Auditing in Egypt
Wahdan, M.A.; Spronck, P.H.M.; Ali, H.F.; Vaassen, E.; van den Herik, H.J.

Published in:
Proceedings of the MSM Partners’ conference 2005

Publication date:
2005

Link to publication

Citation for published version (APA):

General rights
Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.
- Users may download and print one copy of any publication from the public portal for the purpose of private study or research
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal

Take down policy
If you believe that this document breaches copyright, please contact us providing details, and we will remove access to the work immediately and investigate your claim.
Auditing in Egypt: A study of the legal Framework and professional standards

Mohamed A. Wahdan, Maastricht School of Management, The Netherlands
Pieter Spronck, IKAT, Faculty of General Sciences, Universiteit Maastricht, The Netherlands
Hamdi F. Ali, Maastricht School of Management, The Netherlands
Eddy Vaassen, AIM, Faculty of Economics, Universiteit Maastricht, The Netherlands
H.Jaap van den Herik, IKAT, Faculty of General Sciences, Universiteit Maastricht, The Netherlands

Abstract
The objective of the paper is to present an analysis of the legal framework surrounding the auditing profession in Egypt, and the problems faced by the profession. The basic Company Law of 1951 and the Banking Law of 1957 mainly govern the legal framework of auditing practice. A revision of the Company Law has been proposed in 1997, but it is yet to be finalized and implemented. Furthermore, the Central Accounting Organization Law (1988) and Capital Market Law (1992) have had considerable impact and influence on the practice of auditing in Egypt. The combined set of laws represents the legal framework for the auditing profession in Egypt. The Egyptian Society of Accountants and Auditors is the widely recognized association of chartered accountants and auditors that develop the educational and professional standards in Egypt. Despite this infrastructure, Egypt faces the problem of nonconformity to the professional standards in the auditing profession. Hence, our problem statement reads: (1) can we establish the reasons for nonconformity?, and (2) what measures are to be proposed to transform nonconformity into conformity?

To get a fair view of the Egyptian world of auditing practices, a questionnaire consisting mainly of questions requiring a response on a five point Likert-scale was presented to thirty-two auditors in Egypt; thirteen auditors of academic nature and nineteen practitioners within 17 auditing firms including international auditing firms. In addition, 18 interviews were carried out with them. Based upon the results of these investigations, the nonconformity is found to be caused by four reasons: (1) the lack of experience and expertise in the profession, (2) the weaknesses in the required apprenticeship, (3) the lack of accounting and auditing education, and (4) the lack of competitiveness of the profession in terms of salaries and incentives. Our findings indicate that despite great efforts to comply with accounting and auditing standards, there is still a gap between the accounting and auditing standards and actual practices. In addition, there is a gap between the letter of the law and the practices regarding the organization of the auditing profession and compliance with the accounting and auditing standards. It was seen that the revision of the accounting practice law (133/1951) would remedy some of these problems and weaknesses, but the law is yet to be finalized by the People’s Council and will then be ready for implementation.

Key words: Auditing, Egypt, professional standards, legal framework, laws, auditing problems.

1. Introduction
The purpose of the paper is to present an analysis of the legal framework surrounding the auditing profession in Egypt, and the current problems faced by the profession. Egypt has a history in the field of financial and management accounting. During the 1960s, with the triple movements toward (1) central economic management, (2) nationalization, and (3) expansion of the public sector, the Central Auditing Organization became responsible for auditing the public sector. In the mid-1970s, the Egyptian government had followed an open-door policy to liberalize the national economy, and had initiated several improvements in the accounting and auditing standards and practices. In 1991, the Egyptian government launched a widespread economic development and structural modification program supported by the World Bank and the International Monetary Fund (IMF). This development aimed at sound financial principles, availability of reliable corporate information, and adoption of the international accounting and auditing standards. There are many laws governing the legal framework of auditing practice in Egypt. Despite the legal infrastructure, Egypt faces the problem of nonconformity to the professional standards in the auditing profession. Hence, our problem statement reads: (1) can we establish the reasons for nonconformity? And (2) what measures are to be proposed to transform nonconformity into conformity?

