

**The Kuwait Investment Office (KIO) Scandal: A Study of
Auditing and Audit Expectations in an International Context**

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Submitted March 2000

*For My Parents, My Wife Safa'a, My Children Abdullah
and Ahmed*

Summary

Auditing has grown substantially in recent times, expanding into different parts of the world through a network of international audit firms (dominated mainly by the Big Six or more recently the Big Five). The growth of auditing and audit firms has not been hindered significantly by consistent criticism, doubts and debates about the value of the auditing function and what it can deliver in countries with long established audit traditions. Much of such criticism and debates usually surface in the aftermath of major financial scandals and corporate collapses and have increasingly been captured of the term of the “audit expectations gap” – a phrase referring to the difference between what auditors perceive as their duty and what the users of financial statements expect from auditors. Research has examined the main elements of the audit expectations gap, including the nature of assurance, audit reporting, auditor independence and regulation/liability of auditors. Few research studies, however have focused on examining the audit function through a case study of a major financial scandal. Even fewer studies have paid attention or researched the audit function in non-Anglo-American contexts. This is the primary aim of the thesis. To explore such a research area, this study uses the scandal that surrounded Grupo Torras, the Kuwait Investment Office’s (KIO) investment holding group in Spain. The collapse of the group in 1992 offers the opportunity to examine auditing in Spain, a country with notably high expectations of auditing in recent times, and Kuwait, a developing country recently having returned to democracy. The issue of the audit expectations gap in Kuwait is also explored using a questionnaire survey of the views of auditors, directors and users in Kuwait. Such survey represents the first comprehensive survey of auditing expectations in the Gulf region – an increasingly significant economic area given the growth in oil revenues. The case study reveals different response to the scandal. In Spain, criticism and debates started to surface immediately after the scandal while in Kuwait no major criticism or debate about the audit function has taken place. The case study shows how auditing was unable to cope in a complicated financial and political environment, where senior powerful managers, were involved in mismanagement and fraud. Despite the limitations of the auditing function in practice, the questionnaire survey shows only a limited audit expectations gap in Kuwait and considerable degree of satisfaction among people in Kuwait with auditing. This shows that the image of auditing is mostly based on perception rather than on its ability to perform in practice and raises a range of important issues for the future, especially giving the growing doubts about the uniform nature of auditing service provided by “multinational” audit firms.

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List of Abbreviations

C&L	Coopers & Lybrand
CNMV	<i>Comisión Nacional del Mercado de Valores</i> National Securities Market Commission (Spain)
GT	Grupo Torras
GRF	General Reserve Fund
ICJCE	<i>Instituto de Censores Jurados de Cuentas de España</i> Spanish Institute of Chartered Accountants (Spain)
ICAC	<i>Instituto de Contabilidad y Auditoría de Cuentas</i> Accounting and Audit Institute
KAAA	Kuwaiti Accountants and Auditors Association
KAB	Kuwait Audit Bureau
KIA	Kuwait Investment Authority
KIB	Kuwait Investment Board
KIO	Kuwait Investment Office
KOC	Kuwait Oil Company
KOTC	Kuwait Oil Tankers Company
KPC	Kuwait Petroleum Corporation
REA	<i>Registro de Economistas Auditores</i> Register of Economist Auditors (Spain)
RTM	<i>Registro de Titulares Mercantiles</i> Register of Commercial Graduate Auditors (Spain)
RFFG	Reserve Fund for Future Generations
TH	Torras Hostench
THL	Torras Hostench London
PTCSAR	Permanent Technical Committee for Setting Accounting Rules (Kuwait)

Acknowledgement

It has been a long journey of scholarly learning for me, but I was blessed with the guidance and support of different people during my study. I am very grateful for the contribution of the following people:

Professor Christopher Humphrey, my supervisor, whose guidance and trust set me on the correct passageway to the completion of my thesis. Thank you for being a generous mentor.

My parents, Abdullah and Badriah, who engraved in their children the irreplaceable values of discipline, morality, and education. Thank you for loving and supporting me in every possible way. I appreciate all the work you've done to help me with my thesis and my life.

My gracious wife, Safa'a, who provided me with a love emanating environment, which granted me the moral and emotional support I needed. Thank you for your love and understanding. My older son, Abdullah, to whom I have to apologise for depriving him of the company of his cousins and other children in Kuwait while I was doing my research, and for all those times he had to suffer from the boredom of staying home. I'm sorry son for not being there for you all the time. My younger son, Ahmed, whom I regret missing the first year of his life, due to the extensive work on my thesis.

