AN ANALYSIS OF ACCOUNTING DISCLOSURE IN THE ANNUAL REPORTS OF LIBYAN AND EGYPTIAN CONSTRUCTION COMPANIES

K. Ellabbar, D. Eaton
The Research Institute for Built and Human Environment,
University of Salford, Salford, M5 4WT, UK
E-mail: k.a.ellabbar@pgt.salford.ac.uk

ABSTRACT: This paper examines the level of accounting disclosure in the annual reports of two developing countries, Libya and Egypt. Although the two countries are form part of the Arab world and exhibit many similarities, there are important differences in their stock markets. In Egypt, they were established more than one hundred years ago whereas in Libya, there is still an absence of an official stock market. Document analysis was the research method utilised to analyse the information items that are currently disclosed in the annual reports of the sample companies. It reveals that the level of disclosure of Libyan companies is at a low level compared to Egyptian companies. This means that Libyan construction companies are at a disadvantage when competing for the available capital sources. Establishing domestic standards or complying with the international accounting standards will help Libyan construction companies to make more effective accounting disclosures and hence improve the indigenous construction market in Libya.

Keywords - Accounting Information, Construction companies, Disclosure Index, Egypt and Libya.

1. INTRODUCTION

The most common approach to improving the efficiency of any capital market depends on the availability of information to all investors at low transaction costs. Information should be conveyed to all interested parties so that they can behave in a way which permits securities prices to continuously adjust to any new information. In this respect, the disclosure of accounting information has a great impact on the behaviour of investors with respect to the buying and selling of stocks in the financial markets. In addition, reliable and timely accounting information has a significant role in facilitating, controlling and directing both private and public activities (Al-Mulhem, 1997). The relationship between capital markets and disclosure has been the subject of numerous studies.

According to R. Hussey, 1999:131, disclosure is defined as:

> *"The provision of financial and non-financial information, on a regular basis, to those interested in the economic activities of an organization. The information is normally given in an annual report and accounts, which includes financial statements and other financial and non-financial information. The annual report and accounts of a limited company is regulated by company legislation, accounting standards, and, in the case of a quoted company, by stock exchange regulations. "*

From the above definition, it can be noticed that the concept of disclosure covers a wide area. It goes beyond the annual reports to cover information outside the financial statements, such as discussion of competition, economic statistics, and analysis about the company. This tendency towards disclosure outside the financial statements was partly as the result of efforts by the accounting profession and the corporate reporting community to reduce their legal exposure, and partly in recognition of the deficiencies of the financial statements format for the purposes of communicating uncertain, interpretative and subjective data (Burton, 1981). Such outside information plays a great role in the current global market place, but there is no agreed standard that rules the measurement of these items of information (Hendriksen and Van Breeda, 1992).

Disclosure can be made in accordance with legislation, accounting standards, or it can be voluntary. Companies in their annual reports disclose information in financial statements and the notes thereto in accordance with formats, which in many countries are specified by law. They also disclose the accounting policies underlining these statements. Further information is disclosed in the UK in the directors' report and the chairman's statement.

Stock Exchanges around the world accept financial statements prepared according to Generally Accepted Accounting Principles (GAAP) or to their own domestic GAAP. They also accept accounts prepared according to International Accounting Standards (IASs) of for example: London; Paris; Frankfurt; and Tokyo (Tarca, 2004).

By their nature, some industries need a special type of disclosure. Particularly, in the construction industry disclosure is characterised by high capital investment, an extensive and complex regulatory framework, high interest costs, and competition. The operations of companies in this industry focus on efficiency and safety. In addition, these construction companies face various risks including the availability of funds for repayment of borrowings, the availability of skilled labour and fluctuation of material costs and interest rates. Due to this, certain specific information should be included in the annual reports of construction companies to enhance comparability, to disclose capital expenditure and related financial arrangements and to highlight the risks associated with high gearing.