To get a fair view of the Egyptian world of auditing practices, a questionnaire consisting mainly of questions requiring a response on a five point Likert-scale was presented to thirty-two auditors in Egypt; thirteen auditors of academic nature and nineteen practitioners within 17 auditing firms including international auditing firms. In addition, 18 interviews were carried out with them. Based
upon the results of these investigations, the nonconformity is found to be caused by four reasons: (1) the lack of experience and expertise in the profession, (2) the weaknesses in the required apprenticeship, (3) the lack of accounting and auditing education, and (4) the lack of competitiveness of the profession in terms of salaries and incentives. Our findings indicate that despite great efforts to comply with accounting and auditing standards, there is still a gap between the accounting and auditing standards and actual practices. In addition, there is a gap between the letter of the law and the practices regarding the organization of the auditing profession and compliance with the accounting and auditing standards. It was seen that the revision of the accounting practice law (133/1951) would remedy some of these problems and weaknesses, but the law is yet to be finalized by the People’s Council to be ready for implementation.

The outline of the paper is as follows. Section 2 presents the legal framework of auditing. Section 3 deals with professional and educational environment. Section 4 discusses the accounting and auditing standards. Section 5 presents the conclusions. Section 6 provides some recommendations to recover the auditing problems in Egypt.

2. Legal framework of auditing

This section deals with the efforts applied by the Egyptian government to restructure (1) financial reporting, (2) disclosure requirements, and (3) accounting and auditing standards and practices. The Egyptian government has proposed to modify the law to achieve this restructuring. The modifications include (1) modifying the company law, the banking law, and the capital market law, (2) establishing the Central Auditing Organization, and (3) drafting a new accounting practice law.

The Company Law 159/1981

The Company Law requires all companies registered to maintain proper accounting records and prepare yearly audited financial statements. It states that the annual meeting of shareholders should evaluate the auditor’s performance, and should assign a new auditor or renew the engagement of the existing auditor. It requires the auditor to report the following features at the annual meeting, whether:

1. the company maintains proper accounting records;
2. all legal requirements have been applied to the accounts;
3. all information (evidence) for accomplishment of duties has been collected; and
4. the financial statements fairly present the entity’s financial condition and results of operations.

The Company Law requires that external auditors should be carried out in compliance with the Accounting Practice Law 133/1951. The Company Law states that the auditor must not have other contracts with the auditee, for instance, as a founder, director, or employee. However, shareholders can be appointed as external auditor of the auditee. In 2000, there were 1,236,000 registered companies in Egypt; 29,000 corporations and 1,207,000 partnerships. The main four characteristics of the listed companies in Egypt are: (1) most companies are closely held (separation between owners and management is uncommon, and communication with shareholders is weak), (2) considerable state ownership in privatized companies, (3) weak board independence/ one level board structure, and (4) disclosure is not a common practice (Fawzy, 2004).

The Banking Law

The Banking Law 163/1957 requires all banks to follow accounting and auditing requirements and guidelines set by the Central Bank of Egypt. So, the banks are required to follow the Egyptian Accounting Standards regarding a financial reporting. In the case of bank audits, the Central Bank of Egypt controls the auditors’ performance and reviews the auditor’s report and annual financial statements prior to the shareholders’ meeting. The rules that ensure the audit quality state that two auditors -it is allowed that they are from the same auditing firm- must audit bank financial statements. Moreover, an individual auditor cannot formulate reports for more than two banks yearly. However, according to Egypt’s current legislative framework, the individual auditors, not the auditing firms, can be auditors of auditees. In practice, auditees assign individual partners of auditing firms so that the auditing firm cannot be held legally responsible for bad auditing. The draft of new Accounting Practice Law allows auditing firms to be appointed as auditors (Berg & Capaul, 2004).

Capital Market Law 95/1992

Egypt has a Stock Exchange since 1882. This exchange was considered the fifth most active market in the world in the 1950s (ACCE, 1995). In the late 1950s, the activities of the Stock Exchange decreased and remained inactive for 30 years because of a process of nationalization (which led to a socialist era). In the 1990s, the Egyptian government decided to refresh its capital market by recovering its status and the confidence of investors. The Egyptian government has encouraged new foreign capital along with national capital. Therefore, a new Capital Market Law No. 95 was issued in 1992.

