Accounting standards and practices of financial institutions in GCC countries

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Abstract
In recent years, there has been a growing tendency to establish closer ties among the Gulf Cooperation Council (GCC) countries (Bahrain, Saudi Arabia, Oman, Qatar, and United Arab Emirates) in economies and financial institutions. As a result, there is an increasing need for the harmonization of accounting regulations in order to improve cooperation and enhance the efficiency of the financial institutions among GCC countries. This study is an investigation of the accounting standards followed by the financial institutions in five GCC countries with some policy prescriptions for harmonization of the accounting regulations in GCC countries. This paper deals with accounting policies and practices, including loans and provisions, assets, investments, taxation, liabilities, foreign exchange, revenue recognition, and consolidation of GCC countries’ banking and other financial institutions.

Introduction
The socio-economic, cultural and political norms and environments in different countries significantly influence accounting system/standards, and hence the accounting standards differ in different countries. May and Sundem (1976) have argued that accounting policymaking should be seen as a social choice process, one that is political by nature. However, many developing countries have adopted accounting standards, policy and procedures that are not in consonance with their national heritage. In many cases, they contradict their environmental dynamics. This contradiction appears in several ways such as:
- the adoption of accounting policies/standards of an advanced industrialized country (e.g. Indonesia adopting those of USA);
- the adoption of stereo-type pre-colonial accounting policies and practices (e.g. the adoption of British accounting standards and practices by India, Kenya, and Nigeria (Hove, 1986));
- the adoption of the International Accounting Standards (IAS) (Nobes and Parker (1995), for example Jordan and Arab Gulf States, without any modification; and
- the non-existence of any clear accounting policies and standards in many developing countries (Hassan, 1998).

Drummond (2001a, b, c) highlights the developments of financial markets in GCC countries and the implications of information technology on the performance of GCC financial institutions. Jermakowicz et al. (2000) examine the recent development of accounting standards in China, Poland, and Russia to determine their conformity to IASs.

The Gulf Cooperation Council (GCC) countries have adopted the IAS, but there are some differences in their accounting standards/systems for the aforementioned reasons. Although there is a growing cooperation among these countries in many areas, this area appears to be neglected. Hence, there should be harmonization (or at least the elimination of the major differences) of accounting standards and practices in GCC countries. Thus, our present study is an in-depth analysis of the similarities and differences in accounting standards and practices in GCC countries except for Kuwait[1]. In order to achieve this objective first, an attempt has been made in this paper to highlight the important aspects of accounting standards in the selected five GCC countries. Then the important features of accounting standards and practices are discussed. Finally, the conclusions and future research directions are presented. The data are gathered from the Capital Intelligence Report of 2000 (Capital Intelligence, 1999-2000) as well as other sources from the respective countries. Hussain et al. (2001), Khalaf (2001) and Maskooki and Puri (2000) stress the implications of policies and structural characteristics of financial institutions on the long-term objectives and goals.

The organization of the paper is as follows: section two presents the accounting practices in GCC countries; a critical overview of the accounting standards and practices in GCC countries are summarized in section three; section four concludes the paper with some future research directions.
State-of-art of bank accounting standards

Bahrain

Regulatory environment and supervisory authority

The Bahrain Monetary Agency (BMA) was established under Law 23 in 1973 and, inter alia, is authorized to specify the form and manner in which banks operating in the country should make public the balance sheet and the profit and loss statement of all operations carried out during the year. The Law decrees that an (independent) auditor must certify the accounts. The Law also specifies that the financial year should coincide with the calendar year. Exceptions are made for some Islamic banks, including Bahrain Islamic Bank, which uses the Hijri[2] calendar. Publication of financial statements should take place within a maximum period of three months after the end of every financial year, although an extension may be granted if there are justifying circumstances.

In addition to the annual audited accounts, banks are required to submit to the BMA monthly statements on assets, liabilities and foreign exchange positions; also quarterly and half-yearly reports of a comprehensive nature both on a consolidated and unconsolidated basis. The BMA may publish any information it obtains provided that no details relating to particular operations or banks are divulged without prior written consent. Disclosure of information relating to the affairs of any customer may only be made under court order.

Auditors

All banks in Bahrain must appoint a technically qualified auditor acceptable to the BMA to ensure the independence of auditor requiring integrity of the accounts auditing. No person having an interest in a bank (other than a deposit relationship), nor any director, official, employee, agent or representative, may be appointed as auditor. An auditor’s report on the annual balance sheet and the profit and loss statement must be submitted with the board of directors’ report to the annual meeting of shareholders for discussion and approval. In the report, the auditor must state whether, in his opinion, the balance sheet and profit and loss statement are complete, correct and properly drawn up and whether they reflect a true and correct picture of the operations carried out by the bank.

At their discretion, auditors have direct access to the BMA, which in turn has access to the auditors in circumstances where such contact is protecting the financial integrity of the bank or in other exceptional circumstances. Internationally recognized firms of accountants audit all the 16 Bahraini banks.

Significant accounting principles and practices

Until 1992, there was no legislation prescribing accounting policies to be followed nor was there a prescribed minimum level of disclosure. Management and the auditor had considerable discretion in determining the accounting policies that were to be followed. As a result auditors’ reports are at variance making reference to proper books of account, international accounting guidelines, generally accepted auditing standards and generally accepted accounting principles (Capital Intelligence, 1999-2000).

