described above.

**Auditing Requirement:**

It is legally required that shareholding companies to have their financial statements audited by an independent auditor who must not have participated in the formation of the company concerned (S.161). The auditor can not be member of the board, owner or manager of the company or render work for any of its board members or managers (S.162). He can not be related to people who maintain the accounts of the company or are involved in the business of managing it. For an auditor to practice in Kuwait, he must obtain a licence from the Ministry of Commerce and Industry, and be listed in the auditor's register.\(^{(2)}\)

**Publicity:**

Shareholding companies are required to deposit a copy of their constitution with the Commercial Registry, and to file their audited financial statements on an annual basis with the Ministry of Commerce and Industry. This applies to both public and
closed shareholding companies. Public companies are further required to file their audited financial statements with the Kuwait Stock Exchange.

In principle, the shareholding companies are required to publish in the official gazette their financial statements on an annual basis, together with the name of the auditor, and a list of the board members. In practice, however, only the minutes of the shareholders' general meetings are published. Publication in the local press includes the balance sheet, the profit and loss account, and the shareholders' minutes.

The name of a shareholding company must appear in their letterheads, together with details of its corporate status, headquarters, the date of its establishment, subscribed capital, paid in capital, and registration number in the Commercial Register.

**Taxation:**

Since its inception in 1955, the income tax law has seldom been amended or supplemented. The law left considerable areas uncovered or dealt with them somewhat ambiguously, a fact which should be considered in interpreting its relevant rules. Only corporate bodies are subject to income tax in Kuwait. Salaries, wages, and other individual incomes are not taxable. Partnerships are regarded under the Commercial Companies Law as separate legal bodies, but they are still exempt from the income tax requirement, being seen as an association of individuals. 

(3)
Corporation tax: In the case of companies, the corporate income tax is levied on profits, regardless of the place of incorporation. A company incorporated abroad becomes taxable so long as it carries on trade or business, whether directly or through an agent. Income tax law also applies where a company carries on trade or business in Kuwait as an agent for other principals.

The following categories of income are generally subject to corporate income tax: (4)

1. The net profits of a foreign corporate entity operating in Kuwait or both inside and abroad simultaneously, to the extent that the profits are connected with the operation in Kuwait.

2. The proportion of the net profit of a Kuwaiti corporate body (i.e. public or closed shareholding company) attributable to foreign corporate shareholders.

3. The proportion of the net profit of a Kuwaiti joint venture attributable to foreign corporate partners.

As it is apparent in the above cases, it is always the foreign corporate body which is taxed. Foreign individuals are exempt from income tax, as are foreign corporate participations in Kuwaiti limited liability companies registered in the names of individual nominees.

The taxable income is defined as the gains and profits of a corporate entity derived from a trade or business in Kuwait. Taxable activities include the purchasing and selling of property, goods or related rights in Kuwait, and maintaining a permanent
office in Kuwait where the execution of purchase and sale contracts takes place. Other taxable activities include: the operation of any other manufacturing, industrial or commercial enterprise in Kuwait, the lease of any property located in Kuwait and the rendering of services therein.

4.3 The Importance of Financial Statements:

The comparative financial statements published by companies are regarded as sources of information for decision makers in the fields of economics in general and investment in particular. The figures included in such statements reveal the activities of the relevant company for the interested parties (owners, creditors, investors, analysts, government departments, etc.), so that they may derive a variety of quantitative indicators, such as:

1- the company's profitability;

2- its ability to service its short-term and long-term debts or commitments;

3- the level of its managerial efficiency and the management's capacity to employ the company's assets productively; and

4- the prospects of the company's performance in future and its impact on possible fluctuation in the prices of its listed shares and securities. This helps rationalise dealings in the company's securities and protects against negative effects of speculation on the company's shares.

The objectives behind the preparation of financial statements, include provision for evaluation and financial decision-making. Consequently, a user of such statements can rely on them only when they are fair, true and clearly represented. The
information needed to fulfil this objective are in most cases far more comprehensive than the legally required information.

The annual reports constitute the most important form of corporate disclosure to the shareholders. The significance of annual reports may be related to the following:

(1) It is difficult to obtain the required information through direct communication with the management.

(2) The alternative information which other sources may offer may be inadequate, inaccurate, and is not audited.

In order to make the right decisions, investors need adequate and accurate corporate financial information. Such decisions, when soundly made, would protect them against unfair or dishonest securities practices.\(^5\)

The problem of immeasurable national accounting practices has given rise to an immense amount of literature world-wide complaining about the consequent difficulties faced by investors. It has been suggested that the proper remedy would be to bring the diverse national accounting practices into uniformity.\(^6\)

Comparing the annual reports disclosure in developing and developed countries, it has been widely found that information in the former is less reliable than in the latter. Reliability, as far as the user is concerned, denotes true description of the economic events, adequacy and accuracy. The user ultimately needs to know whether or not he may depend on the information for his investment decision.\(^7\)
4.4 The Subject-Matter of the Survey:

This survey is intended to provide an overview of the nature and boundaries of financial accounting practices in Kuwait.

The survey deals with information reporting practices as revealed in the annual reports of all of the listed shareholding companies (comprising public and a few closed shareholding companies whose shares are tradable in the Kuwait Stock Exchange, but excluding other entities).

Participating Companies:

The survey covers presentation and disclosure practices in annual reports for three financial years (1984, 1985, 1986) by all of the shareholding companies listed on the Kuwait Stock Exchange (42 companies, see Appendix A). Information for subsequent years is not available, due to the destruction of data during the Iraqi Invasion.

The share list classifies companies by sector. There are seven such sectors: Banking, Investment, Insurance, Real Estate, Industrial, Services, and Food.

Table (4-1): No. of Company annual reports in different financial years

<table>
<thead>
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<th>YEAR</th>
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<th>INV</th>
<th>INS</th>
<th>R.E.</th>
<th>IND</th>
<th>SER</th>
<th>FOOD</th>
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<td>6</td>
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<td>5</td>
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</tr>
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<td>8</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>6</td>
<td>5</td>
<td>41</td>
</tr>
</tbody>
</table>
Source of Annual Reports:

The annual reports of listed shareholding companies were collected from Kuwait Stock Exchange.

The financial year of the companies was based on the calendar year. However, all of the companies dealt with presented their annual reports on 31 December.

Language of Presentation:

Accounts in the business sector are prepared and presented in Arabic, the only language used by the general public of Kuwait. Some of the companies, however, present their balance sheets in both Arabic and English.

4.4.1 Depreciation:

This section deals with the disclosure and presentation of depreciation charges for tangible fixed assets. Reported profits and net asset values of fixed assets may be materially affected by depreciation methods and rates. Since management judgement and experience form the basis for deciding which methods to use and which depreciation rates to adopt, it is important to disclose depreciation policies in order to enable the assessment of financial performance of companies and the drawing of comparisons between companies.\(^8\)

Statutory Requirements:

Schedule C of the Commercial Law No. 15 of 1960, (S.3) requires companies to show fixed assets in historical cost and deduct the amount of provision for depreciation in respect of all
fixed asset items. However, the schedule does not require the disclosure of the method used for making the provision for depreciation of fixed assets, or the grounds adopted for deciding the depreciation rates.

**Analysis:**

1- Method of depreciation:

The methods of depreciation adopted by the Kuwaiti companies for property covered by the survey are shown in table (4-2).

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Straight-line method</td>
<td>30</td>
<td>72</td>
<td>36</td>
</tr>
<tr>
<td>Total in year of purchase</td>
<td>6</td>
<td>14</td>
<td>5</td>
</tr>
<tr>
<td>Method not disclosed</td>
<td>6</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

The most common method applied by Kuwaiti companies in assessing property depreciation is the straight-line method. This was followed in 1984 by thirty companies (72%). In the years 1985 and 1986, thirty-six companies adopted the method. The other method in practice is that of total depreciation in the year of purchase, which was adopted by six companies in 1984, five companies in 1985 and only four companies in 1986. No method other than the two mentioned here was followed by Kuwaiti companies. Companies which did not disclose their depreciation method amounted to six in 1984 and only one company in both 1985 and 1986.
Table (4-3) reveals that as far as accounting methods are concerned, the difference is small between property depreciation and furniture and equipment depreciation.

### Table (4-3): Methods of Calculation Depreciation on Furniture and equipment in Kuwaiti Companies

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Straight-line method</td>
<td>27</td>
<td>64</td>
<td>31</td>
</tr>
<tr>
<td>Total in the year of purchase</td>
<td>7</td>
<td>17</td>
<td>7</td>
</tr>
<tr>
<td>Method not disclosed</td>
<td>8</td>
<td>19</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

The straight-line method remains predominant, as twenty-seven companies (64%) adopted it in 1984 and thirty-one companies in 1985 and 1986. With regard to the other method operative in Kuwait, "total in the year of purchase", this was followed by seven companies in the years (1984, 1985, and 1986). Companies which did not disclose their depreciation method were eight, four and three, respectively.

2- Disclosure of depreciation rates or assumed lives of fixed assets:

Table (4-4) shows the companies which disclosed their depreciation rates or years of assets depreciation. These were twenty-four companies in 1984 (57%), thirty in 1985 (71%) and twenty-nine in 1986 (71%).
Table (4-4): Disclosure of depreciation rates, or assumed lives of fixed assets

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Disclosed.</td>
<td>24</td>
<td>57</td>
<td>30</td>
</tr>
<tr>
<td>Not disclosed</td>
<td>18</td>
<td>43</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

Only generalised statements about depreciation were made by companies included in the survey. It was not always clear from the statements why a certain approach was found suitable for adoption, or why a given method was substituted for another.

One of the difficulties encountered in conducting the analysis was the variability in the placing of information within the accounts or reports. Most companies followed their own statement accounting policies for this purpose, while others adopted the fixed assets schedule. In a small proportion of cases, this problem was compounded by the information being split between two or more places.

Despite the fact that a good number of companies showed precise details of depreciation methods and depreciation rates or assumed lives, the categories of fixed assets shown in the accounts were in many cases so general, that such information becomes of little value.

In general, the accounting policy used to calculate depreciation is disclosed by companies. The prevailing approach among those who prepare the financial statements in Kuwait is the straight-line method. Another common practice is the disclosure of
details of the rates of depreciation, which is of use in writing off a variety of fixed assets categories. Rates are determined by making an estimation of the useful lives of the given assets beyond which their cost will be written off.

4.4.2 Investment:

Treatment of investments in companies other than subsidiaries will be examined in this section.

Statutory Requirements:

Schedule C of the Law No. 15 of 1960 provides in Section 2(b) as follows:

"Investments in an associated company (whether holding or subsidiary) must be separated from all other investments and disclosed as a special group showing the amounts representing both long and short-term investments".

The law does not require the separation between quoted and unquoted investments, and it remains silent as to the basis for the evaluation of investment.
Analysis:

1- Quoted Investment:

Table (4-5): Methods of calculating quoted investment

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th></th>
<th>1985</th>
<th></th>
<th>1986</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Method</td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
</tr>
<tr>
<td>The lower of cost and market value</td>
<td>33</td>
<td>79</td>
<td>34</td>
<td>81</td>
<td>35</td>
<td>85</td>
</tr>
<tr>
<td>Cost value</td>
<td>4</td>
<td>10</td>
<td>2</td>
<td>5</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Market value</td>
<td>2</td>
<td>5</td>
<td>4</td>
<td>10</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Not stated.</td>
<td>6</td>
<td>14</td>
<td>6</td>
<td>14</td>
<td>5</td>
<td>12</td>
</tr>
</tbody>
</table>

Table (4-5) shows that three methods were followed by Kuwaiti companies in calculating quoted investments. Among these three methods, "the cost or market value, whichever is lower" was the method most followed, having been adopted by thirty-three companies in 1984 (79%), thirty-four in 1985 and thirty-five in 1986. The second method depended on cost in evaluating investment, and was adopted by four companies in 1984, two in 1985 and only one company in 1986. Finally, the third method was based on market price. It was followed by two companies in 1984, four in 1985 and two companies in 1986.

Some companies used a combination of methods in their investment evaluation, and others shifted from one method to another without giving any reasons for the shift nor expressing that it has taken place.
2- Unquoted Investment:

Table (4-6): Methods of calculating unquoted investment

<table>
<thead>
<tr>
<th>Method</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>The lower of directors' estimate value and cost value</td>
<td>5</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>38</td>
<td>18</td>
<td>44</td>
</tr>
<tr>
<td>Cost value</td>
<td>15</td>
<td>36</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Directors' estimate value</td>
<td>3</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>14</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>The lower of cost value and market value</td>
<td>5</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>1 KD. or nil value</td>
<td>1</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Not stated</td>
<td>15</td>
<td>36</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>26</td>
<td>12</td>
<td>29</td>
</tr>
</tbody>
</table>

The following are the methods for the evaluation of unquoted investment:

1- The lower of cost value and directors' estimate value: The number of companies which applied this method in 1984 was relatively small-only five (12%). In 1985 and 1986 the number increased to sixteen (38%) and eighteen (44%) respectively.