According to the Capital Market Law 95/1992, all listed companies are required to follow the Egyptian Accounting Standards. At first, the Capital Market Law requires all listed companies to prepare financial statements in compliance with the International Accounting Standards (IAS). Then, the Ministerial Decree 503/1997 mandated the use of Egyptian Accounting Standards by all enterprises and in the absence of Egyptian Accounting Standards
regarding the accounting treatment, the requirements set by IAS were applied. Subsequently, the Capital Market Law required all listed companies to publish financial statements in two widely spread newspapers and to establish an Audit Committee. In addition, the Capital Market Authority has recently issued a new Capital Market Law, which includes various punishments against violators of financial reporting and disclosure requirements. The new listing rules approved by the Capital Market Authority became effective since August 2002. The rules aim at ensuring that the preparation and presentation of financial statements comply with accounting, auditing, and legal requirements.

The Central Auditing Organization
The Central Auditing Organization is an independent public organization that reports directly to the People’s Assembly (Parliament) by submitting its reports to Parliament. It controls the government funds and those of other public corporate bodies. It helps the Parliament to control financially both the accounting and legal sections, to check performance, to follow up the implementation of the plan, and to review legally the decisions issued on financial irregularities. It is responsible for the audit of state-owned enterprises. It governs the auditing of government departments and agencies, public sector enterprises, and companies in which ownership interest of public investment is not less than 25 percent. The Central Auditing Organization has implemented important steps toward coordination of the public-sector accounting and auditing standards with the internationally accepted standards. Furthermore, the Ministry of Finance and the Central Auditing Organization work together to ensure that state-owned companies comply with accounting and auditing requirements.

Accounting Practice Law
The main law governing professional accountants and auditors, particularly in the private sector, is the Accounting Practice Law 133/1951 and its amendments, which are considered out-of-date by most practitioners. According to the current law, individuals joining the public practice of accounting and auditing must register with the General Register for the Accountants and Auditors, which is maintained by the Ministry of Finance. The current law does not require a qualifying examination for entry. The main features of the new law include the creation of a council for accounting and auditing to stress on coordination among professional accountancy organizations, enrichment of the auditor’s independence, introduction of qualifying examinations for auditors, and acknowledgement of auditing firms as well as individuals auditors as providers of the auditing services (Berg & Capaul, 2004). The draft of a new accounting practice law had been under discussion since 1997. As a result, the efforts to improve accounting and auditing practices slowed down. The new law was drafted under the funding of the Ministry of Finance, the Syndicate of Accountants, and the Egyptian Society for Accountants and Auditors.

3. Professional and educational environment
This section deals with the current situation of the auditing profession, the education, and the auditing firms’ structure in Egypt. It explains the gap between law and normal practice.

3.1 Auditing profession
This subsection presents the current framework of auditing profession in Egypt and the role of the Egyptian Society of Accountants and Auditors in practice. It also explains why there is a gap between the letter of the law and the normal practice. The Egyptian Society of Accountants and Auditors plays a central role in the accounting profession. It is an organization of chartered accountants and is responsible for developing educational and professional standards. It functions like a particular body of accounting professionals. It is a member of the International Federation of Accountants (IFAC), but it does not test whether its members comply with IFAC standards (IFAC, 2004). It was established in 1946 and managed by a Board of Directors. Members have been admitted when they satisfy one or more of the following conditions (Egyptian Society of Accountants and Auditors, Cairo).

1. Membership in the Institute of Chartered Accountants in England and Wales, or another acceptable foreign professional body.
2. Doctoral degree in accounting or auditing with three years of full-time work experience in practice.
3. At least three years of full-time work experience in the office of a practicing Egyptian Society of Accountants and Auditors member or equivalent and successful completion of the two-part examination (The first examination is performed after half of period and the second at the end of three years).

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

It is observed that the audit practitioners are not required to follow any modern code of ethics in line with IFAC Code of Ethics for Professional Accountants. There is no effective code of professional ethics for accountants and auditors in Egypt. However, the Syndicate’s Law 40/1972 discusses ethics breach criteria (such as fraud). Although the Ministry of Finance and the Syndicate have been highlighting awareness of legal requirements, some accountants and auditors ignore the code of ethics for practical performance. In practice, there is little awareness among many practitioners of international best practice concerning conflicts of interest and auditor independence (Rahman, Msadek, & Waly, 2002).