Since 1992 financial year-end, the BMA required all banks to produce statements in accordance with IAS and, without exception auditors’ reports. Thereafter, they referred to International Standards on auditing and IAS. Further, locally incorporated and publicly quoted banks have been required to publish financial statements on a quarterly basis. These statements need not be audited, but should be reviewed by external auditors and published within eight weeks of the end of the quarter. The following significant accounting principles have been applied:

- **Accounting convention.** Financial statements are prepared under the historical cost convention, modified in the case of some banks by the revaluation of premises and equipment in respect of certain subsidiaries.

- **Income and expenses.** These are generally recognized on an accrual basis.

- **Foreign currency.** These transactions are translated to the currency of the bank’s balance sheet at rates prevailing on transaction dates. Assets and liabilities denominated in foreign currencies are translated at rates prevailing at year-end and any resulting gains or losses are taken to income.

- **Trading securities.** These are generally stated at market value at the balance sheet date, although some banks show the lower of cost or market value.

- **Investment securities.** These are stated at cost, with provision being made for any permanent decline in value.

- **Loans and advances.** These are stated net of accumulated provisions. They are placed on non-performing status as soon as payments of interest or repayments of principal are 90 days past due.
• **Provision for bad and doubtful debts.** Specific and general provisions for loan losses are made on the basis of a continuous appraisal of the lending portfolio, taking into account the bank’s previous experience and current economic conditions. The general provision covers doubtful debts which are likely to be present in any portfolio of bank advances but which have not yet been specifically identified.

• **Depreciation.** Freehold land is not depreciated. The cost of leasehold improvements is depreciated by equal annual installments over the period of the lease. The cost of other fixed assets is depreciated by equal annual installments over their estimated useful lives.

• **Revenue recognition.** Interest income is generally accounted for on an accrual basis. Loan interest that is 90 days or more overdue is excluded from income until received in cash. Dividend income, fees and commissions are normally accounted for as and when received.

• **Taxation.** There is no tax on corporate income in Bahrain. Taxation on foreign operations is provided at the rates applicable in each location.

• **Employees’ terminal benefits.** Provision is made for amounts payable under Bahraini law applicable to employees’ accumulated periods of service at the balance sheet date.

• **Fiduciary assets.** These are held in trust or in a fiduciary capacity are not included in financial statements.

**Saudi Arabia**

**Regulatory environment and supervisory authority**
The regulation and supervision of banks in the Kingdom of Saudi Arabia (KSA) is the responsibility of the Saudi Arabian Monetary Agency (SAMA), which was formally established by royal decree in 1952. SAMA does not possess all the characteristics of a central bank[3], and operates more as a currency board with regulatory and supervisory powers. Its stated objectives are to:

• issue and strengthen the Saudi national currency and to stabilize its internal and external value;

• act as the banker to the government;

• oversee and monitor the country’s commercial banks and money-changers[4].

Accordingly, it is also responsible for the management of Saudi Arabia’s considerable foreign exchange and gold reserves.

The foundation for banking legislation in Saudi Arabia is the Banking Control Law (1966), and the Regulations for Companies. By its charter, as well as by law, SAMA is provided with broad powers to license, regulate, supervise and inspect the activities of commercial banks in the kingdom. These laws, as well as SAMA, make certain requirements with regard to accounting practices. SAMA may at any time require a bank to provide any information it deems necessary for ensuring the realization of the purposes of the law.

SAMA has almost 50 years of experience in carrying out its duties, which in the early days it did with technical advice provided by several foreign central banks, as well as private banks (SAMA has long had a good working relationship with US-based Morgan Guaranty). Over the past two or three decades, SAMA has become more independent, but it recognizes the importance of close communication and cooperation with other central banks, especially given SAMA’s importance in that network. While most of this cooperation has been in the areas of monetary and exchange rate policy, SAMA has also benefited in the development of its regulatory and supervisory departments. This development can be seen in the different approaches to two similar situations a decade apart. In the late 1980s, a major bank controlled by a powerful individual experienced asset quality problems. For several years both domestic and foreign bankers raised questions about the bank’s solvency, a concern that was compounded by the bank’s failure to issue its annual accounts. Despite the fact that this was in defiance of law and SAMA regulations, it was awkward for SAMA to act against such a high-profile figure. When the bank returned to compliance in 1993, it was without the Sheik of the helm, a situation that lasted until 1996. Following his return to the bank’s management, some of the same problems (arbitrary and capricious lending to less than creditworthy borrowers) returned. In 1999, SAMA was able to flex its muscle, and it would appear that during the first six months of the year there was a behind-the-scenes tête-à-tête between the Sheik and SAMA, which is anxious to apply its professional standards to the entire Saudi banking system. On this occasion, SAMA apparently prevailed, and in the final days before the six-month deadline for publication of annual accounts, a major change in ownership and management was announced for the bank (Capital Intelligence, 1999-2000).
External auditors
The Banking Control Law requires that banks appoint two joint external auditors from a list of approved auditors who have been registered with the Ministry of Commerce for more than five years. The General Auditing Bureau and the Ministry of Commerce have issued comprehensive auditing standards and Saudi Arabian auditing standards. These standards address such issues as professional qualification, independence and impartiality, professional care, methods for planning an audit, control and documentation, audit evidence and the auditors’ opinion.

It is preferred that auditors be members of a professional organization, such as chartered accountants in the UK or certified public accountants in the USA. There are no legal requirements or prohibitions relative to making a change in the appointed auditor. All Saudi banks are now audited by at least one local company representing one of the large international accounting firms[5].

Logistically, the two auditors may operate in one of several manners, depending on the working relationship between the two. They may work as one team, or they may divide up the universe to be audited, and then crosscheck each other’s results.