This paper focuses on disclosure in two developing countries, namely Libya and Egypt, which are both part of the Arab world. Although, there are many financial similarities between these countries, there is one important financial difference which is the stock market. Where as in Egypt it was established more than one hundred years ago it was only in 2005 that Libya issued a law to allow the establishment of a stock market and it is expected to be established as soon as operational procedures have been confirmed.

Also there is an absence of domestic GAAP in Libya. The major impact on disclosure requirements have come from Libyan laws related to economic activities, such as the Libyan Commercial Code (1953), the Financial System Law (1967), the Income Tax Law (2004), and Accounting & Auditing Profession Law (1973) (Saleh, 2001).

Historically, the Egyptian stock exchanges in Alexandria and Cairo were established as two independent stock markets, in 1883 and 1903 respectively. They merged a few years later. Before the stock market folded in 1961; following the state-sanctioned demise of Egypt's private sector; it reached its historic peak in the 1940's, when it constituted the fifth largest market in the world (Cairo & Alexandria Stock Exchanges, 2004).

After several decades of low market activity, in 1992 the Egyptian stock market started to grow again, spurred on by economic reforms, privatization and changes in the regulatory environment. The Egyptian stock exchange now maintains trading floors in both cities, and securities are automatically listed on both floors with listing fees divided between both cities. Listed companies are eligible for a tax exemption equivalent to the three months deposit rate paid by the Central Bank on paid up capital. To remain listed, there must be at least one trade every six months (Cairo & Alexandria Stock Exchanges, 2003).

Since 1996, the International Finance Corporation (IFC), Morgan Stanley and Standard & Poor's have added Egypt to their emerging market indexes, while ING Barings and EFG Hermes have created country indexes for Egypt (Cairo & Alexandria Stock Exchanges, 2003).

Nine Egyptian companies are traded abroad through Global Depository Receipts (GDRs); eight in London and one in Luxembourg.

The number of listed companies in the Egyptian capital market has grown from 676 companies in 1995 to 1150 at the end of 2002, when it reached its peak. Then it decreased to

792 companies in December 2004. Market capitalization increased from US$8,074 million in 1995 to US$38,077 million in 2004 (Cairo & Alexandria Stock Exchanges, 2004).

This paper aims to compare and contrast the accounting requirements for the degree of disclosure in annual accounts in two emerging financial markets; Egypt and Libya. It does so by comparing these markets against an international benchmark of accounting requirements as specified for UK disclosure.

The remainder of the paper is divided in the following manner. The second section describes the research methodology that has been used. The third section details the data used and reports the results while section four summarizes their implications.

2. THE RESEARCH METHODOLOGY

The stated objective of this study is to examine the effect of stock market requirements on the level of company accounting disclosure. To achieve this, the disclosure level in two countries, one of which has a capital market, Egypt, and the other, Libya, which has not are compared. Egypt and Libya are used to control and limit the exogenous culture variables as far as practicable.

The first step was to prepare a questionnaire to determine Libyan perceptions of the most important items which should be included in the annual reports issued by Libyan companies. The reason for this step was the absence of any Libyan accounting standards and Stock Market both of which would normally determine the disclosure requirements. After analysis of the data collected by the questionnaire, the results were used to develop a disclosure index in Libya which included the most important items which should be disclosed. This was then used to determine the level of disclosure of a sample of construction companies from Libya and Egypt by using the document analysis method.

2.1 The Questionnaire Sample

The questionnaire sample included Libyan professionals from four groups; Chartered Accountants, Academic staff, Senior Construction Management and Governmental Auditors.

The various groups of respondents and the size of the sample of respondents are shown in Table 1. This table also shows the response rate of the questionnaire survey from different groups in the sample. It can be seen from this table the rate of response of all groups was 64% and the highest response rate group was from the Chartered Accountants (82%).