The findings of the survey carried out by the first author in Egypt indicates that the corporations’ limited legal obligations for having auditors have led smaller companies to ignore the auditing process and to ignore the legal procedures of contract auditors. The companies also change them from time to time on purely subjective basis. This behaviour leads to an increase in instability of the auditors’ job. In addition, the auditor’s independence is strongly affected by the prevalence of the closely held companies in which both the majority of stockholders, the Board of Directors, and the companies’ management are the same. This is further aggravated by the lack of separation between auditing and consultancy services provided by the auditor. Finally, in most companies, accounting for the purpose of tax minimization takes precedence over the sound application of accounting principles. As a result, the auditor’s independence is affected and the auditor may be changed according to the management’s willingness.

Sometimes, a Board of Directors invites the auditors to attend the regular Board regular meetings and, at the end of each meeting, the auditors receive compensation for attendance as members of the Board (source: personal communications with auditors). All these actions negatively affect a fair auditor’s report, which is the main concern of the stakeholders. In addition, the non-separation between the auditing service and other services provided by auditors affect the auditor’s independence. Consequently, the above practices distort the picture for users of audited financial statements.

The side effect of the auditor’s report is auditees’ tendency to switch auditors after receiving a qualified or adverse audit opinion. The probability of the auditor switch increases with the severity of qualification (Spires, 1990; Louwers, 1998). The perception that companies may change auditors to improve the auditor’s opinion has serious implications for auditors’ independence and the credibility of their reports (Smith, 1986; Spathis, Doumpos, & Zopounidis, 2003). Table (1) illustrates the results of a Likert-scale survey of experienced auditors regarding the lack of professional code of ethics of the auditing profession in Egypt (e.g., Anderson, Sweeney, & Williams, 2002; http://www.arches.uga.edu/~porterk/likertscale.html).

The questions in Table 1 are designed to elicit perceptions of the auditors on the actual professional ethics gap in Egypt.

Table 1. The lack of professional ethics

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Lack of professional ethics</td>
<td>3.75</td>
</tr>
<tr>
<td>2. Misunderstanding of relationship between the auditor and auditee</td>
<td>3.97</td>
</tr>
<tr>
<td>3. Auditor’s switch because of problems with managers and/or shareholders</td>
<td>3.84</td>
</tr>
<tr>
<td>4. Prevalence of closely held companies</td>
<td>4.19</td>
</tr>
<tr>
<td>5. Issue clean opinion to retain the auditee</td>
<td>3.70</td>
</tr>
</tbody>
</table>

The questions are on (1) the lack of professional ethics, (2) the presence of misunderstanding of the relationship between the auditor and the auditee, (3) changing the auditor because of problems with managers and/or stockholders, (4) the widespread presence of closely held companies, and (5) the practice of issuing clean opinion in order to retain the auditee. Table (2) shows that auditors agree as to the presence of all of these professional problems and their negative contribution to the professional ethics, with the notable exception of the widespread presence of closely held companies as a negative contribution to the ethics problems in Egypt.

3.2 Auditing Education

This subsection presents the current situation of accounting education at universities and the apprenticeship in Egypt.

Educational programs

Educational quality suffers from a lack of a modern syllabus and teacher/students squeeze. According to Rahman et al. (2002), the teacher-student ratio in accounting and auditing departments of large public universities is about 1 to 1,000, which hinders educational quality and restricts essential teacher-student communication. Educational programs are not improving students’ critical thoughts and expertise. Accounting and auditing courses focus on basic topics and application of...
standards and do not include international standards. At the postgraduate level, the quality of accounting and auditing education is relatively high because the syllabus includes international accounting and auditing standards and practices as well as encourages development and empirical research.

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

**The apprenticeship**

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

**3.3 Auditing firms structure**

Egypt has a combined structure of the auditing firms. All the major international auditing firms have a presence in Egypt in addition to well-established local auditing firms. It might be expected that international auditing firms working in Egypt would be more familiar with IAS including parts of the IAS which are not publicly available in Arabic. As a result, it is expected that Egyptian companies audited by one of the international auditing firms will comply more closely with the IAS. KPMG, Ernst and Young, Deloitte Touche Tohmatsu, and Price Waterhouse Coopers are the major international accountancy and legal firms with local partnership.  