2- Cost value: Fifteen companies (36%) applied this method in 1984, three in 1985 and only two in 1986.

3- Directors' estimate value: This method was followed by three companies in 1984, six in 1985 and five companies in 1986.

4- The lower of cost and market value: Five companies followed this method in each of the three years (1984, 1985 and 1986).
5- Nominal value (such as 1 K.D. or nil value): This method was applied by one company in 1984, five in 1985 and two in 1986.

The number of companies which did not disclose the method of investment evaluation was relatively large. These were fifteen in 1984 (35%), eleven in 1985 and twelve in 1986.

4.4.3 Revaluation of Fixed Assets:

Historical cost forms the basis of valuation in financial accounting. This method seriously distorts the measurement of income, when the value of money is undergoing change. The reason for such distortion is the difference between the historical and current costs, which is a function of the time gap between the acquisition and the utilisation of assets directed to earning revenues on a periodic basis. In the case of items such as wages and similar current expenses, the said difference may be very small, but for fixed assets the difference may be considerable, as for example under the matching rule, where such assets are charged against revenue.

No correspondence exists between the information provided about the financial position of an enterprise and the situation of the same at the accounting date. Therefore, comparisons based on HCA become invalid and misleading.

The requirement to disclose current values for property and other assets is based on a fundamental assumption regarding the value of the information to investors and shareholders.
Statutory Requirements:

Schedule C of the Law No. 15 of 1960 provides under Section 3 as follows:

"The fixed assets shall be disclosed generally at cost value minus the total depreciation allocated for each item thereof up to the budget date, and where no cost value exists for any of such assets then the basis for calculation shall be the original estimate value".

Analysis:

All or most of the fixed assets were shown by all the companies in their balance sheets, on an historical cost basis.

Tables (4-7) and (4-8) show an analysis of the revaluation of fixed assets contained in the accounts of companies covered by the survey. There has been very little revaluation of fixed assets, though some piecemeal revaluation of property assets at various dates in past years has occurred. The balance sheet total is made up of the sum of these valuations together with other properties shown at cost and any additional expense incurred since the last evaluation.
Table (4-7): Revaluation of fixed assets

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Most recent major revaluation shown</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Some fixed assets revaluation</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>No material revaluation shown</td>
<td>41</td>
<td>98</td>
<td>40</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>41</td>
</tr>
</tbody>
</table>

Table (4-8): Statement as to market value of investment in land & building (property)

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Assessment of value mainly by:</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Directors</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Professional valuers</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>No assessment of value</td>
<td>9</td>
<td>22</td>
<td>9</td>
</tr>
<tr>
<td>No statement provided</td>
<td>29</td>
<td>69</td>
<td>27</td>
</tr>
<tr>
<td>Book value</td>
<td>3</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Nominal value</td>
<td>26</td>
<td>64</td>
<td>26</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>41</td>
</tr>
</tbody>
</table>

Few differences were found in the practices followed by companies in disclosing the market value of property as between the years 1984, 1985 and 1986. Ten companies in 1984 made positive statements clarifying the extent to which book values were or were not indicative of market values. In 1985 and 1986 the number of companies which disclosed such statements rose to twelve.
In the years 1984, 1985 and 1986, thirty-two, thirty and twenty-nine companies respectively, stated property at book value or nominal value.

While fixed assets are generally stated at cost, land and property are most often stated at valuation. The notes to the accounts sometimes disclose the basis for the revaluation of fixed assets, where such revaluation takes place.

4.4.4 Stocks and Work in Progress:

These form an important asset heading in the accounts of most manufacturing and commercial companies. The amount which appears in the balance sheet is determined in practice through the application of various methods. This will have its impact on the profit and loss account which will in turn significantly affect the year's results.

Statutory Requirements:

It is required under Schedule C of the Commercial Law No. 15 of 1960 (S.2:b) that current assets be separately identified, and the stocks and work in progress shall be sub-classified in accounts in such a way as to show the amounts held in each of the main categories.

Analysis:

A- Basis of Computation of Stock and Work in Progress:

The accounting policy is generally disclosed in respect of inventories, but this is usually limited to the basis of valuation. The method used in calculating cost is rarely disclosed. As a
result, it is generally not clear whether or not the cost of inventories includes any overheads.

Preparers do not generally analyse the various components of inventories into categories such as finished goods, raw materials and work in progress.

Table (4-9): Basis of computation of stock and work in progress

<table>
<thead>
<tr>
<th>Method</th>
<th>1984</th>
<th></th>
<th></th>
<th>1985</th>
<th></th>
<th></th>
<th>1986</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
</tr>
<tr>
<td>The lower of cost and net realisable value</td>
<td>12</td>
<td>29</td>
<td>15</td>
<td>36</td>
<td>15</td>
<td>37</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost Value</td>
<td>10</td>
<td>24</td>
<td>11</td>
<td>26</td>
<td>9</td>
<td>22</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous basis</td>
<td>1</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not disclosed</td>
<td>25</td>
<td>60</td>
<td>22</td>
<td>52</td>
<td>22</td>
<td>54</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table (4-9) gives a summary of the bases on which stock and work in progress are stated in the accounts of the forty-two companies included in the survey. More than one basis has been used by a number of companies for different categories of their stocks, giving rise to a number of instances greater than the number of companies involved.

As is apparent from table (4-9), the majority of companies did not present the basis of computation of stock and work in progress.

Two methods have been applied by the companies, namely:

1- The lower of cost and realisable value: this was used by 12 companies in 1984 (29%), and 15 companies in the years 1985 and 1986.
2- Cost value: this method was applied by 10 companies in 1984 (23%), 11 companies in 1985 and only 9 companies in 1986.

B- Basis for Calculation of the Cost of Stock and Work in Progress:

With regard to the various categories of stocks and work in progress, cost should include the cost of conversion incurred in bringing the product of service to its current location and condition. This is, of course, in addition to the cost of purchase. The cost of conversion as defined here should cover production overheads, based on the normal level of activity, and any other relevant overheads which the enterprise in question may incur. The fairest practicable approximation to actual cost should be a target to be attained by management in selecting methods of ascertaining cost.

| Table (4-10): Methods of calculating cost of stocks |
| --- | --- | --- | --- |
| | 1984 | 1985 | 1986 |
| Method | No | % | No | % | No | % |
| FIFO | 6 | 14 | 6 | 14 | 6 | 15 |
| Average Cost | 6 | 14 | 7 | 17 | 8 | 20 |
| Standard cost | 1 | 2 | 1 | 2 | 1 | 2 |
| No disclosure | 31 | 74 | 29 | 69 | 27 | 66 |

Table (4-10) gives a summary of the methods used in the calculation of cost of stocks.

Only three of the known methods have been applied by companies. The first method, FIFO, was followed by 6 companies
(16%) in each of the three years 1984, 1985 and 1986. The second method, i.e. the average cost, was applied by 6 companies in 1984, 7 companies in 1985 and 8 companies in 1986. The third and last method, the standard cost, was used by no more than one company in each of the three mentioned years. The number of companies which did not state the method of computation was thirty-one (74%) in 1984, twenty-nine in 1985 and twenty-seven companies in 1986.

4.4.5 Associated Company Treatment:

We shall deal here with the aspects reflected in the balance sheets of the accounting treatment of non-subsidiaries investments.

Companies are not required to disclose associated company treatment.

Analysis:

Quite often, companies conduct a remarkable part of their business through other companies where they have long-term equity investments and considerable influence or control. Most such companies refrain from disclosing any information as to the nature of associated companies business.

The accounting treatment adopted by the companies which reported investments ranging between 20% and 50% of other companies' equity shares is shown in table (4-11)
Table (4-11): Associated company treatment

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company reporting equity holdings of between 20% &amp; 50% in other companies</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Treated as associated companies</td>
<td>19</td>
<td>45</td>
<td>20</td>
</tr>
<tr>
<td>Not as associated companies</td>
<td>6</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>No holdings of between 20% &amp; 50% in other companies</td>
<td>17</td>
<td>41</td>
<td>18</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

As apparent from table (4-11) the number of companies holding between 20% and 50% in other companies’ equities was twenty-five in 1984 and 1986 and twenty-four in 1985. However, not all of these companies stated such other companies as associated ones. Those which did so amounted to nineteen companies in 1984, twenty companies in 1985 and twenty-two in 1986. The number of companies which did not have holdings in associated companies (within the given range) amounted to seventeen in 1984, eighteen in 1985 and sixteen companies in 1986.

The reasons given by companies holding between 20% and 50% in equity for not using associated company treatment, either fully or partially, are shown in table (4-12)

Table (4-12): Reasons for not using associated company treatment

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount involved not material</td>
<td>5</td>
<td>12</td>
<td>3</td>
</tr>
<tr>
<td>Insufficient influence of investing company</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Reason not given</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
<td>14</td>
<td>4</td>
</tr>
</tbody>
</table>

165
Table (4-12) indicates that the reason why some companies did not disclose their holdings in associated companies is that they considered such holdings to be of little material significance, or the influence exercised over the associated companies to be insufficient to necessitate such treatment.

4.4.6 Group Accounts:

Kuwait has witnessed no development in group financial reporting, since Kuwaiti companies have traditionally focused, not on consolidated financial statements, but rather on parent company financial statements.

Statutory requirements:

Consolidated financial statements are not required by the Commercial Law. There is no local requirement which necessitates group accounts in Kuwait, nor a local definition of a subsidiary. In practice it is accepted that a subsidiary is an enterprise in which the holding company has over 50% share capital interest.

Analysis:

Consolidation of subsidiaries is not a common practice in Kuwait. Only accounts of individual companies are prepared in most cases. Some details of the investments in subsidiaries are generally included in holding companies' accounts.

Table (4-13) shows the current practice followed by companies in the treatment of subsidiaries as reflected in their financial statements.
Table (4-13): Group Accounts

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Presented</td>
<td>5</td>
<td>12</td>
<td>6</td>
</tr>
<tr>
<td>Not presented</td>
<td>14</td>
<td>33</td>
<td>12</td>
</tr>
<tr>
<td>Not applicable</td>
<td>23</td>
<td>55</td>
<td>24</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

Five out of forty-two companies in 1984 consolidated one or more of their subsidiaries. In 1985 and 1986 the relevant figures were six and seven respectively. The number of companies which did not consolidate subsidiaries were fourteen, twelve and ten in the years 1984, 1985 and 1986 respectively. The remaining companies did not have subsidiaries. These numbered twenty-three in 1984 and twenty-four in 1985 and 1986.

Table (4-14) provides a summary of the reasons given for not consolidating subsidiaries in the accounts of parent companies.

Table (4-14): Reason given for non-consolidation

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Figures not material</td>
<td>8</td>
<td>19</td>
<td>7</td>
</tr>
<tr>
<td>Business radically different</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>No financial reports available</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Reason not given</td>
<td>6</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>33</td>
<td>12</td>
</tr>
</tbody>
</table>
That the investments in the subsidiary were of insignificant size was the main reason for non-consolidation. This reason was given by eight companies in 1984, and seven companies in 1985 and 1986.

Table (4-15): Presentation of minority interest

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Minority interest shown</td>
<td>3</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Minority interest not shown</td>
<td>2</td>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>

With regard to the presentation of minority interests, table (4-15) reveals that only three companies in 1984 and 1985, and four companies in 1986 have presented their minority interests.

4.4.7 Foreign Currency Translation:

Two different types of foreign currencies may have to be accounted for by a company:

(a) **In the individual company:**

Company transactions may have to be made in foreign currency, such as in the case of purchasing or selling goods where settlement is affected in foreign currency. Such a situation necessitates the translation of the foreign currency items into the domestic currency upon the preparation of financial statements of the company.

(b) **In the consolidated financial statements:**

Where a company has foreign operations which are to be consolidated in the accounts with the accounts of other
companies in a group which are denominated in foreign currency, then the financial statements must be translated into domestic currency.

Multinational groups face a special problem of consolidation, since several different currencies are used in the component financial statements. This is of immense practical importance because the method chosen will considerably affect the balance sheet and, in particular, the profit figures of the multinational group.\(^9\)

**Statutory requirement:**

The Commercial Law does not require companies to disclose the basis on which assets or liabilities in foreign currencies have been translated into Kuwaiti currency (K. Dinar).