A bank’s annual accounts must include a certificate from management, countersigned by the auditors, stating that the Banking Control Law, Regulations for Companies, and related standards and circulars have been complied with, that all necessary provisions for loan losses have been made and that the statements present a fair view of the results and the financial condition of the bank. Following the audit certification, the statements are sent to SAMA for approval, and after that (but not before) banks must publish in a national newspaper the balance sheet, profit and loss account and auditors’ report. In the past, auditors have qualified their opinions in cases where loan-loss provisions were found to be inadequate (Capital Intelligence, 1999-2000).

The financial statements, audit report and annual report by the banks’ management must be approved in general meetings, following which the annual report may be published and distributed. Further, banks must file a copy of their final accounts with both SAMA and the Ministry of Commerce within six months of the year-end.

Accounting standards and practices
In 1989 SAMA, in consultation with local auditors, issued accounting and disclosure standards for commercial banks licensed to operate in the kingdom (except for money exchange firms), and these have been updated and amended so that they now comply with IAS. Originally, the disclosure standards were issued as voluntary guidelines, but they became compulsory in 1994. From 1997, the entire set of standards applied to the bank’s quarterly statements as well.

SAMA requires banks to use the Gregorian calendar and end their fiscal year on 31 December. Published quarterly results are unaudited and are considered not totally reliable because, while loan-loss provisions are made continually, a final determination for the year is not usually made until the budget cycle is concluded in the fourth quarter.

Basis of consolidation and associated companies. Investments in affiliated companies in which the bank holds an equity stake of up to 20 per cent must be reflected in the bank’s books at cost, adjusted to reflect any permanent reduction in the equity of the affiliate. The accounts of the affiliate must not be consolidated with the bank’s own financial statements. Investment in an affiliate in which the bank holds a 20-50 per cent share of the equity must be reflected using the equity method. In this case, the affiliate’s accounts must not be consolidated with the parent’s financial statements. The cost of the bank’s investment must be adjusted to reflect its share of the realized profits or losses (net of its share of dividend payments) of the subsidiary company.

An investment of over 50 per cent in a subsidiary must also be accounted for using the equity method. In addition to its own financial statements, the investor bank must issue consolidated financial statements reflecting the accounts of the bank and its subsidiary unless the subsidiary’s operations are not banking or finance-related. Investment in a joint-venture type institution must be accounted for using the equity method, and the financial statements of the joint venture must be consolidated with the bank’s own on a proportional consolidation basis.

Deposits customer. Deposit balances must be classified as call deposits, savings accounts or time deposits; deposits from the public sector[6] and deposits with favorable conditions must be disclosed. All of the preceding must be reported and broken down into local and foreign currency amounts. Up to 1993, banks did not provide a breakdown of customer deposit liabilities, arguing that the disclosure of such information would compromise their competitive position with respect to non-interest bearing deposit (NIB) balances. However, all banks now disclose
that breakdown, and have done so since their 1994 financial statements. Bank placements (deposits with banks) must be disclosed separately and broken down into deposits with:

- other domestic banks;
- foreign offices of other domestic banks; and
- foreign banks.

Interest accrual. Sharia law and compensation for loans prohibit receipt or payment of interest which is referred to as “special commission.” Special commission earned on loans and expended on deposits or other borrowing is recognized on an accrual basis.

Non-performing loans. Banking law makes only general reference to problematic loans by assigning management the responsibility of studying and analyzing loan performance and determining borrowers’ solvency. It is up to each bank to identify and classify its portfolio according to guidelines prepared by SAMA. No specific classification or method of classification is mandatory, and the rate of provision for each category of loan is entirely at the discretion of the bank (Capital Intelligence, 1999-2000).

Non-accrual. Special commission on loans thought to be uncollectible is credited to special commission in suspense, and includes commission suspended for the entire year during which the management decision is taken, regardless of the date of such decision. When there are clear indications of possible insolvency on the part of a borrower, the bank must estimate the amount of loan principal and/or special commission in doubt (taking collateral into consideration), and charge that amount to the current financial period as a provision for loan losses. The bank must also determine what will be the accounting treatment of special commission in future periods.

Write-offs and recoveries. In practice, Saudi banks are reluctant to write off loans, because the borrower can use that fact in court as prima facie evidence that the loan is no longer payable. Further, banks have had some experience in the past 20 years with loans thought to be uncollectible being eventually repaid through a combination of persistence, social or political pressure, and such practices as the SAMA lists, which identify delinquent borrowers and mitigate against their obtaining credit from any other bank in the kingdom.

When recoveries are effected, certain accounting rules apply. When a non-performing loan is repaid, loan-loss reserves may be written back or retained as general reserves. A real asset acquired in repayment must be recorded at the lower of the amount of the obligation so secured or the fair market value of the asset at the date of acquisition. Such amounts may be used to reduce the amount of the loan, and if it is then overprovided, excess reserves may likewise be written back or retained as general reserves. Losses incurred as a result of acquiring or revaluing other real estate in settlement of past due loans must be disclosed (Capital Intelligence, 1999-2000).

Loan-loss provisions. These may be taken as specific or general provisions, either of which is deducted from the gross portfolio. General provisions are not deductible for tax purposes, while specific provisions may be, subject to SAMA approval. As a practical matter, however, tax considerations play only a small part in the determination of the level of provisions.

Related-party lending. This must be fully collateralised for amounts exceeding three times an employee’s monthly salary (effectively 100 per cent for directors and senior officers). Furthermore, banks may have at risk no more than 10 per cent of their capital to any one related-party borrower, and no more than 50 per cent of their capital to related-party borrowers in the aggregate.