My brothers (Zeyad, and Hamad) and sisters (Abeer, Hadeer, and Sarah) who were always there for me and my wife and children whenever I needed them. Thank you for being courteous siblings.

Dr. Wael Al-Rashed, Dr. Shuiab Shuiab, Dr. Yousef Al-Hashash, Dr. Ibrahim Shahin, Dr. Yousef Al-Ebraheem, Dr. Mahdi Al-Barak, Dr. Yousef Al-Adli, and Dr. Ghanim Al-Najar from Kuwait University. Mohamed Maharib from College of Business Studies, and Abdullah Al-Mudaires from KAB. I am grateful for your help and intellectual guidance.

My university colleague Ahmed Al-Jawhary, I value all the enlightening views and recommendations that you shared with me. My friends and colleagues at Sheffield, Saud Al-Otaibi, Mohamed Al-Shamsi, Naoko Komori, Gulfidan Baris, and Professor Toshifumi Matsumoto. I would like to express my thankfulness for your support.

All the people who provided me with information but elected to remain anonymous. My respectful gratitude goes out to you.

All the people that participated in my survey, I would like to thank you as a group for taking part in the questionnaire, and helping me progress in my thesis.

Thank You...

Walid AlHusaini

In the Name of God, the Merciful, the Benevolent

Chapter 1

Introduction

The auditing function has been immersed in controversies and criticisms since the late 19th century. Chandler and Edwards (1996) argued that not only have the profession's problems remained the same from the last century but also the profession responses have remained the same. Many of the persistent issues that have dogged the profession throughout the years have been included under the label of the "Audit Expectation Gap" since 1974 (Humphrey, 1997). The Audit Expectation Gap refers to the difference between what the users of financial statements see as the duty of the auditor and what the auditors perceive as their duty. The main issues identified with such a gap are long-standing ones that include debates about audit assurance, audit reporting, regulation of the auditing profession, independence of auditors and auditors liability. These controversial issues usually surface in the aftermath of causes célèbres in different parts of the world. In recent years, spectacular financial scandals around the world (e.g. BCCI, Barings, Maxwell, Savings & Loans) have all questioned the role and function of auditing, with aggrieved shareholders and other stakeholders asking the typical question of "where were the auditors?".

Despite the crisis that surrounds the profession, it seems to withstand the consequences of such controversies through a mixture of strategies. A popular method is to stress the unreasonable nature of public expectations, blaming the audit expectation gap for the perception of audit failure (see Power, 1997). The audit firms also usually dismiss audit failure as an isolated incident not representative of the general work of their audit firms (Kaplan, 1987). The profession has been maintaining income growth by providing non-audit services to their audit clients, with the fees from such services in some instances superseding those from audit. Targeting the middle tier audit market is another method adopted by the Big Six audit firms to fuel their growth. In the last decade, the Big Six audit firms have embarked on expansion into new or virgin markets for audit services, especially in Eastern Europe, Russia and China. The spread of audit in some of these new regions is seen as a mechanism for enhancing transparency and accountability in new democracies.

Despite the criticism of the profession and its apparent ability to live with the crises and to expand around the world, there still remains a great deal to be learned about auditing. Hopwood (1996) argued that despite the overriding importance of auditing to the accounting profession and its regulation, auditing "remains a relatively poorly understood phenomenon" (p.217). He thought that most of the research on auditing either focused on the economic aspects of auditing or technical aspects highlighted in the professional pronouncements. He believed that it would be more fruitful to study "audit in action", focusing on the wider "organisational, regulatory and societal contexts in which it functions" (p.218). Few case studies have investigated the development of auditing in practice and even fewer have been conducted in non Anglo-American contexts. Several accounting journals have started to develop such studies in recent years (e.g. *European Accounting Review*, *Accounting, Organizations and Society*, *Critical Perspective on Accounting, Accounting, Auditing and Accountability Journal*, *International Journal of Auditing*) but studies in non Anglo-American contexts remain a rarity, despite the world-wide growth and internationalisation of auditing. Such contexts are of particular interest in that Anglo-American auditing systems are largely being employed/exported on the belief that they can serve as a crucial mechanism for enhancing transparency, improving corporate governance and accountability. However, implementing such Anglo-American systems at face value in different countries with different cultures might not be either compatible or constructive given the different corporate governance structures inherent in non Anglo-American different contexts. At present, there is little evidence available as to what audit has achieved in these 'developing' countries. Accordingly, studies are needed in such contexts to examine how audit has been received and what contribution it has made to processes of corporate governance, accountability and broader notions of enhancing democracy in 'new democracies'.