**4. Accounting and auditing standards**

**4.1 Accounting and Auditing Standards**

In 1997, the Ministry of Foreign Trade had issued Ministerial Decree 478/1997, establishing the Permanent Committee for Accounting and Auditing Standards. This Committee has the official responsibility for setting the standards. Once the Egyptian Society of Accountants and Auditors has selected the international accounting and auditing standards applicable to the Egyptian situation, it translated them into Arabic language. These standards have become the basis for drafting an Egyptian standard. The first version of such standards is introduced to the Permanent Committee for discussion and adoption, and then sent to the Ministry of Foreign Trade for issuance by a ministerial decree.

The Ministerial Decree 503/1997 is considered the first Egyptian Accounting Standards to be issued. In 2002, Egypt had twenty-two accounting standards and six Auditing Standards. The Egyptian Standards on Auditing (ESA) deal only with the reporting issues and ignore the other areas of International Standards on Auditing (ISA) (Navady, 2001). Egyptian standards on auditing only handle the auditor’s report on financial statements, which enhances the form of the report without covering the whole auditing process. The six Egyptian standards on auditing are as follows (The Ministry of Foreign Trade, 2003).

1. ESA 100 ‘the framework of Egyptian standards on auditing’.
2. ESA 200 ‘the auditor’s report on financial statements’.
3. ESA210 ‘reporting on information accompanying the audited financial statements’.
4. ESA 220 ‘the auditor’s report on the auditing tasks for special purposes’.
5. ESA 230 ‘testing future financial information’.
6. ESA 240 ‘limited auditing tasks for financial statements’.

However, the international standards on auditing are applied in the absence of Egyptian standards on auditing, as stated in the introduction of the Egyptian standards on auditing. In addition, the Egyptian Society of Accountants and Auditors had issued auditing standards, which constitute a translated copy of the ISA (Egyptian Society of Accountants and Auditors, Cairo).

**4.2 Non-compliance with Accounting and Auditing Standards**

The six features of non-compliance with accounting and auditing standards, which have been adopted by the Egyptian government, are the following.

First, ineffective control mechanisms exist for imposing sanctions on public accountants and auditors who fail to comply with accounting and auditing standards. For example, the Cairo and Alexandria Stock Exchange does not have the necessary authority to ensure listed companies to comply with financial reporting requirements, and is incapable of applying sanctions for non-compliance with accounting standards requirements. Moreover, the Central Bank does not have enforcement mechanisms to guarantee compliance with bank statutes.
Second, the quality of the auditing process is influenced by assigning, or changing, auditors. Shareholders have the power to assign, or change, auditors, and to determine levels of auditors’ compensation, but in practice, management makes these decisions. This practice forces auditors to comply with the wishes of top management, which affects the level of compliance with accounting and auditing standards. For example, an auditor may be forced to change an opinion to retain the auditee, although this behaviour is against professional ethics and due care (Louwers, 1998).

Third, a lack of knowledge and guidelines regarding the application of Egyptian and international standards restricts the preparation of financial statements in compliance with these standards. Some auditing firms have competent auditors, who serve more clients than their capacity. This overstretching can negatively affect the audit quality, which, in turn, can result in non-compliance with accounting and auditing standards (Aly, 2001).

Fourth, the revisions by the Capital Market Authority disclose that many listed companies do not comply with disclosure requirements. Moreover, auditors’ reports frequently do not comply with required reporting design (Rahman et al., 2002).

Fifth, the Cairo and Alexandria Stock Exchange does not have the necessary authority to guarantee or enforce the listed companies to comply with financial reporting requirements. Thus, the Stock Exchange is incapable of applying sanctions for non-compliance with financial reporting requirements.

Sixth, the company decisions to implement (or not to implement) IAS are strongly affected by the culture and socio-economic factors. All companies comply with IAS when they do not conflict with local culture factors, but they have deviated where conflict exists. For example, the disclosure level in the company financial statements is considerably lower than the IAS requirements, especially when the disclosure conflicts with the Egyptian tendency for secrecy (Dahawy, Merino, & Conover, 2002).