Fixed assets and depreciation. Fixed assets include bank premises, furniture, fixtures and equipment used for business purposes, but not assets acquired in settlement of a debt. Fixed assets are recognized at cost of acquisition, including any direct capital expenses incurred. Any generally acceptable method of depreciation can be used, but the straight-line method is most common. Fixed assets are stated at cost less accumulated depreciation.

The basis for the determination of assets’ useful lives (three to 45 years) is standardized among the banks. Land is not amortized; leased assets are depreciated by the lessor, and are not accounted for by the lessee until legal title has passed. Banks as lessors hold title and depreciate the asset, which provides additional security in case of a need to repossess collateral.

Investment and trading in securities. The banks’ objective in acquiring securities must be defined beforehand as to trading or investment purposes and the two securities portfolios must be kept separately, with each further divided into domestic and international portfolios. Any authorized transfers between the trading portfolio and the investment portfolio must be recorded at the lower of cost or market value.

Trading securities must be valued at cost upon acquisition and thereafter be marked to
market value on an individual securities basis at the date of each financial period. Profit or loss realized from trading in securities and revaluation differences must be included in the income statement. Investment securities must be valued at cost, with any differences between cost and the nominal value of a security being recorded as premium or discount and amortized over the remaining life of the security. Temporary changes in market value of such securities must be ignored and only permanent changes must result in a revaluation of the securities. A permanent reduction in the value of a security must be reflected in the income statement.

**Foreign currency translation.** Transactions denominated in foreign currencies are recorded in Saudi riyals at the actual exchange rates prevailing on the date of the transaction. FX-denominated assets and liabilities are converted at the rate of exchange as of balance sheet date. All resulting realized and unrealized gains and losses (including those on foreign exchange derivative contracts[7]) are recorded in the income statement as income from major operations, except those from equity investments in subsidiaries and affiliates, which are equity accounted.

Assets and liabilities held by foreign branches or subsidiaries must be translated to local currency applying the spot rate of exchange. Revenues, expenses, gains and losses must be translated using the weighted average spot exchange rate. Exchange differences resulting from the translation of financial statements prepared in foreign currencies should not appear in the income statement but should be taken to special equity reserves.

**Taxation.** Deferred tax assets arise from the Saudi system of taxation and from permitted deferrals because of tax holidays and other tax-sparing events. Under Saudi law, it is not the firm which is taxed, but the shareholder, whose tax is assessed against any dividends distributed. The calculation of that tax, however, is not based on the amount of the dividend.

Saudi and GCC shareholders pay a religious tax (Zakat), whose proceeds are distributed to the needy. It is assessed at the rate of 2.5 per cent of net income and deducted from those shareholders' dividend payments. If there is no dividend payment, either the tax is deferred and the amount booked as a deferred tax asset, or the tax is paid by deduction from the respective shares of reserves in the statement of appropriation of profits (Capital Intelligence, 1999-2000).

After an initial five-year exemption period, which applies to joint ventures, non-Saudi shareholders are responsible for income tax at the rate of 45 per cent on their share of profits. Similar to the situation in regard to Zakat, taxes are only paid on the amount distributed, so that in some cases substantial sums had accumulated as deferred taxes. In 1991, an effort was made to regularize this by adding to each year’s tax liability an amount equal to 10 per cent of deferred taxes outstanding as of 1990. Nevertheless, deductions cannot exceed 75 per cent of the dividend payment.

**Contingent accounts.** Banks generally disclose their year-end balances of guarantees on account of customers, letters of credit issued, lease commitments, FX contracts (divided into forward contracts and options), and interest rate contracts (divided into FRAs, swaps, and futures and options). Banks are not required to identify, in respect of the latter two categories, what portion has been undertaken for dealing purposes and what portion for the purpose of hedging risk. As noted above, all derivative contracts are marked to market.

**Offsets.** Financial assets and liabilities are offset and reported net on the balance sheet when there exists a legally enforceable right to set off the amounts and when the bank intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

**Oman Regulatory environment and supervisory authority**

The Central Bank of Oman (CBO) is responsible for the supervision of all banks in Oman. It administers the provisions of the Banking Law of 1974 and is empowered to act as lender of last resort. CBO is considered by Capital Intelligence to be one of the most capable bank supervisory authorities in the Middle East. CBO closely supervises the banks’ accounting policies and takes prompt action when it identifies a treatment with which it disagrees. All Omani companies are required to use International Accounting Standards (IAS) by royal decree, which was addressed to auditors. All banks have adopted IAS.

**Auditors**

The CBO requires banks to have annual independent audits. Audit firms must register in the Commercial Register and obtain a licence to practice. At its annual general meeting, a bank must appoint auditors for a one-year period and fix their remuneration. The auditors must be
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independent of the bank and may not hold any office or other appointment in the bank.

The auditors have the right to examine all books, records and documents of the bank at any time and obtain all the information they consider necessary for the proper performance of their duties. During their examination, the auditors must ensure that proper books of account have been maintained. Auditors must report any violations of commercial law or of the bank’s articles of incorporation to management or to the shareholders, depending on the gravity of the offence. Auditors are liable to the bank, the shareholders and third parties for any damages resulting from acts of negligence or fraud committed in performing their examinations.

The auditors’ opinion is not standardised, but must state whether the financial statements are presented in conformity with IAS. The opinion may include such phrases as “present fairly” or “give a true and fair view.” It may state that the examination was performed in accordance with either IAS or generally accepted auditing standards. Oman’s bank auditors are affiliated with the large international accountancy firms. The quality of auditing in Oman is believed to be reasonably high. Auditors have been known to insist on adequate loan-loss provisions (Capital Intelligence, 1999-2000).