Table 1. The respondents by groups

Groups	**Sample Size**	**No. of Responses**	**Rate of Response**	**Percentage (to total)**
Chartered Accountants	45	37	82 %	25 %
Academic Staff	60	42	70 %	29 %
Senior Management	45	25	56 %	17 %
Governmental Auditors	80	43	54 %	29 %
Total	**230**	**147**	**64 %**	**100 %**

2.2 Structure of the Questionnaire

The questionnaire was divided into two parts. The first part included five standard demographic questions about the respondent. The second part lists 96 items of information derived from a substantial literature review that forms the basis of a potential disclosure index. These items are expected to be included in the annual financial reports and statements. In addition four free items are available so that respondents can add any extra items they think are important. The initial list was populated in accordance with the International Accounting Standards (IASs) and many previous studies. That is, studies prepared by: Al-Mulhem (1997), Street and Bryant (2000), Coombs and Tayib (1998), El-Gazzar, Jacob, and Finn (1999), Naser and Nuseibeh (2003) and Archambault and Archambault (2003).

The respondents were asked to judge the importance of each item of information on a five point Likert numerical scale reflecting the perceived importance of an item of information appearing in the construction companies' annual report. Using the scale, a respondent could assign a value of:

(0) Not at all important………...(should not be disclosed)

(1) Not important…..(should be disclosed but is of minor importance)

(2) Less importance or unimportant…(Intermediate importance)

(3) Important……….(should be disclosed and item is very important)

(4) Very important……………..(it is essential to disclose this item)

This scale is similar to most of the previous studies which used a five point scale at either 1 to 5 or 0 to 4. The mean scores received by each item of information, as perceived by the respondents were used as weights in the weighted disclosure index against which the annual reports were examined to establish the extent of disclosure by the sample companies. To be included in the proposed index an item should have a mean response average of greater than 3.0. This matches the approaches as listed previously.

As shown in Table 2, there were 74 items accepted after analysis of the questionnaires.

Table 2. Summary of Index Disclosure Items

Parts	**Total Items**		**Number of Items accepted**	**Percentage of items accepted**
	Number	**%**		
General Disclosure	18	19 %	11	61%
Accounting Policies	12	13 %	8	67%
Income Statement	18	19 %	11	61%
Balance sheet	42	44 %	38	90%
Cash flow statement	6	6 %	6	100%
Overall Disclosure	**96**	**100%**	**74**	**77%**

The sample from the Libyan construction companies contains 45 companies, as a result of which one respondent from two groups namely Chartered Accountants and Senior Management at these companies where selected. The Academic staff group includes all academic staff in the accounting departments at the two biggest universities in Libya: Garyounis (in Benghazi city); and Alfateh (in Tripoli city). The Governmental Auditors group includes all auditors at the Public Control Committee and Tax Department in Tripoli and Benghazi cities.

The sample comes from just two cities in Libya; namely Tripoli (the capital city) and Benghazi (the second biggest city). The reasons for this are:

a) Tripoli and Benghazi are the biggest cities in Libya;
b) The population of these cities is almost half of the total Libyan population;
c) Most Libyan economic activities are conducted within these cities.

After analysis of first part of the questionnaire the respondents are profiled as follows:

* Work experience duration: More than 75% of the respondents have more than 5 years experience;
* Academic qualifications: All respondents have at least a university degree;
* Qualification place: More than 70 % of the respondents were qualified in Libya
* Age groups: More than 95% of respondents are between 25 and 65 years old.

This demonstrates the validity of the respondent selection as being suitable to develop the research aim.

2.3 Design of the Disclosure Checklist

As shown in Table 2, 74 items were accepted for inclusion in the disclosure index. This index was used to examine the level of disclosure in Libyan and Egyptian construction companies as demonstrated by the items disclosed by these companies in there annual reports.

Each company report was analysed and data was recorded in three parts: firstly information about the company which includes; the Name of Company, Date of Financial Statements, Legal Status, Name of Auditor, Date of Auditor's Report and Date of Publication.

In the second part the 74 items are assessed and the reason for inclusion is indicated. Items which are excluded are designated under the terminology of the 2002 Disclosure Checklist of the IASB.