The level of compliance with familiar aspects of IAS disclosure requirements in Egypt is significantly higher than for relatively unfamiliar aspects of IAS disclosure, although both sets of requirements are available in Arabic. Where aspects of IAS disclosure requirements are relatively unfamiliar, the level of compliance is lower when regulations are not available in official Arabic translations (Abd-Elsalam & Weetman, 2003).

4.3 Auditing Standards in Practice

Almost all ISA are applicable in Egypt. Auditors are required to follow the six Egyptian auditing standards that relate to an auditor’s report, and any ISA that relates to other aspects of the auditing process. Knowledge deficiencies of most practitioners by ISA in practice restrict ensuring sound auditing practice. Although large auditing firms have greater competence to provide high auditing quality, compliance with the applicable auditing standards is not always ensured: in this respect the large firms differ from the small firms. Abd-Elsalam and Weetman (2003) noticed in Egypt that international auditing firms, in most cases, stated that the financial statements were prepared according to the IAS. In many cases, international auditing firms referred to compliance with IAS, but not the ISA. In contrast, local auditing firms, in most cases, stated that the financial statements were prepared according to Generally Accepted Accounting Principles (GAAP) without giving any further explanation of what the phrase meant.

According to the survey findings, a gap exists between auditing standards and actual auditing practice. At present, a lack of understanding results in non-compliance or partial-compliance with auditing standards, which is a problem faced by many auditors who are not part of the international accounting firm networks. This gap results from the lack of Egyptian standards on auditing to perform all auditing tasks. In addition, this gap is attributed to the complexity of the auditing environment. The auditing standards regarding the auditor’s opinion have become ever more detailed and complex, as the auditor’s opinion on financial statements is influenced by three factors: (1) the auditor’s professional characteristics (e.g., independence, a scope of responsibility, competitiveness, and expertise), (2) the characteristics of the auditing environment (e.g., ability to collect evidence, efficiency of the internal controls, and compliance with auditing standards and other regulations), and (3) the auditee’s characteristics (e.g., going-concern ability, disclosure of the accounting principles, compliance with accounting principles, and fairness of the representation of the financial statements). Table 2 illustrates the results of the Likert-scale survey of experienced auditors regarding legal and organizational problems in Egypt.

The problems result from the insufficiency and/or the vagueness of the Egyptian standards on auditing in addition to the legal issues related to the registration of auditors, the auditing obligations on the corporations, and the regulations of getting auditees. Table (2) presents the responses to six questions concerning these issues. As to the limited legal auditing obligation of the corporation and the automatic registration of auditors, the auditors are in mild agreement with these problems. As to the shortage of auditing standards and the shortage of law ruling and regulations related to getting the auditees, auditors are also in mild agreement with these problems. In addition, they are in a certain level of neutrality regarding the vagueness of auditing standards and the complexity of the auditing environment. During several interviews, auditors stressed the facts that: (1) laws do not include rules that state their rights and obligations, (2) there is no strong independent professional organization to guarantee their rights with the auditees, (3) there are no standardized measures for audit
quality, and (4) there is no separation between the auditing service and other services provided to the auditees by the auditors.

Table 2. Legal and organizational auditing problems

<table>
<thead>
<tr>
<th>Question</th>
<th>Mean Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent do you agree that there are the following six legal and organizational problems in Egypt:</td>
<td></td>
</tr>
<tr>
<td>1. Shortage of auditing standards</td>
<td>3.53</td>
</tr>
<tr>
<td>2. Vagueness of auditing standards</td>
<td>2.97</td>
</tr>
<tr>
<td>3. Shortage of the law in relation to getting auditees</td>
<td>3.72</td>
</tr>
<tr>
<td>4. Limited legal audited obligation on corporations</td>
<td>3.78</td>
</tr>
<tr>
<td>5. Automatic registration of auditors</td>
<td>3.84</td>
</tr>
<tr>
<td>6. Complex audit environment</td>
<td>3.28</td>
</tr>
</tbody>
</table>

5. Conclusions

This paper describes the current auditing situation and the legal framework of the auditing profession in Egypt. In the recent years, Egypt had made significant efforts (1) to align corporate financial reporting requirements with the IAS and (2) to close the compliance gap in both accounting and auditing practice.