Accounting policies and practices

Loans and loan-loss provisions. Loans and advances are stated at cost net of provision for loan losses and reserved interest. Specific provisions are made on non-performing loans; in addition, some banks make general provisions. Provisioning levels are advised by the CBO from time to time. The CBO’s examiners have the right to direct banks to increase their loan loss provisions. A bank’s provision must be acceptable to the CBO before the bank declares dividends or makes remittances to a head office abroad. Banks are required to fully reserve interest due but not received, and CBO recommends that banks do not recognise interest received on classified accounts as profit until the principal is recovered.

Intangible assets. Goodwill is recognised as an asset and amortised on a systematic basis over its useful life. This period may not exceed five years, unless a longer useful life can be justified and explained in the financial statements. Goodwill may also be written off immediately against shareholders' equity.

Fixed assets. Fixed assets are carried at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. The asset lives used for calculating depreciation vary from bank to bank, but are generally consistent with those allowed by the tax authorities and are within the following ranges: buildings 20 to 25 years, equipment, furniture and fixtures three to 20 years, motor vehicles three to five years. Fixed assets may be revalued, but the revaluation gain is subject to tax.

Investments. Long-term investments are stated at cost, fewer provisions for any decline in value other than of a temporary nature. Treasury bills are stated at face value. Short-term investments are stated at the lower of cost and market value.

Taxation and deferred taxation. The ownership of a bank affects its tax status in Oman. Omanc and GCC owned banks were exempt from paying taxes until 1993. From 1994 this exemption has been withdrawn and all banks, except the newly merged operations, are required to pay local taxes. Banks that were newly established through mergers were exempt for a period of five years. General loan-loss provisions are not tax-deductible. All banks pay levies based on the size of their staff. These are usually included in personnel expenses.

Other liabilities. Banks contribute to a pension scheme for Oman employees under the social security law of 1991. The provision of non-Omani staff terminal benefits, included in other liabilities, is based on the liability that would arise if the employment of all non-Omani staff were terminated at the balance sheet date.

Foreign exchange. The banks translate transactions in foreign currencies into Omani rials at the exchange rates prevailing on the transaction dates. Assets and liabilities denominated in foreign currencies are translated into Omani rials at the exchange rates prevailing at the balance sheet date. Differences on exchange are included in the profit and loss account as they arise.

Foreign currency gains or losses resulting from forward exchange contracts entered into in connection with loans and deposits, and which are translated into Omani rials at the rates of exchange prevailing on the transaction dates, are included in the profit and loss account pro rata over the life of the contract. Other forward exchange contracts are valued at rates prevailing at the balance sheet date, and the resulting gains or losses are included in the profit and loss account.

Omani banks that have foreign branches are required to translate their assets, liabilities and income statements into Omani rials at the rates of exchange at the balance sheet date. In accordance with IAS, any differences between opening and closing net
assets arising from changes in exchange rates are taken directly to reserves.

Revenue recognition. Interest income and expense are recognised on an accrual basis. Interest income is reserved when the recovery of interest or principal is in doubt. Reserved interest is only released to income when the interest is received. Advances are returned to the accrual basis only when doubt about recoverability is removed. Commission/fees paid and dividends received are recognised when due.

Consolidation. The commercial banks in Oman do not have subsidiaries, so the matter of consolidated accounts does not arise. The banks include in their financial statements the balances of all their branches, both domestic and overseas. Oman’s largest investment bank, Oman International Development and Investment Company (OMINVEST), which has two majority-owned subsidiaries, produces consolidated financial statements.

Qatar

Regulatory environment and supervisory authority

Law 15 of 5 August 1993 established the Qatar Central Bank (QCB). QCB is responsible for the supervision of all banks and money exchange companies in Qatar. QCB closely supervises the banks’ accounting policies and takes prompt action when it identifies a treatment with which it disagrees. The central bank is responsible for promoting a sound banking and financial system and is empowered to determine interest rates and to prescribe reserve, liquidity and capital requirements, among others (Capital Intelligence, 1999-2000). The banking sector is primarily geared to meeting domestic needs. All Qatari companies are required to use IAS. All banks have adopted IAS.

Auditors

The QCB requires banks to have annual independent audits by two external auditors. Audit firms must be registered and licensed with the Ministry of Economy and Commerce to practice in Qatar (Law 7 of 1974). The ministry maintains a “Register of Auditors” and an auditor is subject to severe penalties if he operates in Qatar without being entered therein. In order to obtain his license he must be a university graduate in accounting from an approved university with at least ten years’ post graduate experience, or be a member of an accounting society or institute approved by the Ministry of Economy and Commerce. Approval for an auditor’s license is given on a case-by-case basis but generally qualifications from universities and accounting institutes in the USA, UK, France and the Arab world are acceptable.

Auditors are appointed for a term of five years and upon completion of their term the bank is responsible for appointing a new firm. If, for any reason, a bank fails to appoint an auditor approved by the QCB, the latter may appoint an auditor to such bank and fix the remuneration that is to be paid by the subject bank. The auditors must be independent of the bank and may not hold any office or other appointment in the bank. The auditors have the right to examine all books, records and documents of the bank at any time and obtain all the information they consider necessary for the proper performance of their duties. During their examination, the auditors must ensure that proper books of account have been maintained. Auditors must report any violations of commercial law or of the bank’s articles of incorporation to management or to the shareholders, depending on the seriousness of the offence. Auditors are liable to the bank, the shareholders and third parties for any damages resulting from acts of negligence or fraud committed in performing their examinations (Capital Intelligence, 1999-2000).