This study aims to contribute to such research arena by examining auditing in practice in Kuwait, through a twofold approach. The first approach entails exploring the major corporate collapse of a Spanish corporation owned by the

Kuwait Investment Office (KIO). KIO was established in London in the 1950's as a result of the British government, then Kuwait's official protector, lobbying the Kuwaiti ruler to invest his country's oil revenues in Britain. The London based investment office has grown throughout the years, investing Kuwait's oil revenues around the world. The portfolio of KIO's investments was estimated at \$100bn in 1990 before the Iraqi invasion of Kuwait. The investment revenues of KIO exceeded those of oil in the years between 1986-1989, for instance in 1989 investments revenue were estimated at \$8.8bn while oil revenues estimated at \$7.7bn. Seeking to diversify its investments, KIO started investing in Spain from 1986, banking on the potential growth of the Spanish economy in the aftermath of joining the European Community. KIO's investments in Spain grew substantially throughout the years, climaxing to \$5.5bn in mid-1992 which made it Spain's biggest single investor. Grupo Torras (GT), the conglomerate group created by KIO, however collapsed in 1992 giving rise to Spain's biggest collapse in the post Franco era. The devastating collapse of Grupo Torras revealed large scales of fraud, misappropriation of funds and mismanagement by the senior management of KIO and Grupo Torras. The case of Grupo Torras is used here as a vehicle for enhancing the understanding of the implications of the role and performance of audit firms in practice in Kuwait, Spain and Britain.

Spain provides an interesting research site in that it gives the opportunity to study the operation of auditing in a new democracy (established in 1975 following the death of Franco). The accounting profession in Spain is regulated by a government-appointed body, *Instituto de Contabilidad y Auditoría de Cuentas* (ICAC). Following entry into the European community and the adoption of the fourth directive in 1988, auditing became a statutory requirement for all public companies. This change was met with positive attitudes financial reporting was expected to be more transparent and auditing expectations were generally high (see Garcia Benau and Humphrey, 1992). However, Positive declarations about auditing have become far fewer in the aftermath of a string of recent financial scandals in Spain in the early 1990's (e.g. PSV, Grupo Torras, Banesto) and talk of an audit expectation gap started to emerge. In particular, the GT case enables

a detailed reflection on the state of auditing in Spain, especially given that the GT affair made history in Spanish auditing circles when Coopers & Lybrand, the auditors of GT, were the first Big Six audit firm to be fined £175,000 by ICAC for their audit of GT. KIO laid another milestone in Spanish accounting history when its management refused to sign the group accounts that showed the group made losses rather than the profits claimed by GT, again raising doubts about what can be achieved through the function of auditing in Spain.

It is interesting to look at Kuwait's experience with auditing as it provides a contrasting context. Unlike Britain and Spain, Kuwait is a developing nation with an emerging new democracy. The government, through the Ministry of Commerce, regulates the accounting profession in Kuwait. In addition, unlike Britain, which has a long history of expectation gaps, and Spain where the gap is growing, it is unknown in Kuwait whether or not an expectation gap exists. The KIO case provides interesting evidence on the ability of auditors to understand the fallout from scandals and how the profession handled it. It also provides an opportunity to trace what audit was doing in terms of delivering enhanced accountability and openness in the operations of a major Kuwaiti organisation. The collapse of KIO's Spanish investments will also help to shed some light on the role of the Audit Bureau, the public sector auditing body in Kuwait, which is in some form of competition with the international audit firms. The implications for auditing of the offshore financial centres will also be an issue for examination, given that the accounting firms involved in the KIO case have been promoting and engineering tax minimising schemes through international tax havens.

The KIO case study has been constructed from interviews with key people involved with the case and a detailed examination of all the official investigation reports of KIO/GT, legal judgements issued about the case, press reports published in the UK, Kuwait, USA and Spain (the latter involving a process of translation into English) and the financial statements of Grupo Torras and some of its main subsidiaries. While the criticisms of researchers that financial collapses are not representative of normal standards of audit work are recognised (see Lee, 1993), the case reveals a number of concerns with audit practice which

are common across many scandals (e.g. the significance for auditing of dominant senior managers, complicated transactions etc.). The study also seeks to overcome such criticisms of generalisability by conducting a questionnaire survey seeking contemporary views of auditing in Kuwait.