**Analysis:**

Almost all business enterprises in Kuwait come across dealings in foreign currency, because most goods and services are imported from other countries. The policies adopted by companies as regards foreign currency translation are mostly vague and incomplete.

(1) **Translation method used for balance sheet items:**

The bases of translation adopted by the companies covered by the survey are shown in table (4-16).

Three methods have been used by Kuwaiti companies in translating foreign currency as regards the balance sheet particulars. Table (4-16) indicates that most Kuwaiti companies opted exclusively for the closing rate method, with an increasing
tendency in this direction. This method was used by 24 companies (57%) in 1984, increasing in the following years, 1985 and 1986, to 27 and 29 respectively.

Table (4-16): Foreign currency translation methods used for the balance sheet methods Year

<table>
<thead>
<tr>
<th>Method</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>No %</td>
<td>No %</td>
<td>No %</td>
<td>No %</td>
</tr>
<tr>
<td>Closing rate</td>
<td>24</td>
<td>57</td>
<td>27</td>
</tr>
<tr>
<td>Average rate</td>
<td>3</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Current/non-current</td>
<td>4</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>No evidence of foreign operations</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Not disclosed</td>
<td>10</td>
<td>24</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

The second method in popularity terms is the current/non-current. This was used by four companies (10%) in 1984 and 1985, but the number decreased to only three companies in 1986.

Finally, the average rate method was used by three companies in 1984 and 1986, and four companies in 1985. In the case of one company, no evidence was available to the effect that it had foreign currency operations. Some companies did have such operations but refrained from disclosing the adopted method of translation. These were ten such companies (24%) in 1984, six in 1985, and five in 1986.

(2) Translation method used for the transaction:

The bases of translation adopted by the companies for the transactions are shown in table (4-17)
From the above table we can see that Kuwaiti companies have used two methods for currency transactions' translations. The first method is the rates prevailing at the date of the transaction, which was used by 23 companies in 1984, 25 companies in 1985, and 30 companies in 1986.

The second method of fixed rate was used by two, four, and three companies in 1984, 1985, and 1986 respectively. Sixteen companies (38%) did not state the method in 1984, but the number decreased to twelve and seven companies in 1985 and 1986 respectively.

(3) Disclosure of exchange differences:
Table (4-18) reveals how far the Kuwaiti companies disclose their accounting policies in regard to the treatment of differences on exchange.
Table (4-18): Disclosure of exchange differences

<table>
<thead>
<tr>
<th>Year</th>
<th>Exchange difference shown:</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
</tr>
<tr>
<td>Only in the profit and loss account</td>
<td>Only in movements in reserves.</td>
<td>Shown in both</td>
<td>No difference of foreign operations shown</td>
<td>No evidence of foreign operations</td>
</tr>
<tr>
<td>1984</td>
<td>25</td>
<td>60</td>
<td>31</td>
<td>74</td>
</tr>
<tr>
<td>1985</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1986</td>
<td>2</td>
<td>5</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>14</td>
<td>33</td>
<td>6</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>42</td>
<td>100</td>
<td>42</td>
<td>100</td>
</tr>
</tbody>
</table>

Table (4-18) shows that most companies have disclosed the differences resulting from the translation of foreign currencies. Their number amounted to 27 companies in 1984, and 35 companies in 1985 and 1986. The number of companies which disclosed the differences in the profit and loss account together with the reserves was two, four and four companies in 1984, 1985, and 1986 respectively. Fourteen companies did not disclose the differences in 1984, but the number dropped in 1985 and 1986 to six and five companies respectively.

The translation of transactions in foreign currencies takes effect at the rate of exchange prevailing at the time the transactions take place. This is equivalent in most cases to the rates used by the banks to convert the foreign currency to the reporting currency of the company. The translation of all assets and liabilities denominated in foreign currencies is normally effected
at the balance sheet date, with any differences arising being transferred to the profit and loss account.

4.4.8 Accounts Treatment for Goodwill

Statutory requirement:

The decree No. 15 of 1960 requires companies under schedule C (S.2:c) thereof to show the value of any goodwill in their balance sheets.

Analysis:

Table (4-19) shows details of the accounting treatment of goodwill.

Table (4-19): Accounting treatment for goodwill

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill shown as asset:</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Under fixed assets........</td>
<td>2</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Neither fixed nor current</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Goodwill written off......</td>
<td>2</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>No reference to goodwill in balance sheet or accounting policies</td>
<td>37</td>
<td>88</td>
<td>37</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

As the table clearly shows, few companies presented goodwill on their balance sheet. Out of a total of forty-two companies included in the survey, only five companies in 1984, 1985, and 1986 referred to goodwill. This represents 12% of the companies. All of these disclosed the policies adopted in accounting treatment. These are shown in table (4-20).
Table (4-20): Accounting policies for goodwill

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill:</td>
<td>No %</td>
<td>No %</td>
<td>No %</td>
</tr>
<tr>
<td>Written down or amortised</td>
<td>5</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Shown at cost</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Written off in year of</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>acquisition</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

4.4.9 Contingent Liabilities:

Statutory requirement:

Companies are required by law to give information on the general nature of any contingent liabilities, together with the amounts included (S.8:a).

Analysis:

Table (4-21): Statement of contingent liabilities

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement:</td>
<td>No %</td>
<td>No %</td>
<td>No %</td>
</tr>
<tr>
<td>Provided</td>
<td>30</td>
<td>71</td>
<td>31</td>
</tr>
<tr>
<td>Method not disclosed</td>
<td>12</td>
<td>29</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>41</td>
</tr>
</tbody>
</table>

Table (4-21) shows that in the year 1984, thirty (1985 and 1986: 31) of the companies surveyed disclosed the existence of contingencies in their accounts. But with regard to the companies which did not make reference to contingencies, it was not possible to ascertain from financial statements whether or not these companies had contingencies.
4.4.10  Source and Application of Funds Statement:

Neither the profit and loss account nor the balance sheet alone can present a readily comprehensible view of a company's performance. This can be achieved by the funds statements, which seek to provide, among another things, the following information: (10)

(a) The application of profit for the accounting period.

(b) The situation as to investment or disinvestment in subsidiary or associated companies, fixed assets, and working capital.

(c) How far the company's finances have been supplied by either internally or externally granted funds.

(d) What forms the external finance has taken, whether equity, long or short-term loans.

To the user of accounts, the presentation of a funds statement, together with other financial statements is of great help.

Comprehensive information as to revenues, expenses, and dividends offered by a detailed profit and loss account is available, but this does not show the overall cash position during the accounting period. A company's profitability over a given period does not preclude the possibility of a deteriorating cash position. The following are some of the possible reasons for this:

- fixed assets purchases,
- loan repayments,
- creditors being repaid more rapidly, and
debts not being collected as quickly.

This may be illustrated by comparing the opening and closing balance sheets. Nevertheless it would be of great use to users to have a single statement which highlights changes in the financial position and explains the relationship between liquidity and profitability.

**Statutory requirements:**

There are no clear cut provisions of law in relation to the presentation of funds statement.

**Analysis:**

Table (4-22): Source and application of funds statement

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement:</td>
<td>No</td>
<td>%</td>
<td>No</td>
</tr>
<tr>
<td>Presented</td>
<td>19</td>
<td>45</td>
<td>33</td>
</tr>
<tr>
<td>Not presented</td>
<td>23</td>
<td>55</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>100</td>
<td>42</td>
</tr>
</tbody>
</table>

According to table (4-22), the numbers of companies which provided source and application of funds statement was 19 companies in 1984, representing 45% of the companies surveyed. In 1985 the figure increased to 33, and was the same in the following year. As to the location of the statement, it was placed before the notes and following the balance sheet and profit and loss account.
4.4.11 The Contents of Historical Summaries:

The information which is provided by historical summaries is of remarkable importance as far as the strength of a company and its financial performance are concerned. It assists in revealing the general tendency and the results which follow the progressive sequences. Profit and loss in the current year and the balance sheet information are included therein, and the presentation of corresponding figures and information covering the preceding few years can give a fair indication of the trend followed by the company's performance, down to the latest disclosed position.\(^{(11)}\)

**Analysis:**

Table (4-23): Information shown in historical summaries

<table>
<thead>
<tr>
<th>Year</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period covered by summaries:</td>
<td>No %</td>
<td>No %</td>
<td>No %</td>
</tr>
<tr>
<td>2-5 years</td>
<td>7 17</td>
<td>5 12</td>
<td>5 12</td>
</tr>
<tr>
<td>Over 5 years</td>
<td>7 17</td>
<td>6 14</td>
<td>5 12</td>
</tr>
<tr>
<td>No historical summary</td>
<td>28 66</td>
<td>31 74</td>
<td>31 76</td>
</tr>
<tr>
<td>Total</td>
<td>42 100</td>
<td>42 100</td>
<td>41 100</td>
</tr>
</tbody>
</table>

Only a few companies included in their annual reports a historical summary for a number of years as a salient feature of their accounts. These were in many cases accompanied by statistics, such as relevant ratios, relating to the accounts at issue. The 1960 Decree No. 15 and other relevant laws do not require the provision of such information.
Table (4-23) shows the number of companies which provided historical summaries. Some of the figures shown in these summaries were isolated and scattered, with no linking connection. However, other summaries reflected some logical progression from turnover to retained profit.

4.4.12 Post-balance Sheet Events:

It is sometimes necessary to disclose certain events which have taken place after the balance sheet date. This is in order either to clarify the financial position as shown in the balance sheet or to ensure against misleading figures resulting from their omission.\(^{12}\)

Non-disclosure of particular events which occur after the balance sheet date precludes investors from being aware of material change, which could influence their decision-making.

No company surveyed referred to post balance sheet events.

4.4.13 Current Cost Statements:

Historical cost accounts are of limited usefulness, because they do not reflect current values. If we take asset valuations, for example, we find that are often so low as to have little meaning, if they are valued by reference to the lower of cost or net realisable valuation rule. The same is the case if, due to annual depreciation charges, historical costs are systematically written down\(^{13}\)

The basic objective of current cost accounts as mentioned in SSAP 16 "...is to provide more useful information than that available from historical cost accounts alone for the guidance of
the management of the business, the shareholders and others on such matters as:

(a) the financial availability of the business;
(b) return on investment;
(c) pricing policy, cost control and distribution decisions; and
(d) gearing."

Current cost accounting data are not required to be disclosed under Kuwaiti law, and preparers of financial statements in Kuwait give no data in respect of inflation.

4.4.14 Research and development cost:

In order for a company to maintain a share in high technology markets, it may need to allow for the cost of research and development which must be accounted for. Information on this matter is useful for accounts' users, especially if companies usually defer the amount to be spent on research and development.

In Kuwait, however, only a small number of companies have specific research and development cost centres. Certainly, a few enterprises maintain programmes for this purpose, but these companies do not present in their accounts the cost of research and development. Among the companies included in the survey, only one company disclosed as part of its accounting policies the basis adopted for amortisation.

Kuwaiti law does not require the accounting and disclosure of research and development expenditure.
4.5 Conclusion:

An analytical study of companies' annual financial statements revealed remarkable differences and variations among the items of information disclosed by the companies, both with regard to quantity and quality.

The financial information reporting methods used in preparing annual reports varied considerably. Annual accounts had a number of deficiencies which were the result of diverse reporting practices. Most aspects of Kuwaiti financial reporting were characterised by these features. The terminology used in the reports, the methods followed for valuation, presentation, and classification are all important to account users and when impaired, may impede their understanding of company reports.

Shareholding companies generally tend to follow conservative accounting policies and they usually make use of possible latitudes which USA and UK practices may allow. This conservative tendency sometimes goes to the extreme, resulting in secret reserves of remarkable size. The typical example of this policy is to be found in the banking industry, which adopts extreme conservation in line with accepted accounting practice and Kuwaiti government guide-lines, which require that financial statements be drawn up consistently, year by year, and must disclose comparative figures for the previous year. However, no disclosure is effected in practice of movements of secret reserves or undervaluations (if any), although in such cases indication is usually made in the notes to the financial statements of the company's policy in relation to those movements.
The disclosure of accounting policies by companies in Kuwait leaves much to be desired, and more progress in this field is needed, especially towards facilitating understanding by users of the financial reports.

Government action may be necessary to introduce greater uniformity in the selection of measurement methods, a practice which currently suffers from lack of stable standards.
References


4. Ibid., p.10-11.


9. Ibid., p.96.

10. Ibid., p.188.

11. Ibid., p.137.

12. Ibid., p.143.

13. Ibid., p.44.
Chapter Five:

Deficiencies in Kuwaiti Accounting

5.1 Introduction:

As pointed out in Chapter two, financial reporting is not an end in itself per se. It is meant to provide useful information for making business and economic decision relating to the application of available resources. Using the FASB framework as a base, three objectives included in the SFACI are put foreword within the context of decision-usefulness. These are:

(i) Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence. This statement establishes the basic objective for financial reporting.