The auditors’ opinion is not standardized, but must state whether the financial statements are presented in conformity with IAS. The opinion may include such phrases as “present fairly” or “give a true and fair view.” It may state that the examination was performed in accordance with either IAS or generally accepted auditing standards. Qatar’s bank auditors are affiliated with the large international accountancy firms. The quality of auditing in Qatar is believed to be reasonably good.

The responsibilities of the auditors are dealt with in article 52 of Law 15 of 1993. All the banks’ financial statements must be audited by a chartered auditor registered in Qatar who is appointed upon the approval of the QCB. The auditor must submit to the shareholders a report on the master budget and the annual profit and loss accounts. In such a report the auditor must state whether, in his opinion, the financial statements are correct and correspond to the true statement of affairs. He also states whether he has obtained all the explanations and information he considers necessary for the satisfactory performance of his assignment, and whether the operations of the bank are in conformity with the provisions of the Commercial Companies Law (Law 11 of 1981).


Significant accounting principles and practices

Income recognition. Interest receivable and payables are recognized on a time proportion basis, taking account of the rate applicable and the principal outstanding. Interest income on non-performing loans (NPLs) is excluded until the money is received. The fee and commission income is accounted on the date of the transaction-giving rise to that income. Dividend income is recognized when received.

Foreign currency translation. Transactions during the year in foreign currencies are translated into Qatari riyals at the rates of exchange prevailing at the transaction date. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Qatari riyals at rates prevailing at year-end. Exchange gains and losses are included in the statement of income.

Investments. Trading investments, whether quoted on the Doha securities market or unquoted, are stated at cost, with a provision for any decline in value on the basis of the aggregate portfolio of investments and not for each investment individually.

Loans and advances. These are stated at their principal amounts, net of the provision for loan losses and interest in suspense.

Provision for bad and doubtful debts. The provisions for loan losses comprise both specific and general provisions. Specific provisions are created to reduce all impaired loans and advances to their expected realizable value. The general provisions are created in accordance with the QCB regulations, which require a minimum of 0.2 per cent of total facilities granted to the private sector provision until the provision totals 1 per cent of the facilities by the end of 2002 to be transferred each year to a general, provision until the provision totals 1 per cent of the facilities by the end of 2002.

A specific provision is maintained at a level, which in management’s judgement is adequate, to provide for possible losses inherent in the portfolio. The amount of the specific provision is based on estimates of collectibility developed through management’s formal review and analysis of the portfolio as well as assessments of prevailing and anticipated economic conditions. Interest on NPLs is credited to an interest in suspense account, in accordance with the regulations of QCB.

Government bills. The government bills are stated at cost.

Taxation. All local banks are exempt from taxation. However, banks operating branches abroad are required to compute income taxes on the operations of their overseas branches in accordance with the tax laws applied in the countries where they operate.

Statutory reserve. QCB requires that 20 per cent of the yearly profits be transferred to a statutory reserve until the amount of such reserves becomes equal to the bank’s issued share capital.

Fixed assets. Fixed assets are depreciated on a straight-line basis over their estimated useful lives as follows: buildings – freehold 20 years; furniture and equipment three to seven years; motor vehicles five years.

Fixed assets acquired in settlement of mortgages are included in other assets and are not depreciated but provision is made for any diminution in value. Freehold land is not depreciated.

Provision for end-of-service benefits. Provision is made for end-of-service benefits payable to employees in accordance with the Qatar Labor Law and the subject bank’s policies.

United Arab Emirates

Regulatory environment

The banking system comprises 18 locally incorporated commercial banks, two Islamic banks, 27 foreign commercial banks, 36 representative offices of foreign banks and one restricted licensed bank. The banks are supervised by the central bank of the UAE. The central bank also regulates the activities of licensed brokers dealing in shares, bonds, commodities and money market transactions, money exchange houses, investment companies and investment consultants. The Emirates Securities and Commodities Market Authority, which is to be established soon, will regulate share brokers and other participants in the capital markets in the future. The Sharia and Supervisory Board of the Ministry of Religious Endowments regulate the central bank and the Islamic banks (Capital Intelligence, 1999-2000).

Auditors

All financial institutions are audited annually by an independent audit firm, which has been approved by the central bank. Approval is obtained on submittal of detailed information on staff background, qualifications and experience, as well as information relating to the firm’s fee income from bank clients. Auditors are also expected to review all returns submitted by banks to the central bank.

The international accounting firms dominate the industry. Although competition for business is strong, most banks have not changed their auditors for some years nor is there any central bank requirement to do so.
Accounting policies and practices

The central bank has made it mandatory for all commercial banks in the UAE to prepare their accounts to IAS from 1999 onwards. A few banks began to use IAS well before it was required to do so. Locally incorporated banks must submit their audited consolidated accounts (including branches abroad, banking subsidiaries and associated companies in which they have a controlling interest) no later than 31 March of each year. Any publication of financial results, along with any other material that a bank may wish to publish, must be first approved by the central bank. The publication of reports must take place no later than 30 April of each year and they must remain publicised for three consecutive days.

The central bank must approve all dividend declarations, and banks cannot publish their balance sheets until the central bank approves the accounts. On several occasions in the past, the central bank had refused to allow some banks to publish their audited accounts due to differences with bank management on loan-loss provisioning.

The four Sharjah-based banks were not permitted to publish their 1991 accounts until their government debts had been partially settled. The National Bank of Sharjah (NBS) was not able to release its financial statements between 1989 and 1993. The bank published its financials only in 1994, after it was recapitalized to the satisfaction of the central bank. In 1996, FGB was prevented from publishing its annual results until the shareholding structure was changed and the central bank was satisfied that provisioning levels were adequate. In 1997, Dubai Islamic Bank did not publish its financials, as an investigation on a fraud perpetrated on the bank was underway. Banks are not required to publish half-yearly results, although this may change once the official stock exchange is opened, as investors will require additional information on a more frequent basis (Capital Intelligence, 1999-2000). The National Bank of Ras Al Khaimah set a precedent by releasing half-yearly figures last year. All commercial banks state their significant accounting principles.