This survey of audit expectations in Kuwait represents the second major empirical element of the thesis. It was conducted to gain a broader insight into people's view of auditing and to consider the effect of the KIO case and the implications that its seen to have had for auditing in Kuwait, and to assess the international significance of themes to emerge from the empirical analysis. The aftermath of big scandals can make people start to question the role of auditing and change their attitudes toward auditors which can lead to an expectations gap. The questionnaire examined the expectations that people have of auditors in Kuwait comparing the views of Big Six auditors with views of the Kuwaiti Audit Bureau, which had been given a larger role and remit after the scandal. The comparison was also useful as the Audit Bureau claims to conduct audit with 100% testing levels in contrast to the accounting firms who rely on sampling techniques. Calls for joint-audits in Spain (as a way to boost auditor's independence) were dismissed by the Big Six firms in the aftermath of the GT scandal. However, joint audits were introduced in Kuwait to protect shareholders' interests. The questionnaire sought to examine peoples' attitudes towards this law in Kuwait. The lack of debates in Kuwait about the role of auditors in the collapse was also addressed through questions about the respondents' knowledge of the work of KIO's auditors, the objectives of KIO's external audit and the type of information that should be published by KIO. In comparing auditors, financial directors and user groups from some the private and public sectors, the survey provides the first comprehensive empirical assessment of auditing expectations in Kuwait.

The thesis is organised into nine subsequent chapters. The second chapter reviews the relevant literature on auditing, exploring the main dimensions and characteristics of the audit expectation gap. The chapter argues that despite the problematic nature of the audit expectation gap the audit firms seem to survive

and grow around the world. The chapter also discusses wide range of recent debates and official reports on the future of the profession and the emergence of the assurance services as an important new market for the new millennium. The chapter concludes by highlighting the need for international examination of the auditing profession in action. The third chapter outlines the aims of the study and the chosen research methodology, namely an international case study and questionnaire survey. The strengths and limitation of the study and the problems experienced in conducting it are also explored in this chapter.

The fourth chapter sets the context for the Kuwaiti environment in which KIO has been operating and controlled. It provides some reflection on the social, political and economical aspects of Kuwait. The fifth chapter reviews the historical development of accounting and auditing in Kuwait as it is essential in order to understand the different aspect of the case. The sixth chapter similarly explores development of accounting in Spain, both before and after Spain's entrance into European Community.

The seventh chapter documents the historical account of the case starting with the establishment of KIO and its younger parent, the Kuwait Investment Authority (KIA), to understand the environment that shaped the development of these organisations and their dual role in understanding overseas investments for Kuwait. It begins with a brief description of the rise and fall of Grupo Torras and the events and court cases that has arisen since. Subsequently, the chapter explores the main discussions of the KIO case, including discussions of the secrecy doctrine adopted by both organisations, the absence of a clear investment strategy and the lack of control and corporate accountability.

The eighth chapter is devoted to assessing the contributions of different auditors in the KIO case. This involves an examination of the financial statements of Grupo Torras and its key subsidiaries, in addition to other official reports such as those of ICAC (the Spanish audit regulatory body) and the Kuwait parliament. The remainder of the chapter uses such examination to assess the implications of

the KIO's scandal for accounting and auditing practice in Spain, Kuwait and internationally.

The ninth chapter starts with a description of the way in which the questionnaire was constructed and distributed in Kuwait. This followed by an analysis of the questionnaire's main empirical results and the major themes to emerge from them. The concluding chapter summarises the key findings from the case study and the questionnaire survey. It assesses the contribution of the thesis to the existing auditing literature and considers its specific implications for the future of auditing in Kuwait. Overall, the thesis seeks to provide a much-needed analysis of the developing role of audit in a non Anglo-American context, focusing primarily on Kuwait and Spain. The thesis achieves this using a combination of case study of corporate collapse of Kuwaiti investments in Spain and questionnaire survey of the audit expectation gap in Kuwait. Together these offer a range of new insights into the practice and significance of audit in an emerging democracy, while also serving to raise a number of important questions as to the international consistency and effectiveness of leading auditing firms' practices.