The Egyptian government has attempted to modify the law to achieve compliance with internationally accepted accounting and auditing standards. These modifications include drafting a new accounting practice law, and modifying the company law, the capital market law, and the banking law. Consequently, important improvements have been achieved in accounting and disclosure requirements for the publicly traded companies and financial institutions and in Egyptian Accounting Standards as benchmarked against IAS. Moreover, a new Accounting Practice Law has been drafted and agreed upon by all stakeholders. There is a gap between legislation and the practice of the profession regarding its organization and compliance with accounting and auditing standards. In addition, based on the survey, a gap is observed between the auditing standards and the actual auditing practice. This gap results from the differences in belief between auditors and users, and the differences in auditors’ expertise and experience. Users of financial statements are unaware of the importance of auditing report types and are dissatisfied with the Egyptian auditors’ performance. While auditors are unwilling to provide additional information about the results of their audits, they believe that the auditing profession has a central role in investment guidance, companies’ evaluation, and economic development.

There is a scarcity of experienced auditors in Egypt, because of a lack of education and training, the absence of a strong independent council [to grant licences, designations, and enforce training and continuous education] and a lack of competitive advantage of the auditing profession. Auditors are not required to follow a code of ethics in line with the IFAC code. This deficiency is accompanied by a prevalence of the closely held companies and the absence of rules in appointing, or changing, auditors. The auditor’s concern, and main priority, has been tax accounting rather than sound financial reporting. In our conclusion, despite the great efforts made to comply with the accounting and auditing standards, there is still a gap between the accounting and auditing standards on the one hand and the actual practices on the other hand. In addition, there is a gap between the letter of the law and the practices regarding the organization of the auditing profession and compliance with the accounting and auditing standards.

6. Recommendations

Based on the survey, we may conclude that many improvements should be achieved to fill the gap between the Egyptian and International standards on auditing and between the auditing standards and the auditing practices. The recommendations are related to three issues: (1) the legal framework of auditing profession, (2) auditing profession, education and standards, and (3) professional ethics and judgements. These recommendations are discussed below.

6.1 Recommendations regarding the legal framework of auditing profession

Four improvements should be achieved as follows.

1. A modern legislative framework should be issued, including an appropriate law for auditing profession, recovering weaknesses in professional education and training arrangements, introducing qualifying examinations for auditors’ license, supporting compliance with IFAC code of ethics, and developing enforcement mechanisms to ensure compliance with accounting and auditing standards.

2. The Egyptian government should improve the relationship between the tax authority and companies, which contributes to building the confidence between them.
3. The Egyptian government should amend the tax law to achieve justice.
4. The Egyptian government should amend the accounting profession law to protect the public interest.

6.2 Recommendations regarding the accounting profession, education, and standards
Five improvements to be suggested are as follows.
1. The authority of the Central Auditing Organization needs to be strengthened, to ensure compliance with the Egyptian accounting and auditing standards.
2. The requirements for licensing registration should be upgraded, so that the trainee-auditors receive practical training only from the authorized auditing firms. It would be best to have specialised professional institutes to grant auditing degrees and designations and to provide a framework for the required training.
3. The professional accounting and auditing standards applied need to be improved, by raising the quality of the public university education and by updating the accounting syllabus to incorporate international accounting and auditing standards.
4. The Egyptian government should emphasize continuous education. The best international practice stipulates that every practicing auditor should complete at least 30 hours of continuing professional education per year, to be aware of the recent developments in auditing and accounting (Arens & Loebbecke, 2000; Arens, Elder & Beasley, 2005).
5. Universities, business associations, and the proposed independent council have to play a central role in promoting the role of the auditing profession in Egypt.

6.3 Recommendations regarding the professional ethics and judgements
Three improvements to be suggested are as follows.
1. The Egyptian government should establish, or determine, an independent accounting and auditing council, which would be responsible for overseeing the public interest activities of auditors, and the effectiveness of the institutional framework supporting high-quality financial reporting.16
2. The quality and credibility of the auditor’s performance will require reviewing the auditor’s independent standards (auditors should be changed every five years).
3. The auditors must refuse to sign clean audit opinions, unless the financial statements are indeed in full compliance with the Egyptian accounting and auditing standards. To do so, four actions should be applied: (1) constituting penalties applied to violators; (2) supporting professional knowledge and understanding of the ISA; (3) giving more attention to the auditor’s independence; and (4) requiring sole proprietorships to have book-keeping in order to facilitate the auditing process and tax accounting.