Income recognition. Interest receivable is recognised on a time proportion basis, taking account of the principal outstanding and the rate applicable. Other fees receivable are recognised when due. Loan interest accruing on doubtful accounts is recognised on a cash basis. While all banks provide interest income and expense details, most do not provide information on dividend, investment and commission income, or on gains and losses from securities trading and foreign exchange dealings.

Foreign currency translation. Assets and liabilities denominated in foreign currencies are translated into UAE dirhams at rates prevailing on balance sheet date, whereas foreign exchange transactions are translated at rates prevailing on transaction dates. Gains or losses arising from normal banking activities are charged or credited accordingly in the profit and loss. Forward exchange contracts are valued at forward rates prevailing at year-end and the resulting gains or losses are transferred to income. Exchange differences arising from the retranslation of the opening net investments in overseas operations are taken directly to reserves.

Investments. There is no standardised accounting treatment for investments. Emirates Bank International (EBI), National Bank of Abu Dhabi (NBAD), Abu Dhabi Commercial Bank (ADCB) and Mashreq Bank value trading account securities at market price, while investment securities held with the intention of being retained until maturity are stated at cost adjusted for any premiums and discounts amortised from the date of purchase to the date of maturity on a straight-line basis. Commercial Bank of Dubai (CBD) considers its entire securities portfolio as a long-term investment, which has therefore been stated at cost. EBI values “funds under management” at market price. Many banks now state the market value of their securities. UAE Law 10 bars banks from investing more than 25 per cent of depositors’ funds in stocks and bonds.

Loans and advances. Loans and advances are stated net of reserves for bad and doubtful debts and net of interest in suspense.

Provision for bad and doubtful debt. Specific provisions must be maintained by all banks according to the classification of loans and advances. Loans are generally classified when they are deemed “substandard” (high risk and past due for 180 days), “doubtful” (likelihood of loss), and “bad” (irrecoverable). Bad loans must be fully provided for, whereas substandard and doubtful loans must be partly provided for, according to the bank’s experience and the amount of loan that is likely to be defaulted. Interest relating to all accounts that have been classified and provided for must be suspended. Any payment applied towards the recovery of such interest may be taken to the profit and loss, provided that full repayment of the remaining outstanding balance is no longer subject to doubt.
Subsidiaries. Investments in companies not exceeding 20 per cent of their paid-up capital are stated at the lower of cost or fair value, as determined by the banks’ executive committees, whereas investments in companies of over 20 per cent and below 50 per cent of their paid-up capital are accounted for by applying the equity method. The accounts of companies in which a bank directly owns more than 50 per cent of paid-up capital are consolidated with those of the parent. Goodwill arising on consolidation is charged against profit over 25 years or, alternatively, written off at the time of acquisition.

Fixed assets. Fixed assets are depreciated using the straight-line method and are stated at cost less accumulated depreciation. Buildings are depreciated over a period of 20 to 30 years, whereas other fixed assets are depreciated over a period of three to six years or are fully expensed upon acquisition. Freehold land is not depreciated.

Summary discussions

Bahrain

Since financial year-end 1992, the requirement is that Bahraini banks should adhere to IAS 30. In practice, although the 1992 and 1993 accounts show considerable improvement upon earlier years, overall disclosure falls somewhat short of that envisaged in IAS 30. Areas of shortfall include Income Statement Fee and commission income and expense which are generally shown net rather than separately as recommended. Arab Banking Corporation and Gulf Riyadh Bank are two entities that do show these items separately.

A number of banks do not show the market value of dealing and/or marketable investment securities. Net foreign currency exposures are not disclosed, with the exception of Bahrain Islamic Bank and, National Bank of Bahrain. Banks generally follow IAS 30 in showing a maturity analysis of assets and liabilities, and a concentration of risk by geographical area. Many do not disclose a breakdown by customer or industry group. Few banks disclose the accounting policy, which describes the basis on which uncollectible loans and advances are recognized as an expense and written off. Most banks give details of movements in provisions and show the aggregate amount of NPLs. No information is given on the aggregate amount of secured liabilities and the nature and carrying amount of the assets pledged as security.

KSA

Saudi bank financial statements must include at least a statement of financial position, a statement of income and a statement of changes in stockholders’ equity, accompanied by relevant notes. In the last few years a number of banks have also started issuing cash flow statements. The statements must follow the accounting policies and disclosure format prescribed by the accounting standards. Furthermore, SAMA has promoted the use of a common footnote system, so that the same footnote number will refer to the same balance sheet or profit and loss line item for all Saudi banks, significantly increasing ease of interpretation.