(ii) Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors and creditors cash flows are related to enterprise cash flows, financial reporting should provide information to help investors,
Figure 2.3  The FASB conceptual framework for financial reporting
creditors and others, assess the amounts, timing the
uncertainty prospective net cash inflows to the related
enterprise. Stating objectives in terms of the prediction
and evaluation of cash flows provides a vehicle for
assessing and evaluating all accounting information.

(iii) Financial reporting should provide information about the
economic resources of an enterprise, the claims to those
resources (obligation of the enterprise to transfer
resources to other entities and owners equity), and the
effects of transactions, events, and circumstances that
changes its resources and claims to those resources. This
objective is concerned with the needs to evaluate
enterprise performance during a period.

However objectives is, but one element in the FASB framework.
As shown in Figure (2.3), reproduced here for convenience,
qualitative characteristics is to assist in the evaluation of
information systems whenever alternative measurements or
disclosure treatments are possible. The FASB presented a
hierarchy of qualities with usefulness for decision-making
covering benefits and costs such as relevance, reliability,
neutrality, verifiability, comparability ... etc. the primary qualities
are relevance and reliability.

As to elements SFAC3 defines ten interrelated elements of
financial statements - assets, liabilities, equity, investment by
owners, distribution to owners, revenues, expenses, gains, losses
and comprehensive income - all at a high level of generality.

In reviewing the status of its work towards the development of a
conceptual framework the FASB identified three conclusions
which were noteworthy by 1983 (FASB, 1983). Firstly, there are significant differences of option among board members about the concepts that should guide recognition in financial statement statement. Secondly, that recognition concepts are often inseparable from measurement consideration. Thirdly, board members views on financial statement presentation concepts are often related to views concerning recognition criteria.

The board has issued discussion documents on reporting income, reporting funds flows and liquidity and financial statement and other means of financial reporting and an ED on reporting income, cash flows and financial position was published in 1981 (FASB, 1982)

The sources which must be referred to by decision- makers, such as the investor, director, the government or management, are the financial statements. This is in order to obtain a useful and true summary of the business details of the given enterprise. One objective which may be attained by so doing, is the conducting of forecasts of future economic trends.

There are three broad categories of information to be conveyed by accounting reporting: the disclosure of economic resources, the liabilities therein, and any changes which may have taken place concerning the enterprise during the accounting period. Management may thus monitor the affairs of the given enterprise and properly report on the same for the benefit and use of creditors and other parties dealing with the firm. The management itself needs the reported information for its own decision-making process which may affect the handling of resources, planning and other important business activities.1
There is an interchange of effects between the accounting process and the environment embodying it, namely, the process of economic development. This takes place as the accounting process tends to harmonise its status with the requirements of the economic background, while such economic environment could be either enhanced or fettered by the accounting process adopted. An increase is expected in the demand for accounting disclosure. This has been stimulated by the trend for management to be divorced from ownership in companies. Such owners, e.g. shareholders, and would-be investors, need adequate information about the status and operation of the resources in the firm. The quality of the accounting information is thereby expected to be improved under the influence of this rocketing demand.\(^{(2)}\)

However, it can hardly be said that this demand is being met in Kuwait. Information of low quality is still the dominant attribute of accounting processes in the country, and there is a lack of uniformity as regards the entries and amount of information included in the reports. In the absence of alternative information for users of accounting results, attempts at decision-making highlight the acuteness of the problem.

The unfortunate consequence is that the stock exchange, authoritative bodies and users are supplied with accounting information of a very low degree of reliability and comparability, qualities which we shall now analyse.

This chapter relies on the FASB in assessing the deficiencies in Kuwaiti accounting.
5.1.1 Reliability:

Since accounting information -for most purposes- is to be the
grounds for forecasting and future actions, it is submitted that it
should possess good predictive qualities. This is achieved only
when such information is also adequately reliable. In other
words, the accounting data must be a proper representation of
the financial and assets situation so that it may be relied upon
with confidence.¹³

As far as the user of the accounting data is concerned, such data
is reliable when the user has confidence in it as a true
representation of what it purports to disclose. Reliability may
equally be assessed by evaluating the method adopted in the
preparation of the accounts, to ascertain the accuracy and
adequacy of the process itself. For the accounting information to
be adequate; it must comprehensively cover the relevant
financial events, including the important aspects of the same, in
such a way as to make the financial report intelligible for the
user, and to be accurate the information must be devoid of bias
and malassessment.¹⁴

Developed countries, it is generally believed, have a better
record of reliability of accounting information compared to the
developing countries. According to the area survey described in
the previous chapter of this study, financial reporting in Kuwait
does not reach an acceptable degree of reliability.¹⁵

A number of points may be mentioned by way of evidence. The
following items testify to the inadequate disclosure in financial
reports by Kuwaiti firms:

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- None of the Kuwaiti firms surveyed disclosed any current cost statement.
- There was no detailed disclosure of accounting policies.
- No interim reports were published.
- Most companies did not disclose funds statements.
- Most statements were lacking in summaries of important statistics on the financial situation.
- No single company showed research and development statements.
- Statements of value added or employees statistics were not disclosed.

Furthermore, real income and real value are seldom reliable, as shown in the statements of profit and loss and balance sheets.

5.1.2 Comparability:

Comparability denotes the ability -provided by the accounting system- to compare the accounting information of one enterprise with that of another, and to compare the data in the enterprise with other data reflecting events that took or take place in a different period of time. This attribute of accounting information is crucial for decision-making by the user.\(^6\)

Comparison within a single enterprise enlightens the management, creditors and shareholders on the development of events in the financial arena, while comparison between the accounts of two or more different enterprises shows their comparative performances. It is important therefore, that similar inputs be recorded in corresponding numbers which are the subject matter of comparison.\(^7\) The manner of reporting is thus crucial to the user's ability to draw a reasonable
comparison, whether that is within the firm or between different firms. The diversity of the accounting methods followed by Kuwaiti firms revealed in the survey indicate that comparability has not been heeded by the preparers of the relevant accounts.

Table (5-1): Number of methods of various accounting procedures in use in Kuwaiti firms

<table>
<thead>
<tr>
<th>Accounting Procedure</th>
<th>Number of Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unquoted Investments</td>
<td>5</td>
</tr>
<tr>
<td>Revaluation of Property</td>
<td>5</td>
</tr>
<tr>
<td>Quoted Investments</td>
<td>3</td>
</tr>
<tr>
<td>Goodwill</td>
<td>3</td>
</tr>
<tr>
<td>Basis of Computation of Stock and Work in Progress</td>
<td>3</td>
</tr>
<tr>
<td>Foreign Currency Translation</td>
<td>3</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2</td>
</tr>
</tbody>
</table>

The "number of methods" column in the above table shows the diversity of methods in relation to the accounting procedures employed. This must have indeed impeded the process of comparison in Kuwait. The performance of the firms can hardly, therefore, be assessed on the basis of this accounting data. This situation clearly calls for the imposition of uniform accounting standards, in order to promote the quality of accounting and enable the process to produce its intended goals

5-2 The Reasons For Accounting Deficiency:

Kuwaiti firms do not adequately comprehend the value of proper accounting, a fact which impedes the functions of both communication of financial information and measurement thereof within the economic environment. Scrutiny of Kuwaiti
law and the results of the survey conducted in this study, provide no evidence to indicate an adequate apprehension of the significance of accounts data to economic activity. This negatively effects development in this field. There is, from the users' point of view, a lack of information to be gleaned from accounting reports of different firms, since company accounting reports are not all prepared in the same way.

A number of factors contribute to the deficiency evident in Kuwaiti accounting information: first, the failure of law in Kuwait to show the way, by requiring measures to be taken by companies to remove this deficiency; secondly, the absence of a strong accounting profession; thirdly, the existence of broad "Generally Accepted Accounting Principles"; fourthly, and somewhat related to the first reason, the discretion and freedom enjoyed by management; and finally, the lack of adequate research or efficient academic training in Kuwait, which could up-grade the accounting standard.

5.2.1 The Absence of Legal Requirements:

The role of statutory requirements is significant in stimulating change in accounting reporting. Standards relating to auditing and accounting may be enhanced through legal requirements to file information with a government department. Statutory influence could equally affect financial statements in regard to their standard, content, form, accounting periods, frequency of disclosure and the types of books to be kept. The quality of the members of the profession is yet another important area which the law could promote, by raising the minimum standards and qualifications to be attained before the accountant is permitted
to practice.\textsuperscript{[8]} However, until the early 1960's, no legal rules were introduced in Kuwait for the purpose of regulating the accounting profession. The position was then stimulated by commercial expansion and the emergence of companies where management became divorced from ownership. Investors, creditors, and shareholders consequently became in need of crucial financial information for use in decision-making and for the apprehension of their economic position.\textsuperscript{[9]} In 1962 a law was passed in Kuwait which empowered the Ministry of Finance and Economy to issue licences for professional accountants. It was thought by the legislature that this would ultimately serve the public and companies alike. The law laid down the necessary requirements and qualification for an accountant to be "Registered", and it remained in force until replaced in 1981 by a superseding Law, (Law No.5 of 1981).

Schedule C of law No.15 of 1960 attempted to lay down requirements as to the preparation of accounts. However, this was obscured by ambiguity and incomprehensibility.

The policy of the Kuwait government has been to provide basic assistance to practitioners in the accounting field and allow for piecemeal solutions to emerging problems. This policy elevated the reporting practice to some extent, but at same time it blocked the way for uniformity of practice.\textsuperscript{[10]} Again, the legislation process was not backed by adequate knowledge of the realities of the practice, nor the legislature avail itself of professional advice of any significance. No research was conducted either.\textsuperscript{[11]} This added to the haphazard nature of development and, to the lack of comparability of accounting
information, which renders it of little value and provides meagre protection to the user. Capital markets, similarly, were necessarily adversely affected.

It is submitted that the government should exercise a more efficient regulatory role, relying on its power to enforce law, in order to establish adequate professional accounting standards meeting the criteria of reliability and comparability, thereby improving the accounting environment and enhancing the development of economic activity.

5.2.2 The Inadequacy of the Accounting Profession:

The lack of reasonable endeavours to update and promote professional institutes is an ailment which exists in many developing countries. The negative consequences of this situation reflect themselves on the members of such institutes and therefore on the accounting environment within which they practice. The low standard of the institute discourages initiative from government and practitioners alike, because of the ensuing lack of credibility.\(^{(12)}\)

The level of economic growth in Kuwait already demands an organised accounting profession. This has been the position since early in the 1970's - a period of rocketing oil boom resulting in remarkable revenues.

Status of the Accounting Profession in Kuwait:

During the 1950's and 1960's, incomes soared. This was coupled with an influx of immigrant skills and professions, attracted by higher pay and demand for such labour in Kuwait. Accounting
personnel certainly constituted a good proportion of the incoming professional flow. This process allowed for channelling the accounting rules and regulations, through the migrant professionals, from their various (mostly Arab) countries of origin.\(^\text{(13)}\) A positive result has been the establishment of many accounting firms, conceding with a general economic growth in Kuwait. Kuwaiti nationals also directly benefited from the prevailing expertise, and in the early 1970's a few of them entered the accounting and auditing field as suppliers of their own professional services to an increasingly demanding market.\(^\text{(14)}\) This tendency led to a reversal of the situation a few years previously, when all the public accounting firms in Kuwait had been mere subsidiaries or branches of foreign-based companies. Today, only a small minority of such branches exist, the others having been replaced by Kuwaiti firms. The few non-Kuwaiti firms are joint ventures with Kuwaiti capital in participation. This has been made possible through a legal device (Law No.5 of 1981).

The introduction of foreign expertise was not, however, without its negative impact. One reason is that imported skills are not always compatible with local standards and development requirements. This applies to the case of Kuwait, as well as to other developing countries.