Assessment includes six boxes: the item; the item number; document reference part; and three boxes headed by (Y, NA or ND). One of the following should be entered for each disclosure item:

Y …...if disclosure has been made
NA… if not applicable; or
ND…if not disclosed

2.4 The Sample of Annual Reports

Currently in Libya, there are more than 200 construction companies operating, most of which are private companies. The annual reports of the sample companies were collected from the tax departments in Tripoli and Benghazi because most companies refused to give the researchers a copy of their reports. Just 45 Libyan construction companies are included in the initial sample; the reasons for excluding companies from the sample are as follows:

1. Some companies had been established for less than three years and had not yet begun their reporting activities;
2. The companies which are government owned are excluded because they are hugely different in capital size compared with private companies;
3. The annual reports of some companies were not available for the period of study;
4. The smallest companies with capital of less than one million Libyan Dinars are excluded.

The sample from Egyptian construction companies covers the top ten construction companies listed on the Cairo & Alexandria stock exchanges. The annual reports of these companies were collected from the "Egypt for Information Dissemination Company" in Cairo for the financial year 2002/2003.

As a matched sample from Libyan construction companies the top ten companies with the highest disclosure rate from the initial sample have been selected. The disclosure rate for each company report was calculated by using the function:

$$\textit{The Disclosure Rate (R)} = \frac{Y}{(T - NA)}$$

Where; Y = the numbers of items included;
T = total items (74) and
NA= the number of not- applicable items.

3. COMPARISON BETWEEN DISCLOSURE LEVELS

Table 3 shows a summary of the disclosure rate of all items provided by the "top ten" Companies in both countries classified by parts and Appendix 1 shows the rates of all items. It shows that the average percentage of disclosure of the Balance Sheet items is 72%, which is higher than that of the other four parts in Libya. Whereas the highest part in Egypt is the part that includes items related to the Cash flow statement.

Table 3. Summary of Discloses Items by Companies in both countries

No.	Parts	Egypt	Libya
1	General Disclosure	**91%**	58%
2	Accounting Policies	**57%**	14%
3	Income Statement	**66%**	63%
4	Balance sheet	**81%**	72%
5	Cash Flow Statement	**92%**	0%
Overall		**79%**	**56%**

After surveying the sample companies, the average disclosure rate of all companies is 56% in Libya and 79% in Egypt.

Table 4 shows the disclosure rate of the sample construction companies in both countries, which are classified into six levels. All Libyan companies in this sample have a disclosure rate of less than 80% whereas the entire Egyptian sample has a rate of more than 70%.

Table 4. Disclosure Rate Levels of Companies in Both Countries

Disclosure Rate	***Egypt***		***Libya***	
	Number of Companies	*Percentage (To total)*	*Number of Companies*	*Percentage (To total)*
0-49 %	**0**	0 %	**0**	0%
50-59 %	**0**	0 %	**5**	50%
60-69 %	**0**	0 %	**4**	40%
70-79 %	**5**	50 %	**1**	10%
80-89 %	**5**	50 %	**0**	0%
90-100 %	**0**	0 %	**0**	0 %
TOTAL	**10**	**100%**	**10**	**100%**

4. CONCLUSIONS

Information is the lifeblood of capital markets, and the efficiency of any financial market is predicated on the disclosure of accounting information. These disclosures have a great impact on the behaviour of investors with respect to the buying and selling of stocks in the financial markets.

This paper focuses on comparing the level of accounting disclosure of Libyan construction companies with similar companies in Egypt. The study was initiated by determining the items which should be disclosed by Libyan companies as well as the items that are disclosed by these companies. The level of accounting disclosure of Libyan construction companies is at a low level compared with Egypt. As a result, this level will be an obstacle towards establishing a capital market in Libya. Libyan companies can increase this level by complying with the international accounting standards. The Libyan Accounting profession could also aid this process by developing National Accounting Standards of Disclosure that are suitable for the country’s current environment.