Endnotes
2. Amendment to the Company Law includes provisions requiring all companies to observe the same accounting standards as are applicable for companies regulated by the Capital Market Authority. Moreover, these provisions specify the rights and duties of the company auditors.
4. There are about 1,100 listed companies, of which about 100 are actively traded companies. For receiving tax benefits, about 900 companies that are virtually closely held were listed in the Stock Exchange, but their securities are hardly traded.
5. According to the Law No. 144 of 1988 amended by law No. 157 of 1998, for further details about the Central Auditing Organization Law, see: http://www.cagindia.org/mandates/Mandates/Egypt
6. State-owned companies listed on the Stock Exchange operate under the direct guidance of the Ministry of Finance. The Ministry provides circulars, sample budgets, and forms of financial reporting. Through this process, the Ministry monitors operating performance, evaluates progress, and rationalizes costs and inventory holdings of the state-owned companies.
7. The Egyptian Accountants and Auditors Association, in cooperation with the Ministry of Finance, the Commercials’ Syndicate, CMA and the Central Auditing Agency have prepared a new draft law to regulate practice of the accounting and auditing profession in Egypt, as an amendment of the current Law No. 133/1951. The draft law was discussed at the State Council and was referred to the government in preparation for forwarding it to the People’s Assembly for approval.
8. All accounting degree holders are eligible for Syndicate membership
9. The six jobs that are deemed equivalent to work in a practicing accountant’s office include the following: (1) Central Auditing Organization’s auditor, (2) tax
inspector, (3) social insurance inspector, (4) Ministry of Finance’s accountant, (5) inspector in the Ministry of Foreign Trade, and (6) staff dealing with financial matters in the government departments.
10. For further details, see: www.sis.eg

11. The Permanent Committee is composed of nine members representing the major accounting associations.

12. Rahman et al. (2002) indicated that interviews and discussions with financial analysts, investment advisors, and foreign and local bank representatives in Egypt revealed serious concerns that weak enforcement mechanisms facilitate non-compliance with established accounting requirements, and that in practice, internationally comparable auditing standards are inadequately applied. Representatives of the investment community generally agree that audited financial statements are rarely reliable and free from material misstatement. All the interviewees, in this study, strongly agreed that financial reporting would depend on implementation of a strong regulatory regime and effective enforcement mechanisms to ensure compliance.

13. Although there are some legal provisions that mention the liabilities of directors and auditors, these liabilities seem to be unclear. In practice, the accountants and auditors do not face any real liability if they violate the legally established accounting and auditing standards. Egyptian accountants and auditors were never sued for their professional misconduct.

14. In the past, accounting scandals were associated with serious financial difficulties in some banks and other corporate entities. In those cases, company directors and officers were sent to prison, but the auditors were neither investigated nor sanctioned by any regulatory or professional body.

15. None of the companies implemented the insider-trading standard because it conflicts with the collectivist nature of the Egyptian society and the way business is conducted in Egypt.

16. This council may consist of representatives of accounting and auditing stakeholders, including the Ministry of Finance, Ministry of Foreign Trade, Capital Market Authority, Central Bank of Egypt, Cairo and Alexandria Stock Exchange, commerce faculties/business schools of the leading universities, business community, Egyptian Society of Accountants, and Syndicate of Accountants.

References


Egyptian Society of Accountants and Auditors, Auditing Standards, Egyptian Society of Accountants and Auditors, Cairo.

Fawzy, S., How does Corporate Governance in Egypt Compare with Selected MENA and Emerging Markets? The Egyptian Center for Economic Studies, Cairo University, June 2004.

IFAC, Handbook of International Auditing, Assurance, and Ethics Pronouncements, International Federation of Accountants, 2004


Navady, I. A., auditing reports in accordance with the Egyptian Standards on Auditing, Gomhoria for publication, Cairo, 2001.