The fact that there was no strong and reasonably organised accounting profession in Kuwait was one of the reasons behind the low standard of financial reporting in the country and the absence of good accounting and auditing standards.\(^\text{(15)}\) The Kuwaiti government, therefore, had to attempt two roles: the
provision for disclosure and reporting regulations, and the establishment of the necessary auditing and accounting standards. The attempt was unsuccessful and proved ineffective, leading to some response from the accountants in Kuwait who disapproved of the government performance.\textsuperscript{(16)}

Consequently a Kuwaiti Society of Accountants and Auditors (KSAA) was established in 1973. However, the KSAA has been less efficient than was expected. Its goals lacked clarity and the requirement of improving accounting standards was not obviously addressed, perhaps to avoid antagonising the government, thereby risking loss off the right to exist and function, or the withdrawal of necessary financial assistance. Furthermore, the government seemed to monopolise the regulatory function, which according to law was the province of the Ministry of Commerce and Industry alone.\textsuperscript{(17)} This situation necessarily impeded any attempt towards non-governmental regulation and encouraged non-compliance with the same. Accordingly, although the KSAA remained the only officially authorised body to operate as it did in Kuwait, it was far from achieving the required targets, which were mostly long term. These included the establishment of a national accounting profession as a main objective. Other objects included measures to serve the interests and promote the standards of practising accountants, as part of a move towards a better code of practice and higher level of professional efficiency. The relative failure of this attempt leaves accounting practice in Kuwait still in at a rudimentary stage. There is little research work in the field and no local accounting periodical. The lack of adequate organisation and regulation of the Kuwait accounting profession has remained
for almost thirty years. The same applies equally to auditing practice. There have been no self-regulatory attempts on the part of the business community.

Development of the accounting profession in Kuwait is a necessary requirement in order to cope with the remarkably expanded economy, an objective which could also promote corporate orientation among the members of the public. This task could be achieved through the promotion of Accounting Standards which would lead the reporting practice towards uniformity and harmonisation with the local economic environment. For local professionalism to be built and made able to play its role effectively some necessary requirements need be made available. Firstly, technical advice and essential accounting information must be provided, in order that the profession attains the necessary degree of credibility and recognition. Secondly, self-made rules governing qualification and admission to the profession must take precedence over any other system of certification. This will enhance the standard of such accounting services. Thirdly, research work should be promoted by the Kuwaiti profession in order to improve accounting practice in the country. Fourthly, and in order to feed the accounting profession with future practitioners, the education system should provide an adapted accounting education which meets the needs of the local profession.
5.2.3 The Existence of Broad Generally Accepted Accounting Principles:

A variety of methods may be applied to measure and report the same type of business events. One of effects of adopting Generally Accepted Accounting Principles (GAAP), is that it leads to different approaches in evaluating the firm's assets and liabilities. The results of the reported activity may be remarkably changed due to an alternative presentation method borrowed from the GAAP. Differentiated economic environments may be traced in the light of the resulting variety in the reports, but often the real reason behind the variation could well be the adoption of different methods of accounting. The basis for the choice of such methods is often arbitrary, so long as the chosen policy alternative falls within a body of principles which are believed to be equally acceptable.²⁰

Income, which is an example of profitability measurement over a given time, may vary from one enterprise to another, solely as a result of the adoption of different methods of recognition and measurement. Different individual events are thus subjected to inconsistent methods and this will be reflected in the aggregate totals.

Comparability presupposes a uniform test or standard for inter-firm comparison - an attribute of crucial importance in the presentation of financial information. Inconsistency in accounting methodology adopted by various firms certainly hampers the comparability requirement. The profit column in a financial report may show a figure which is there, not because of enhanced business efficiency, but because of the adoption of a
different accounting method. This may be avoided by providing against such a practice in the accounting principles. Examples of the negative effects of arbitrary and inconsistent adoption of methods include a possible distortion of the stock exchange share prices, with all the damage this may bring about. This is because share pricing will no longer reflect corporate efficiency in the real sense and may to that extent be fictitious. Resources may therefore be incorrectly attracted by less efficient companies, to the detriment of efficient ones.\(^{(21)}\)

The GAAP approach could therefore prove quite damaging so long as it comprises a variety of inconsistent methods which are nonetheless acceptable in financial reporting. The basis for the GAAP principles must therefore be disclosed in order to minimise the possibility of misleading or confusing the reader of the reports.

The existence within GAAP of multiple alternatives from among which management may choose, means wide discretionary power in management's' hands to determine the proper accounting method for application. For example, the management can choose the straight-line or accelerated method for depreciation, FIFO or LIFO valuation method for inventories. This allows for bias towards presenting an enhanced view of the outside world, through the choice of those methods which best increase revenue and assets, reduce liability and loss, or avoid tax. The same procedure may also serve the management by disguising a breach which could have otherwise been disclosed.\(^{(22)}\) Again, different accountants applying different methods on identical data may come to different conclusions.
These and other unfortunate outcomes necessitate the laying down of uniform standards for the accounting practice, an objective which could be achieved by tightening up now the lax system of GAAP and similar approaches.\(^{(23)}\)

The lack of standardisation in accounting practice has been mostly the result of differing definitions of accounting concepts, which in turn leads to the adoption of different accounting methods by accountants.

**The Auditor's Position:**

The GAAP embody a great number of different methods of accounting measurement which are endorsed by the accounting profession. This wholesale endorsement of these principles has removed the need to justify the adoption of any particular method to the exclusion of its alternatives. The auditor's position is that he cannot criticise the financial report on the grounds of an improper choice of method by the management of the firm. They may endorse the adoption by different clients of different methods, even with regard to identical or similar events.

The independent auditor exercises certain checks to ensure that the financial reports are fair, and his notes on the reports show the degree of fairness and his auditing approach.\(^{(24)}\) Auditors' notes are important to the user of financial statements, who so often take the independent auditor's judgement as decisive on a matter. The importance of the role played by the auditor may further be shown by his duty to offer accounting advice to the management, for example suggesting a more appropriate accounting method. This is because an auditor's job
is not to remain silent as regards all existing practices\textsuperscript{25}. There is even a strong body of opinion which requires the auditor to assure himself that the best accounting principles are followed by the management of the firm. Thus, the auditor would not necessarily endorse by all the practices possible under the broad principles approach\textsuperscript{26}.

\textbf{The Results of Kuwaiti Multiplicity of Methods:}

Inconsistency prevails in the preparation of financial reports in Kuwaiti companies. This is especially so as regards the methods applied, for example, to decide on the profitability of the firm or the value of its assets. Individual preparers of statements reach different decisions on the matter, leading to an inevitable variety of methods. In calculating income, there is no standard set of items to be included which applies equally to all firms. A few rules, however, exist which apply to the preparation of balance sheets and a general provision provides for the adoption of GAAP in cases not expressly stated. This general provision has been accompanied by no interpretative guide-lines and, in view of its ambiguity, various and inconsistent interpretations have been reached in practice among Kuwaiti practitioners.

The impact of foreign accounting in Kuwait has already been emphasised in this study. In addition to the Arab countries, especially Egypt, expatriate accountants in Kuwait also come from the United Kingdom and the United States of America. The influence of neighbouring (mostly Arab) countries has been gradually replaced by Western accounting and auditing standards, and this has gone hand in hand with the mushrooming of foreign accounting firms. The effect of this
multifarious professionalism is to give rise to various accounting rules which, in the absence of statutory regulation, leads to negative outcomes. These largely revolve around the problems of inconsistency and lack of uniformity which are clearly reflected in the principles governing the calculation of income and other accounting items.(27)

This situation prevents the existence of comparability, which is an important accounting attribute. The problem is made worse by the absence of disclosure of the method of accounting applied by the individual firms. The need for standardisation has mainly arisen to bring about consistency in preparing periodic profit figures and presenting the firm's financial position.(28)

5.2.4 The Discretion Exercised by Management:

The freedom enjoyed by management in the choice of applicable accounting principles for the firm is a major problem in view of the growing importance of external financial reporting, especially with regard to the increasing split between ownership and management of firms. The external financial report of the enterprise becomes more and more a crucial source of information for potential investors who are keen to have a grasp of the operations of the business.(29)

The business management have certain responsibilities which are related to their activities regarding method and contents of financial reporting. These responsibilities include: the efficient operation of business affairs, the preservation and enhancement of business assets, the taking of anti-inflationary or anti-deflationary measures as the case may be, and adjusting to social
and technological changes within the economic environment. Because of these and other duties, management is accountable and is consequently responsible for disclosing such information which reflects the business performance, covering the full scope of responsibility and accountability. It is further required of management to make such disclosures as will reflect the true and accurate position of the firm. The assistance received by management from accountants is mostly confined to counselling, which covers the explanation of rules and principles governing financial reporting. The ultimate decision as to which of various methods and principles to apply is made by management.\(^{(30)}\)

The management's right to choose the manner of performance reporting falls between two incompatible situations. On the one hand, management is in favour of maximum discretion in the exercise of its right, being driven by the desire to enhance the image of the enterprise's performance. On the other hand, the same freedom might lead to distortion of data, inconsistence and lack of uniformity.\(^{(31)}\) This can hardly be guarded against by reliance solely on the existence of the manager's fiduciary duties, so long as various alternatives are available from which management may select.

Certain reasons might cause the management to conceal some information. Firstly, the incompatibility of objectives between the management and investors means that lower information value is given to the requested accounting items by management than by investors. Secondly, the management tends to withhold more and more information for fear of giving an advantage to competing enterprises. Thirdly, there is also the tendency to
curtail expenditure resulting from the act of collecting and reporting information. Finally, disclosure of more information is not mutually stimulated by different companies.\(^{(32)}\)

It is difficult for the investors to guard against suppression of information by the management, because of their lack of awareness of the nature of such information. The quality of stock, for example, may therefore be distorted without them being able to discover same, because of insufficient disclosure. The securities issued by the relevant business may be unrealistically priced,\(^{(33)}\) leading to misallocation of resources. Moreover, since users greatly value the accounting reports of corporations, it is possible for management to be attracted towards the manipulation of stock prices and enjoy undue advantage as a result. The exact level of efficiency of different enterprises can hardly be compared under the circumstances of inadequate financial reporting.\(^{(34)}\) Rather than leave management such potentially dangerous discretion, it is submitted that an independent body or individual should be entrusted with the function of deciding the proper form and manner of reporting. This and similar measures have been advocated for some time by those who object to the variety or even the existence of alternative reporting principles from which management may choose with great freedom. Advocates of this view are driven by the need for accounting comparability and standardisation.

5.2.5 The Absence of Research Work and Adequate Accounting Education:

According to some writers, there is a tendency in the developing world for accounting education and research to
develop along highly theoretical lines, in isolation from the realities of accounting practice. The practical requirements of planning, control and economic analysis are thus implicitly ignored.\textsuperscript{35}

There are two academic institutions in Kuwait which offer degrees in accounting. One is the University of Kuwait (the Department of Commerce, Economic and Political Science) which was established in 1967 and offers the bachelor degree in accounting. The other is the Commercial Institute which offers two-year diploma courses.

The perspective adopted by the University of Kuwait does not adequately balance macro and micro levels of investigation, as it tends to neglect managerial aspects such as planning and control. Such aspects require the teaching of subjects such as national income accounting, decision information systems, cost/benefit analysis and the like. A second problem with Kuwaiti accounting education is the bias against practical orientation. This is also reflected in teaching methods. Thirdly, the text books in the educational institutes are insufficiently authoritative and only of secondary reference level. Slightly adapted Arabic translations of American texts have been in use, giving rise to problems from poor translation and failure to consider the needs of the local environment. Fourthly, the field suffers from understaffing, partly because of inadequate incentives to attract suitably qualified personnel.\textsuperscript{36} Finally, very little research is conducted and no professional publications periodically issued in the country, largely due to the absence of qualified cadres who are sufficiently free to perform such work.

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Accounting education in Kuwait is in need of direction towards the satisfaction of the demands of a developing country. Future accountants must be provided with training which takes into account the local development requirements. Better remuneration and funding for professional teaching should be allowed for by the accounting education bodies, so that a scholarly environment can be created for both training and efficient research.\(^{[37]}\)

### 5.3 The Effect of the Deficient Accounting System on the Community of Users

Having discussed the reasons for deficiency in accounting financial reporting, it is useful now to turn to assess the effects that this deficiency in Kuwaiti accounting may have on the government and investors as the main users of the financial reports.

#### 53.1 Government:

Accurate and reliable accounting is needed to enhance the quality of planning at the macro level, for example by relating the targeted growth rate to the level of investment. The accuracy and reliability of the economic ratio is determined by the quality of financial reporting.

On the macro level, accounting serves in the implementation of economic policies on a nationwide basis, as well as in the more basic function of data collection. Both roles are crucial to the requirements of a developing country.\(^{[38]}\)

In order to manage the national economy in a sound and informed manner, government demands reliable accounting
reporting, which can only be provided if the accounting system is so equipped and prepared as to make that possible. It is in the interests, therefore, of such an important user of accounting reports, to guarantee the provision of certain functions by an accounting system designed to achieve the following objectives:\footnote{39}

First, essential planning and control information must be supplied to the government, which covers the external as well as national economic levels. Secondly, the national social objectives supervised by the government must influence, through an effective accounting process, the financial accounting at the lower/micro level of the firms. Thirdly, data collection, processing and organisation should be made easy, thereby making financial information readily accessible to government departments and agents.