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Appendix 1: Disclosure Rate by Companies in Both Countries (1)

Item No.	Items	Disclosed Rate	
		Egypt	Libya
Part 1 : General Disclosure Items			
1	A Balance sheet	100%	100%
2	A profit and loss account or Income statement	100%	100%
3	A cash flow statement	100%	0%
4	A statement showing all changes in equity	90%	0%
5	Notes to the financial statements	100%	50%
6	An Audit report	100%	90%
7	Accounting Policies	100%	10%
8	Company's name, address and Legal Status	100%	100%
9	Financial Statements date and the period covered	100%	90%
10	The level of precision (thousands or millions)	10%	30%
11	The currency used in the Financial Statements	100%	70%
Part 2: Accounting Policies Items			
12	The comply with International Accounting Standards	50%	30%
13	Accounting Valuation method	70%	0%
14	Foreign currency transactions, translation	67%	0%
15	Events after the Balance Sheet Date	30%	0%
16	Revenue Recognition	60%	0%
17	Valuation of Fixed Assets	80%	50%
18	Inventory physical count & valuation	100%	33%
19	Changes in accounting policy & the reasons	0%	0%
Part 3: Income Statement Items			
20	Revenue of the ordinary activity	100%	100%
21	Non – operating revenues and gains	100%	100%
22	Analysis of costs	60%	100%
23	Operating profit or loss	100%	50%
24	Finance costs	88%	50%
25	Profit or loss from ordinary activities before tax	80%	70%
26	Income Tax expense	29%	60%
27	Net profit or loss for the period	78%	100%
28	The amount of dividends per share	80%	10%
29	Fundamental Errors and how it is treated	0%	50%
30	Effect of significant changes in accounting policies	11%	0%
Part 4: Balance sheet Items			
31	Assets order	100%	100%
32	Assets classification	100%	100%
33	Gross value of fixed assets	100%	100%
34	Breakdown of total fixed assets	100%	100%
35	Net value of fixed assets	100%	100%
36	Accumulated depreciation for each item of fixed assets	100%	100%

Appendix 1: Disclosure Rate by Companies in Both Countries (2)

Item No.	Items	Disclosed Rate	
		Egypt	Libya
37	Financial assets & investments	100%	0%
38	Investments in Projects under construction	100%	89%
39	Market Values of Investments	14%	0%
40	Total value of current assets	100%	100%
41	Total value of Inventories	100%	100%
42	Market value of Inventories	0%	0%
43	Breakdown of Inventories	86%	33%
44	Investment in marketable securities	100%	100%
45	Market Values of marketable securities	33%	0%
46	Balances of Receivables	100%	100%
47	Breakdown of receivables into Trade and others	60%	80%
48	Cash	90%	100%
49	Bank balance	90%	100%
50	Bank balance breakdown (current & deposit)	63%	11%
51	Liabilities order	100%	100%
52	Liabilities classification	100%	70%
53	Total value of loans &long term Liabilities	100%	88%
54	Secured & unsecured debts by mortgage	0%	67%
55	Total value of current Liabilities	100%	30%
56	Classified current Liabilities	100%	90%
57	Liabilities to Banks	100%	100%
58	Liabilities to owners	13%	67%
59	Liabilities to Suppliers & Notes Payable	100%	100%
60	Tax liabilities	70%	70%
61	Instalments of long term loans payable	100%	0%
62	Dividends Payable	10%	43%
63	Accrued Expenses	50%	90%
64	Provisions	100%	70%
65	Stockholders Equity	100%	80%
66	Issued capital	100%	100%
67	Legal reserve & Other reserves	100%	60%
68	Retained Earnings	100%	90%
Part 5: Cash Flow Statement Items			
69	The main items of cash inflows	90%	0%
70	The main items of cash outflows	80%	0%
71	Cash flows from/for investment activities	100%	0%
72	Net cash inflow from operating activities	100%	0%
73	Adjusted by non–cash transactions (depreciation)	90%	0%
74	Cash flows from and to finance activities	90%	0%