As a result, all Saudi banks disclose, at a minimum:

- Accounting treatment of regular income, income on NPLs, and income on Islamic transactions.
- Total gains or losses arising from foreign currency exchange differences.
- Separate breakdowns of trading securities (including cost of acquisition) and investment securities into their domestic and international components, and loans by economic sector (including the government sector).
- Special commission in suspense.
- Movements in the provisions for loan losses account during the year.
- Gains or losses from disposal of fixed assets.
- Breakdown of deposits by depositor (government, private sector, non-resident) and further into demand, savings or time deposits.
- Quantification of the foreign currency deposits in the above group and breakdown into demand, savings or time deposits.
- Schedule of commission rate risk, listing (separately) on-balance sheet assets and off-balance sheet financial instruments by the earlier of re-pricing date or maturity date and broken down by type of asset, liability, or contingent account.
- Totals of FX and derivative contracts outstanding, and of the discount or premium amortization method applied.
- Zakat and income tax due for the period, their reduction from dividends payable to shareholders, and the treatment used in accounting for them.
- Related party transactions, and schedule of assets and liabilities (in the aggregate) by contractual maturity.
Oman
Local banks are required to follow IAS, and their standard of financial disclosure is therefore good. All banks provide details of the movements in the provision and interest in suspense accounts. The sectoral and geographic concentrations of gross loans are also provided. The market value of investment securities is reported with details of provisioning, if any. Income and expenditure items are recorded in some detail. The balances outstanding in (and the income and expenses generated by) related-party transactions are available. Banks provide information on their capital adequacy ratios; some banks disclose their calculations. Banks also disclose the maturity analysis of assets and liabilities, the interest rate sensitivity of the balance sheet and the fair value of financial instruments. In their 1999 financial statements banks have also provided details of their P&L, assets, and liabilities by geographic and business segments. In 1999, BankMuscat disclosed the significant differences in its income account and shareholders’ funds if US GAAP were applied, in preparation for a possible issue of shares in overseas markets.

Qatar
Local banks are required to follow IAS accounting principles set out by QCB and their standard of financial disclosure is therefore good. All banks provide details of the movements in the provision and interest in suspense accounts. The sectoral and geographic concentrations of gross loans are also provided. The market value of investment securities is reported with details of provisioning, if any. Income and expenditure items are recorded in some detail. Some banks publish details with regards to related party transactions. Banks provide information on their capital adequacy ratios; some banks disclose their calculations. Banks also disclose the maturity analysis of assets and liabilities, the interest rate sensitivity of the balance sheet and the fair value of financial instruments.

UAE
International accounting standards have been prescribed for all banks operating in the country from 1999 onwards. However, as all bank balance sheets for 1999 were not available at the time this report was printed, no comments can be made on the new accounting practice. Until 1998, banks followed central bank circulars 466 and 445 of 1987, which require that accounts be prepared in conformity with “internationally accepted accounting principles”. Up until 1998, disclosure levels varied significantly among the UAE banks. Generally, the larger the bank, the lower the level of disclosure in its financial statements. The largest banks in the country (NBAD, National Bank of Dubai (NBD), ADCB and Mashreq Bank) did not refer to IAS in their financial statements until 1998. EBI became the first among the large banks to publish its accounts to IAS in 1997. CBD has also been using IAS since 1997. National Bank of Fujairah was the first among the UAE banks to use IAS. Union National Bank and the National Bank of Ras Al Khaimah also use IAS. The smaller banks from the northern emirates, on the other hand, provide a number of IAS30-type disclosures.

The central bank’s format and disclosure represent the minimum information required, and banks are encouraged to provide any additional information that they feel is necessary. NBD and Mashreq Bank maintained undisclosed amounts of inner reserves for many years. However, these have either been run down over the last few years or disclosed in 1999 to comply with IAS.

Conclusions
The GCC countries adapted IAS, but there are number of areas where they differ in accounting practices. The differences are observed in regulatory and supervisory environments, auditing, and more importantly, the accounting policies and practices. These differences are partly due to their diverse social values and regulatory environments. However, some practices they follow do not match with their socio-cultural and religious norms. For example, Islamic banks exist in all GCC countries (except Oman) but they do not follow a particular accounting standard. Although attempts have been made to make a few changes in some countries (like submission of financial report at the end of Hijri year instead of Gregorian calendar year), they did not fulfill the Islamic banks’ accounting standards. For example, interest is forbidden in Sharia law however, the IAS does not pay any attention to this law. As a result, the Sharia and IAS cannot be mingled easily. Therefore, there are number of issues among the countries and within a country as well, that need to be resolved first. The growing cooperation among GCC countries has increased the need for the harmonization of accounting systems/standards, that sooner or later has to be addressed by the policy makers in these countries. This harmonization would not only increase the transparency and
efficiency of the countries’ financial institutions, but would also expedite the process of globalization. In this respect, the future research will investigate further differences, and policy prescription will be recommended for their removal. The differences of a particular accounting issue can first be studied separately in order to realize the consequences of harmonization to each case. It is to be noted that all differences would not necessarily be eliminated but the accounting practices and policies that will have likely impact on the cross-border transactions (such as tax for foreign venture and corporate tax) could be considered, in order to harmonize the accounting practices/standards in GCC countries. The prime objective of any accounting framework is that the objectives, standards and practices should be heavily influenced by the definitive needs of the users (Radebaugh, 1975).

Notes
1 Kuwait is not included in this study due to lack of sufficient information.
2 Hijri is an Islamic-based calendar that refers to the time Prophet Mohammed migrated from Mecca to Medina.
3 For example, SAMA does not set monetary policy.
4 The operations of some moneychangers were “grandfathered” because of special consideration conveyed by King Abdulaziz al-Saud, but the businesses have been increasingly pressured to submit voluntarily to SAMA regulation and supervision.
5 Audits of 1998 statements for 11 Saudi banks involved 22-audit assignments, of which 19 were carried out by big five firms (Arthur Andersen and Ernst & Young seven each; Pricewaterhouse Coopers four; Deloitte Touche Tohmatsu one).
6 Ministries, municipalities, branches and agencies.
7 These must be amortized over the life of the contract.

References
Capital Intelligence (1999-2000), Capital Intelligence Report, Capital Intelligence, Cyprus.


Further reading