Accurate disclosure of data on the nature of the business, its profit and financial standing is of great importance to the requirements of developing countries. However, the conceptions held by different enterprises in those countries are so inconsistent that a multiplicity of accounting techniques and methods have been developed, thereby damaging the degree of accounting reliability as well as comparability. The financial statements of a given business are a major indicator of its performance for the government and other users of financial reports. However, without adequate accounting reporting in both quantitative and qualitative senses, it is virtually impossible to assess the soundness of business by this method.
Accounting information system is unsatisfactory, because there are few statutory requirements, presentation of financial statements is minimal. Moreover, current figures are compared only with those of the previous year. The information provided in the annual reports is insufficient and inaccurate. Writers on accounting in the developing countries, such as Mahon and Singhavi (writing on India)\(^{40}\) have directed attention to the inadequacy of financial disclosure in these parts of the world.

Like their counterparts in other developing countries, business managers in Kuwait seem not to respond to the demands of national economic planning, nor to the requirement of reliability of accounting data. The government is thus left with a remarkably difficult task of conducting planning and, in the process, trying to assess the relative performance in different sectors of the national economy.\(^{41}\) The situation clearly calls for effective measures to be taken to promote the quality and adequacy of financial reporting.

5.3.2 The Position of the Investor:

More importance has been placed on the role and use of accounting information proportionate with an increasing reliance on the same for the purpose of investment forecasting and decision making.\(^{42}\) The swiftness of communication with investors is determined by the adequacy of disclosure in financial reporting. Investment decisions which rely on poor annual reports, for example, will certainly be equally unsound, to the detriment of capital allocation and the relevant investor in particular. On the basis of financial information, new investments may be decided or ignored, while existing ones may be either
abandoned or continued, depending in all these cases on the available evidence as to financial viability and potential of the relevant business entity or entities. Other decisions which are based on financial reporting include whether or not to promote the establishment of a capital market which could generate foreign involvement and investment, determining whether or not and on what terms to provide lending services, etc. \(^{43}\)

In Kuwait, little reliance is placed on accounting reports by stockholders and investors. This can be at least partly explained by the fact that the quality and quantity of information included in such reports does not attract decision makers, because of their inadequacy. Only annual reports are available for the user in Kuwait and their standard is as described earlier, with very few firms offering balance sheet accompanied by other analyses, explanatory notes or policy disclosure.

The environment as a whole does not allow comparability because of the prevailing lack of uniformity among firm practices. It is also difficult, if not totally impossible, to conduct any trend study, because of the absence of past years' performance reporting.

For investment decisions to be adequately supported a reform of the accounting reporting system in Kuwait is badly needed.

5.4 Conclusion:

After presenting an analysis of the shortcomings in the field of accounting information in Kuwait, with emphasis on the failure to meet the requirements of reliability and comparability, and after discussing the reasons and the effects of these
shortcomings—especially the impact on the investor and government planning—we now turn to draw some broad conclusions.

The users of accounting information in Kuwait are hardly provided with useful, let alone reliable data. The main reason for this deficiency is the absence of uniformity and standardisation.

The accounting profession in Kuwait is increasingly burdened with greater responsibility, given the growing rate of diversity and complexity in the economic atmosphere and the demands of national development. It is submitted, therefore, that action should be taken to enable accountants to shoulder this responsibility with reasonable effectiveness. Such action must include the establishment of uniform accounting and auditing standards in order to remove the damaging inconsistency, and the promotion of a well-adapted accounting education structure. The accounting profession itself needs to be systematically organised so that it may play a better role in the achievement of accounting targets in the country.
References


5. Ibid., p.75.


17. Ibid., p.127.


21. Glautier and Underdown, p.73.


26. Ibid., p.6.

28. Glautier and Underdown, p.73.


31. Newton, p.31-44.


34. Watts and Zimmerman, p.158.

35. Enthoven, p.83.


43. Moustafa, p.203.
Part Three: The Empirical Survey

Chapter Six: The First Questionnaire: Opinions of Users of Financial Statements
Chapter Seven: The Second Questionnaire: Opinions of Preparers of Financial Statements
Chapter Eight: Analysis of Findings and Testing of Hypotheses

In the previous part of the thesis, we examined the regulatory environment of Kuwaiti accounting, and the practices actually employed by the country's business entities. We drew attention to weaknesses, gaps and ambiguities in the legislation, leaving scope for interpretation, and for considerable diversity of practice among accountants, which is increased by the influence of foreign firms and education. It was argued that in this situation, the timeliness, accuracy and reliability of financial statements, and hence their usefulness, are questionable. To test these assumptions, and explore possibilities for improvement, we conducted an empirical survey, the results of which are presented and analysed in this part, which contains three chapters. Chapter six explores the views of users of financial statements, in terms of their needs and the extent to which these are currently met. Chapter seven presents the opinions of the preparers of financial statements, to survey their practices, the influences on them, their interpretation of the present regulation, and their ideas for improvement. The findings from these chapters are subjected to statistical analysis in chapter eight, which uses the empirical findings to test the hypotheses outlined earlier. Thus, this part will provide empirical support for the criticisms made in part three, and a basis for the recommendations to come.
Chapter Six: The First Questionnaire: Opinions of Users of Financial Statements

Two main questionnaires were distributed in this study: firstly, a questionnaire directed towards users of accounts (e.g. individual investors, portfolio managers, financial and credit analysts, researchers, investment and economic consultants ...etc) and secondly, a questionnaire directed towards accountants and people concerned with the accounting profession (e.g. public and private auditors, academics, financial managers, financial consultants ...etc).

6.1 Sampling

The subject of this study concerns the people under the above two categories. One main constraint which limited the sampling of the above two categories was a lack of records in public or private authorities regarding classification of financial jobs.

The researcher tackled this problem by contacting all share holding companies, investment corporations, accounting firms, academic institutions, economic consultation companies, and authorities in the public sector which deal with companies' financial reports.

When the survey was completed, the total number of classified users was 523, and the total number of classified accountants was 854.

The researcher sent 400 copies of questionnaires (200 of each category) to participants chosen randomly from the population by using SPSS+ programme.
6.2 Response Rate:

The researcher received 319 replies. 158 in the user category, representing a response rate of 79%, and 161 in the accountant category, representing a response rate of 80.5%. This response rate is relatively high and was considered very satisfactory.

The following procedures were adopted to gain successful responses:

1- The researcher obtained a certified letter from the Civil Service Commission granting authority to distribute the questionnaire. The letter introduced the researcher as a doctoral degree candidate and gave a brief explanation of the study, explaining the importance of the respondents' full cooperation in answering the questionnaire.

2- The next step was to secure a key person in every agency visited, to facilitate the distribution of the questionnaire, to gain respondents' trust, and to encourage them to reply objectively.

3- A follow up plan was worked out with the key person, for collecting responses. Unfortunately, some delay was experienced in some authorities, but most of the participants responded quickly.

6.3 Pilot Study:

Although the researcher received no objections to the questions in the questionnaire, a pilot study was conducted in September 1989.
Twenty respondents (ten from each sample) were selected randomly for the pilot test of the questionnaire.

A pilot study was taken to avoid errors occurring in the questionnaire where, for instance, respondents might be encouraged to provide the wrong answer. In short, the pilot study irons out most theoretical problems through practical experience, reducing errors to a minimum. Borg and Gall (Borg, W. and Gall, M. 1983), see the advantages of the pilot study as a way of permitting a preliminary testing of the hypotheses, leading to the main testing of more precise hypotheses in the main study. In addition, such a study often provides the research worker with ideas and new approaches and familiarises him with unforeseen circumstances that arise during the pilot study, thereby greatly reducing errors. Finally, such a preliminary study may save the research worker a great deal of time and money on the research project.

The pilot questionnaires were distributed directly by the researcher to 10 users of financial accounts and 10 accountants and others.

Two minor changes were made to the questionnaires following the pilot study:

- Some words were changed to facilitate translation from English to Arabic.
Some examples were given (in brackets), illustrating the meaning of certain terms.

As the results of the pilot test were only by way of managing the questionnaire, the responses of the twenty respondents in the pilot test were incorporated with those to the major survey, and all the data analysed as one.

6.4 Questionnaire I (Users of Accounts)

Two questionnaires were drawn up by the researcher for the two target populations or parties, i.e., the users of accounts and the people concerned with the profession, for instance, accountants, auditors, and academics.

This chapter is devoted to the examination of the first questionnaire (the user) to gauge the perceptions of the user regarding the development of the accounting system in Kuwait.

6.4.1 The Questionnaire:

The questionnaire was constructed to analyse the importance of financial statements and reports, level of satisfaction with the information provided in these statements and reports, qualitative characteristics of such provided information, and the development of the accounting system.

6.4.2 The Build-Up of Question Sequence:

The questionnaire is self-explanatory. The respondents were instructed on how to complete the questionnaire. Some points were
emphasised: (1) definition of the purpose of the questionnaire, and, (2) in keeping with the note on confidentiality, that the name of the respondents would not be required. The questions were divided into six parts, each part identified with a title. The first four parts covered importance of the elements of financial statements, objectives, qualitative characteristics, and financial reporting. A fifth group of questions was included at the end of the questionnaire regarding: (1) evaluation of different parties concerned with the development of the profession, and (2) proposed solutions for developing the profession in general and setting accounting standards in particular. The final section was for general information.

6.4.3 The order of questions within each question sequence:

As emphasised in table (6-1) the first section of the questionnaire asked about the importance of the elements of different financial statements. The second section asked about the objectives of the financial statements, concentrating on users' satisfaction with the information provided in different financial statements. The third section asked about the qualitative characteristics of the provided information, for instance, reliability, comparability, understandability, relevancy, ...etc. The fourth section asked about financial reporting, for instance, the pattern of reading these statements. Section five was devoted to the examination of respondents' views on ways to improve and develop the accounting system, after their evaluation of the current system and the attitude of parties concerned. The final section was devoted to general information, for example, qualifications (accounting and others), job titles, types of organisation, ...etc.
6.4.4 Results of the First Questionnaire:

In the previous sections, the researcher outlined the methods for conducting the empirical investigation. We shall now present and discuss the results obtained from the first questionnaire.

The discussion of the background factors of the participating respondents includes their qualifications, the type of organisations, job titles, and nationality.

Descriptive statistics are used to indicate the respondents' degree of satisfaction with the application of the accounting system.

Respondents' views regarding the contribution of parties concerned in developing the accounting profession in Kuwait, the proposed degree of involvement of these parties in advancing the profession, and suggestions for future improvement, are then discussed.

The testing of hypotheses will follow in a later chapter. However, before the presentation of the data based on the field work, mention will be made, by way of introduction, of general data.

6.4.4.1 Respondents' Background Factors:

Information was gathered to provide means of classifying respondents according to qualifications, categories of job, work sector (type of organisation) and nationality. The following sections discuss each of these background factors.

6.4.4.1.1 Qualifications:
The respondents were classified into two main groups: respondents with accounting qualifications and respondents with other qualifications. The distribution of the two groups is shown in table (6-2). As can be seen from this table, 46.8% of our respondents have accounting qualifications, 36.1% have other qualifications, while 17.1% did not specify their qualifications. In other words, the dominant group is of respondents with accounting qualifications.

6.4.4.1.2 Job Title:

A variety of occupations were stated by respondents. These positions include the following:

Although these respondents gave various and diversified replies, due to the different backgrounds included, these multiple responses provided insight into the determining factors affecting the attitude toward development of the accounting system. A first glance at the sample combination and the associated backgrounds of the participants indicates that investors, portfolio managers, financial analysts, credit analysts, and consultants represent a percentage range of from 15-20%, and the research category represents 5.7% of the respondents.

6.4.4.1.3 Type of Organisation:

The distribution of the respondents among different kinds of organisations is shown in table (6-4).

From this table it can be seen that investment companies and banks constitute the majority of the organisations (55.7%), consultation
institutes, government sector agencies and individuals represent more than one third of the respondents, while 7.6% of the respondents did not specify their type of organisation.

6.4.4.1.4 Nationality:

Table (6-5) shows that the majority of respondents, 59.5%, are Kuwaiti.

In conclusion; 46.8% of our respondents have accounting qualifications; 55.7% of them came from investment companies and banks; finally 59.5% of our respondents are Kuwaiti.

6.4.4.2 Importance of the Elements of Financial Statements and Reports:

6.4.4.2.1 Respondents' Views of the Importance of Elements of Financial Statements and Reports:

Respondents were asked to score on a five point scale the importance of different types of information disclosed in financial statements for their financial decision making. On the five point scale, 1 was defined as very important, 3 as being neutral, and 5 as very unimportant (not at all important).

The views expressed by respondents are summarised in table (6-6), which reflects the degree of importance of the information provided in financial statements. From it, the following results can be summarised:

- It can be seen from the table that all of the elements of the financial statements and reports were considered to be important
or very important by at least 48% of respondents, while the item receiving most support was considered important by 92% of respondents.

- As to the importance of the elements of financial statements, table (6-6) indicates that the most important items are: net profit available for distribution, earnings per share, dividends, sales and cost of sales, outstanding loans amount and the term of debt, retained earnings and revenue reserves, variety of company investments, comparative figures for previous years, and consistency in application of accounting practices. The median and mode for each of these items is 1 (very important), while the main value ranges from 1.433 to 1.732. Other items are less important for their decision making compared with the above items, but still obtain a high percentage of importance.

- This table indicates that the majority of the respondents considered these items as important for their financial decision making.

6.4.4.3 Objectives:

6.4.4.3.1 Satisfaction with Information Provided in Different Financial Statements and Reports:

The respondents were asked to rate their level of satisfaction with the information provided in financial statements on a five point scale. On this rating, 1 meant very satisfied, 2 meant quite satisfied, 3 meant neutral, 4 meant quite dissatisfied, and 5 meant very dissatisfied.
The ratings determined by respondents are presented in table (6-7), from which, the following results can be summarised:

- As to the respondents' satisfaction with the information provided for financial decision making, the ranking of items did not differ strongly from the ranking of importance of provided information. The items with which respondents were most satisfied were dividends, net profit available for distribution, and earnings per share, respectively. These are the only items with a mode value equal to 1, others had a value greater than 1.

- The items with which respondents were least satisfied were research and development costs (mode equal 3, mean 3.639), ranking of auditors (mode equal 3, mean 3.424), translation of foreign currency methods (mode equal 3, mean 3.424), and extraordinary items gains or losses (mode equal 5, mean 3.411).

- It can be seen by referring to the table that the majority of respondents are not satisfied with most of the items disclosed in financial statements and reports, in terms of ability to meet their information needs. For example: although 77.8% of the respondents agree on the importance of the post-balance sheet events, only 27.8% of them were satisfied with disclosure of this item. Although 71.5% of the respondents agree with the importance of extraordinary items, only 26% of them were satisfied with disclosure of this item.

- Respondents' satisfaction regarding some of the items disclosed in financial statements was very low, e.g. research and
development costs, 11.9%; translation of foreign currency methods, 20.9%.

6.4.4.3.2 Respondents' Views on the Degree of Influence of the Different Financial Statements and Reports on Their Financial Decisions:

The respondents were asked to rate the degree of influence of the different financial statements and reports on a five point scale. On this rating, 1 meant maximum influence, 2 meant considerable influence, 3 meant moderate influence, 4 meant slight influence, and 5 meant no influence. The statements were rated according to the purpose of financial decisions.

The ratings determined by respondents are presented in table (6-8). In this table, the degree of influence of each of the 9 financial statements and reports is summarised. From the table, the following can be noted: As to the degree of influence on financial decisions, table (6-8) indicates the following ranking, which is based on points scored (the mean) attributed to respondents' rating of each of the statements and reports.

* Income statements (most influential);
* The balance sheet (second most influential);
* Cash flow statement (third most influential);
* Statement of source and application of funds (fourth most influential);
* Current cost statement (fifth most influential);
* Auditors' report (sixth most influential).
* Group accounts (seventh most influential);
The replies demonstrated some measures of agreement regarding the effects of items upon financial decisions: 95.6% of the respondents considered that the balance sheet has maximum or considerable influence, 96.2% of the respondents considered that the income statement has maximum or considerable influence, 91.2% of the respondents considered the statement of source and application of funds has maximum or considerable influence, 79.7% of the respondents considered the current cost statement has maximum or considerable influence, 85.4% of the respondents considered the cash flow statement has maximum or considerable influence, 61.4% of the respondents considered the value added statement has considerable or slight influence, 66.4% of the respondents considered group accounts have considerable or slight influence, 69% of the respondents considered the directors' report has considerable or moderate influence, and 69% of the respondents considered the auditors' report has a maximum or moderate influence.

6.4.4.4 Qualitative Characteristics of Accounting Information:

6.4.4.4.1 Respondents' Views on the Qualitative Characteristics of Accounting Information Provided by Different Financial Statements:

Respondents were asked to rate on a five-point scale the usefulness of the information provided, by evaluating its qualitative characteristics.
In scoring, 1 was defined as very useful, 3 as neutral, and 5 as being not at all useful.

Information usefulness was rated according to three statements; namely, balance sheet, income statement, and statement of source and application of funds. The descriptive statistics are presented in three tables. These tables show a summary of the results. From these tables, the following can be summarised:

- As to the usefulness of information provided in balance sheet, table (6-9) indicates the ranking of the ten qualitative characteristics, which is based on points scored (the mean) attributed to respondents' ratings of each of the qualitative characteristics. Reliability, consistency, comparability, availability, and relevancy of information were rated as the best qualitative characteristics. Understandability, accuracy, timing, comprehensivity, and predict value of information were rated as the five worst qualitative characteristics of the information provided in the balance sheet.

- As to the usefulness of information provided in income statement and statement of source and application of funds, tables (6-10, and 11) indicate the ranking of ten qualitative characteristics. Reliability, comparability, understandability, relevancy, and consistency of information were rated as the five best qualitative characteristics. Accuracy, timing, availability, predict value, and comprehensivity of information were rated as the five worst
From the above, we can see that the replies demonstrate agreement concerning the five best and worst qualitative characteristics of the information provided in the income statement and statement of source and application of funds. In addition, we can see from tables (6-9, 10, and 11) that the replies demonstrated agreement concerning the three best qualitative characteristics of the information provided in all of the three statements. Meanwhile, there is some difference between the three results as the grand mean scores of the usefulness of the information provided in the balance sheet is 2.905, that for income statement is 2.915, and for statement of source and application of funds, it is 3.246. The qualitative characteristics of the information provided in the balance sheet, therefore, was considered to be slightly more useful than that in the income statement, while the qualitative characteristics of the information provided in both statements, was considered to be considerably more useful than that in statements of source and application of funds.

The median score of the best of the qualitative characteristics is 2 (slightly useful) in both balance sheet and income statement, and 3 (neutral) in statement of source and application of funds. The mode is 1 (very useful) for the first two statements, and 3 for the statement of source and application of funds. The mean is 2.578 for balance sheet, 2.714 for income statement, and 2.961 for the
statement of source and application of funds. Meanwhile, the median score of the worst of the qualitative characteristics is 3 (neutral) for balance sheet and income statement, and 4 (slightly unuseful) for statement of source and application of funds. The mode is 3 for balance sheet, 4 for income statement and statement of source and application of funds. The mean is 3.196 for balance sheet and income statement, and 3.516 for statement of source and application of funds.

The grand mean is 2.905, 2.915, and 3.246 for balance sheet, income statement, and statement of source and application of funds, respectively; a mean of near or more than 3 (neutral) is considered to be high.

It seems that the respondents have a relatively low opinion regarding the usefulness of the information provided in the three statements. For example, the level of usefulness for the best qualitative characteristics is 50% for balance sheet and income statement, and 39% for statement of source and application of funds. The level of usefulness for the worst qualitative characteristics is 29%, 33%, and 23% for balance sheet, income statement, and statement of source and application of funds, respectively.

6.4.4.4.2 Respondents' Views on the Uniformity of Information Provided by Different Financial Statements:

The respondents were asked to rate on a five-point scale the degree of uniformity of the financial statements. The views expressed by respondents are summarised in table (6-12).
The table indicates the following ranking, which is based on points scored (the mean) attributed to respondents rating of each of the six questions:

* Accounting practice used (most uniform);
* Comprehensivity (second most uniform);
* Statements outlook (third most uniform);
* Audit report (fourth most uniform);
* Understandability (fifth most uniform);
* Level of disclosure (sixth most uniform).

As to the degree of uniformity of financial statements, both median and mode are 3 (neutral) except for level of disclosure, where it is 4 (quite low). The mean for the first four items is around 3 and for the last two items, around 3.5.

The highest percentage of agreement regarding degree of uniformity is 35%, which is low, and the lowest is 17%.

6.4.4.5 Financial Reporting:

6.4.4.5.1 Respondents' Views on the Ranking of Importance of the Different Financial Statements for Serving Financial Decision Making:

The respondents were instructed to rank the importance of the different financial statements and reports, from one to nine, with 1 being the most important, and 9 the ninth or least important.

The ranking determined by respondents is presented in table (6-13). The table indicates the following ranking according to the mean of each statements:
* Balance sheet (most important);
* Income statement (second most important);
* Statement of source and application of funds (third most important);
* Cash flow statement (fourth most important);
* Current cost statement (fifth most important);
* Value added statement (sixth most important);
* Group Accounts (seventh most important);
* Auditors' report (eighth most important);
* Directors' report (ninth most important);

Meanwhile, we notice from the table that the majority (51%) of respondents considered the balance sheet the most important statement, and 50% of them considered the income statement the second most important.

6.4.4.5.2 Respondents' Reading of the Annual Financial Statements and Reports:

The respondents were asked to rate to what degree they read annual financial statements and reports. On this rating, 1 was defined as read thoroughly, 2 as read briefly for interest, and 3 being not read at all. The degree of reading determined by respondents and the descriptive statistics are presented in table (6-14). From the table we can see the following results:

- Balance sheet, income statement, Statement of source and application of funds, current cost statement, and cash flow statement are the most widely read statements, because both the
median and mode are 1 (read thoroughly). The mean value is almost 1 concerning the balance sheet and income statement (1.044, 1.032), and above 1 for the other three statements: 1.247 for statement of source and application of funds, 1.420 for current cost statement, and 1.321 for cash flow statement.

The other statements (value added, group accounts, directors' report, and auditor's report) are given less attention because both median and mode are 2 and 3 respectively.

The replies demonstrated some measure of agreement: 96.8% of the respondents read thoroughly the income statement; 95.6% of the respondents read thoroughly the balance sheet; 75.3% of the respondents read thoroughly the statement of source and application of funds; 72.2% of the respondents read thoroughly the cash flow statement; 64.6% of the respondents read thoroughly the current cost statement; 48.1% of the respondents read briefly the auditor's report; 59.5% of the respondents read briefly the directors' report; 41.8% of the respondents read thoroughly the group accounts; and 45.6% of the respondents do not read the value added statement.

In the previous sections it was concluded that the balance sheet, income statement, statement of source and application of funds, and cash flow are the most influential statements (question 3), and the most important statements (question 6). In this section, it was seem that these statements are the most widely read statements. In other
words, these results indicate a reasonable level of understanding of the financial statements' objectives by our respondents.

6.4.5 Summary:

A- 46.8% of the users sample have accounting qualifications, 55.7% of them work in investment companies or banks, and 59.5% of them are Kuwaiti.

B- The majority of the respondents considered the information provided in different financial statements and reports as important for their financial decisions. The percentage of importance of the information ranged from 48% to 92%.

C- The majority of respondents are not satisfied with the disclosure of most of the information provided in financial statements and reports. In spite of the importance of such information, the percentage of satisfaction with some items disclosed in the annual reports is very low, e.g. research and development cost (11.9%).

D- As to the qualitative characteristics of the provided information in the balance sheet, income statement, and statement of source and application of funds, reliability, comparability, and consistency of information were rated as the best three qualitative characteristics for these three statements. Comprehensivity, predict value, and timing (or accuracy) of information were rated as the worst three qualitative characteristics of the provided information for the three statements. The qualitative
characteristics of the information provided in the balance sheet were considered to be slightly more useful than those in the income statement. The qualitative characteristics of the information provided in the above two statements, however, were considered to be considerably more useful than those in the statement of source and application of funds. The level of uniformity was generally low, ranging from 35.4% down to only 16.5%.

The most important statements are balance sheet, income statement, cash flow, and statement of source and application of funds. The majority of respondents considered the balance sheet as the most important statement, and the income statement as the second important statement. The balance sheet, income statement, cash flow, and statement of source and application of funds are the most widely read statements. This result confirms the previous results that these statements are the most important and influential statements for serving financial decisions.

The final part of the questionnaire will be presented later, to compare it with the second questionnaire results.
Supplement to Chapter Six
Table (6-1): Design of Users' Questionnaire

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<thead>
<tr>
<th>Section No.</th>
<th>Title</th>
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<th>Its Sequence</th>
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<tr>
<td>2</td>
<td>Objectives</td>
<td>2</td>
<td>2-3</td>
</tr>
<tr>
<td>3</td>
<td>Qualitative Characteristics</td>
<td>2</td>
<td>4-5</td>
</tr>
<tr>
<td>4</td>
<td>Financial Reporting</td>
<td>2</td>
<td>6-7</td>
</tr>
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<td>5</td>
<td>Proposal</td>
<td>6</td>
<td>8-13</td>
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Table (6-2): Qualifications

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<th>Valid Percent</th>
<th>Cum Percent</th>
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Table (6-3): Job Title

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<td>Financial Analyst</td>
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<td>Credit Analyst</td>
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<td>Researcher</td>
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### Table (6-4): Type of Organisation

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<tr>
<td>Individual</td>
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### Table (6-5): Nationality

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<tr>
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<td>Kuwaiti</td>
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<td>59.5</td>
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<td>Non-Kuwaiti</td>
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Table (6-6): Respondents' views on the degree of importance of the information provided in different financial statements to the financial decisions. (1=Very Important, 2=Slightly Important, 3=Neutral, 4=Slightly not Important, 5=Not at all Important).

<table>
<thead>
<tr>
<th>Financial Statements’ Items</th>
<th>Degree of Importance</th>
<th>Mean</th>
<th>Ranking</th>
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<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>A Dividends</td>
<td>65.2</td>
<td>20.9</td>
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<tr>
<td>B Earnings per share</td>
<td>69.0</td>
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<td>C Net profit available for distribution</td>
<td>67.7</td>
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<td>D Retained earnings and revenue reserves</td>
<td>53.8</td>
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<td>E Movements in reserves</td>
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<td>F Exchange gains and losses</td>
<td>20.9</td>
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<tr>
<td>G Sales and cost of sales for the period</td>
<td>27.2</td>
<td>33.5</td>
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<tr>
<td>H Outstanding loans amount interest rate, and term of debt</td>
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<td>32.3</td>
<td>3.8</td>
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<tr>
<td>I Methods and rates of depreciation</td>
<td>60.1</td>
<td>25.3</td>
<td>11.4</td>
</tr>
<tr>
<td>J Goodwill and intangible assets</td>
<td>27.8</td>
<td>25.3</td>
<td>36.1</td>
</tr>
<tr>
<td>K Research and development costs</td>
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<td>30.4</td>
<td>36.1</td>
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<tr>
<td>L Translation foreign currency methods</td>
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<td>27.8</td>
<td>31.0</td>
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Table (6-6): Respondents' views on the degree of importance of the information provided in different financial statements to the financial decisions. (Continued/2...)
(1=Very Important, 2=Slightly Important, 3=Neutral, 4= Slightly not Important, 5=Not at all Important).

<table>
<thead>
<tr>
<th>Financial Statements' Items</th>
<th>Degree of Importance</th>
<th>Mean</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>M The basis of revaluation of fixed assets</td>
<td>31.6</td>
<td>27.2</td>
<td>24.7</td>
</tr>
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<td>N Movements on fixed asset accounts during the period</td>
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<td>O Variety of company investments</td>
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<td>27.8</td>
<td>11.4</td>
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<tr>
<td>P Extraordinary items (gains or losses)</td>
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<td>35.4</td>
<td>17.1</td>
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<td>Q Basis of carrying inventories</td>
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<td>R Basis of determining cost of inventories</td>
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<tr>
<td>S Contingent liabilities</td>
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<td>25.9</td>
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<td>T Associated company treatment</td>
<td>32.9</td>
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<td>17.7</td>
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<tr>
<td>U Consistency in application of accounting practices</td>
<td>53.8</td>
<td>26.6</td>
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</tr>
<tr>
<td>V Comparative figures for previous year</td>
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<td>8.2</td>
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<tr>
<td>W Post-balance sheet events</td>
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</tr>
<tr>
<td>X Ranking of auditor</td>
<td>32.3</td>
<td>34.2</td>
<td>14.6</td>
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</table>
Table (6-7): Respondents' views on the degree of satisfaction of the information provided in different financial statements to meeting the informational needs of the users.
(1=Very Satisfied, 2=Quite Satisfied, 3=Neutral, 4=Quite Dissatisfied, 5=Very Dissatisfied).

<table>
<thead>
<tr>
<th>Financial Statements' Items</th>
<th>Degree of Importance</th>
<th>Mean</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>A Dividends</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>B Earnings per share</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>C Net profit available for distribution</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>D Retained earnings and revenue reserves</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>E Movements in reserves</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>F Exchange gains and losses</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>G Sales and cost of sales for the period</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>H Outstanding loans amount interest rate, and term of debt</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>I Methods and rates of depreciation</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>J Goodwill and intangible assets</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>K Research and development costs</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>L Translation foreign currency methods</td>
<td>%</td>
<td>%</td>
<td>%</td>
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Table (6-7): Respondents' views on the degree of satisfaction of the information provided in different financial statements to meeting the informational needs of the users. (Continued/2...)
(1=Very Satisfied, 2=Quite Satisfied, 3=Neutral, 4=Quite Dissatisfied, 5=Very Dissatisfied).

<table>
<thead>
<tr>
<th>Financial Statements’ Items</th>
<th>Degree of Importance</th>
<th>Mean</th>
<th>Ranking</th>
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<tr>
<td>M The basis of revaluation of fixed assets</td>
<td>12.7</td>
<td>13.9</td>
<td>25.9</td>
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<tr>
<td>N Movements on fixed asset accounts during the period</td>
<td>8.2</td>
<td>17.1</td>
<td>29.7</td>
</tr>
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<td>O Variety of company investments</td>
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<td>21.5</td>
<td>20.9</td>
</tr>
<tr>
<td>P Extraordinary items (gains or losses)</td>
<td>8.9</td>
<td>17.1</td>
<td>24.1</td>
</tr>
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<td>Q Basis of carrying inventories</td>
<td>11.4</td>
<td>13.3</td>
<td>37.3</td>
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<tr>
<td>R Basis of determining cost of inventories</td>
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<td>S Contingent liabilities</td>
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<td>31.6</td>
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<td>T Associated company treatment</td>
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<td>24.1</td>
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<td>U Consistency in application of accounting practices</td>
<td>14.6</td>
<td>20.3</td>
<td>25.9</td>
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<tr>
<td>V Comparative figures for previous year</td>
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<td>24.1</td>
<td>27.8</td>
</tr>
<tr>
<td>W Post-balance sheet events</td>
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<td>19.6</td>
<td>24.7</td>
</tr>
<tr>
<td>X Ranking of auditor</td>
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<td>7.0</td>
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Table (6-8): Respondents' views on the degree of influence of the different financial statements and reports on the financial decisions.
(1=Maximum, 2=Considerable, 3=Moderate, 4=Slight, 5=None).

<table>
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<th>Mean</th>
<th>Ranking</th>
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<tr>
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<td>16.5</td>
<td>1.9</td>
</tr>
<tr>
<td>B Income Statement</td>
<td>77.8</td>
<td>18.4</td>
<td>2.5</td>
</tr>
<tr>
<td>C Statement of Source and Application of Funds</td>
<td>28.5</td>
<td>62.7</td>
<td>6.3</td>
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<td>D Current Cost Statement</td>
<td>27.2</td>
<td>52.5</td>
<td>13.3</td>
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<tr>
<td>E Cash Flow Statement</td>
<td>41.1</td>
<td>44.3</td>
<td>10.8</td>
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<tr>
<td>F Value Added Statement</td>
<td>17.7</td>
<td>23.4</td>
<td>18.4</td>
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<tr>
<td>G Group Accounts</td>
<td>15.8</td>
<td>29.1</td>
<td>16.5</td>
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<td>H Directors' Report</td>
<td>8.2</td>
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<td>I Auditors' Report</td>
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<td>12.7</td>
<td>51.3</td>
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Table (6-9): Respondents' views of the qualitative characteristics of the provided information in balance sheet. (1=Very Useful, 2=Slightly Useful, 3=Neutral, 4=Slightly Unuseful, 5=Not at all Useful).

<table>
<thead>
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<th>Qualitative Characteristics</th>
<th>Degree of Usefulness</th>
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<th>Ranking</th>
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<tr>
<td>A  Reliability</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>B  Comparability</td>
<td>24.7</td>
<td>21.5</td>
<td>16.5</td>
</tr>
<tr>
<td>C  Understandability</td>
<td>23.4</td>
<td>19.6</td>
<td>17.1</td>
</tr>
<tr>
<td>D  Relevancy</td>
<td>20.9</td>
<td>24.7</td>
<td>17.1</td>
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<tr>
<td>E  Consistency</td>
<td>30.4</td>
<td>12.0</td>
<td>19.6</td>
</tr>
<tr>
<td>F  Accuracy</td>
<td>20.3</td>
<td>17.7</td>
<td>22.2</td>
</tr>
<tr>
<td>G  Timing</td>
<td>17.7</td>
<td>15.8</td>
<td>22.2</td>
</tr>
<tr>
<td>H  Availability</td>
<td>27.8</td>
<td>17.1</td>
<td>14.6</td>
</tr>
<tr>
<td>I  Predict Value</td>
<td>13.9</td>
<td>15.2</td>
<td>24.7</td>
</tr>
<tr>
<td>J  Comprehensivity</td>
<td>16.5</td>
<td>17.7</td>
<td>15.8</td>
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</table>
Table (6-10): Respondents' views of the qualitative characteristics of the provided information in income statement.

<table>
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<th>Qualitative Characteristics</th>
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<th>Ranking</th>
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</thead>
<tbody>
<tr>
<td>A) Reliability</td>
<td>1 25.9 17.7 15.8 20.9 14.6</td>
<td>24.7</td>
<td>3</td>
</tr>
<tr>
<td>B) Comparability</td>
<td>2 24.1 12.7 21.5 13.3</td>
<td>15.2</td>
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<tr>
<td>C) Understandability</td>
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<tr>
<td>D) Relevancy</td>
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<td>E) Consistency</td>
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<td>F) Accuracy</td>
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<td>G) Timing</td>
<td>7 21.5 19.0 18.4 20.3</td>
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<tr>
<td>H) Availability</td>
<td>8 13.3 20.9 20.3 24.1</td>
<td>3.196</td>
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<tr>
<td>I) Predict Value</td>
<td>9 14.6 18.4 17.1 27.2</td>
<td>3.196</td>
<td>10</td>
</tr>
<tr>
<td>J) Comprehensibility</td>
<td>10 19.6 21.2 17.1</td>
<td>3.196</td>
<td>10</td>
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Table (6-11): Respondents' views of the qualitative characteristics of the provided information in statement of source and application of funds. 
(1=Very Useful, 2=Slightly Useful, 3=Neutral, 4=Slightly Unuseful, 5=Not at all Useful).

<table>
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<th>Qualitative Characteristics</th>
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<th>Ranking</th>
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<td>%</td>
<td>%</td>
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<td>B Comparability</td>
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<td>21.5</td>
<td>22.8</td>
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<td>C Understandability</td>
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<td>17.1</td>
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<td>D Relevancy</td>
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<td>17.7</td>
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<td>E Consistency</td>
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<td>F Accuracy</td>
<td>11.4</td>
<td>13.9</td>
<td>23.4</td>
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<td>G Timing</td>
<td>8.9</td>
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<td>H Availability</td>
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<td>15.2</td>
<td>13.9</td>
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<tr>
<td>I Predict Value</td>
<td>8.2</td>
<td>17.1</td>
<td>22.2</td>
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<tr>
<td>J Comprehensivity</td>
<td>8.2</td>
<td>14.6</td>
<td>18.4</td>
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Table (6-12): Respondents' views on the degree of uniformity of the information provided in different financial statements.
(1=Very High, 2=Quite High, 3=Neutral, 4=Quite Low, 5=Very Low).

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<th>Mean</th>
<th>Ranking</th>
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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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<td>Accounting Practice Used</td>
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<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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<td>C</td>
<td>Audit Report</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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<tr>
<td>D</td>
<td>Statement Outlook</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
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</tr>
<tr>
<td></td>
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<td>%</td>
<td>%</td>
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Table (6-13): Respondents’ views on the ranking of importance of the different financial statements and reports on the financial decisions. (1=Very Important, and so on.)

<table>
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<th>Ranking of Importance</th>
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<th>Ranking</th>
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<td>C Statement of Source and</td>
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<td>D Current Cost Statement</td>
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<td>G Group Accounts</td>
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Table (6-14): Respondents' Reading of the financial statements and reports.
(1=Read Thoroughly, 2=Read Briefly, 3=Don't Read)

<table>
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<th>Mean</th>
<th>Ranking</th>
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