Chapter 2

Auditing: A Growing Profession Always in Crisis?

2.1 Introduction

The recent scale of financial scandals around the globe has shadowed the role and function of company auditing with controversy and dissatisfaction. The United Nations criticised the Big Five audit firms for issuing unqualified audit reports for corporations in Asia only for it to be revealed within a short period of time that they had a going concern problem (FT, 30 October 1998). The World Bank also called on the Big Five to withhold from using their name to sign audit reports in Asia unless international standards were adopted (FT, 19 October 1998). The Chairman of the SEC, Arthur Levitt, also criticised the auditors for not withstanding the pressure from corporate managers for adopting what he described as "Hocus-Pocus" accounting. He said "too many corporate managers, auditors, and analysts are participants in a game of nods and winks" (<http://www.sec.gov/news/speeches/spc220.txt>, 1/10/1998). These criticisms are not something new to the profession with controversy related to auditing being well documented. Indeed, the problems and debates about auditing known as Audit Expectation Gap have not seemed to hinder the growth of auditing. The auditing function continues to expand into other forms such as environmental, medical, educational etc. (Power, 1994). Auditing is also expanding into new democracies such as those of Eastern Europe. The Big Five accounting firms continue to grow world wide in attempts to globalise their services. Advances in, and the sheer growth of, information technology are currently a major force for re-thinking the role of the accounting profession and the structure of audit firms, mainly in Anglo-American countries. These efforts are targeted to two directions, the future of the accounting profession in general while the other on the assurance services. Some of these developments are already taking place in some parts of the world. The recent acquisition of and partnerships with some of law firms by audit firms support the prospective of establishing multidisciplinary firms.

However, it seems to be very strange that the audit and assurance function is growing when it remains so difficult to answer straightforward questions such as

“Why audit?” (Power, 1997). Some would go so far as to argue that that auditors do not have a duty to detect fraud, they do not have responsibility to third parties and that their report is based on an ambiguous terminology such as “True and Fair View” or “Present Fairly”. Even auditor’s independence looks increasingly questionable when so many firms provide consulting services to audit clients. The apparent shortcomings of auditing and the firms that provide it have raised some serious questions about the appropriateness of such function in general and in an international context in particular.

This chapter will examine the literature to reflect on how auditing and the international audit firms are surviving confidence crises and growing globally. The first section will describe the crises in auditing with emphasis on the expectation gap. The second section will document the growth of the audit firms around the world and the prospect of this continuing in the future. The final section will discuss the lack of evidence on the work of the Big Five and the importance of examining the practice of auditing in non Anglo-American contexts, especially given the international growth of auditing.

2.2 Auditing in Crisis

The role of auditors has long been hailed as an unglamorous boring task (Belkaoui, 1985, Jones, 1995). However, since the 1980s auditing research has grown in the USA and UK (Gwilliam, 1987) and it is seen as an interesting research task (Power, 1997). The expanding interest in auditing research can be attributed to the growth of the auditing function around the world and the subsequent application of auditing in other fields (*e.g.* value for money auditing, environmental auditing, medical audits). The spread of auditing into other fields in countries like the UK have given rise to claims of living in an audit society (Power, 1997). This growth seems strange if one considers the problematic nature of auditing throughout history. The break out of financial scandals usually calls into question the role of auditing and auditors but somehow the profession

has always seemed to wither out these difficulties. However, surviving the different crises has not succeeded in resolving many of the recurring issues that been labelled in the 1970's as the "Audit Expectations Gap". The audit expectations gap can be defined as the difference between what the auditors perceive as their responsibility and what people believe their duty should be. While the term 'expectations gap' first appeared in the USA in 1974, it has been claimed that research on the expectations gap reveals a longer history with ambiguities in the roles, responsibilities and performance of auditors having existed for over 100 years (Humphrey, 1997). Henderson (1997) claimed that while the expectations gap was not identified by name in Australia until the 1980's, some of its characteristics were evident in the 1960's and 1970's. Chandler and Edwards (1996) have also demonstrated that several of the issues currently creating the expectations gap were valid concerns about the audit function in the late nineteenth century. The issues they identified included the role and scope of the audit, audit reporting, auditor independence, competition between auditors, the level of litigation against auditors and auditor regulation.

The emergence of financial scandals and the failure of auditors to detect such scandals have repeatedly led to the establishment of committees to examine criticisms of the accounting profession¹. These have commonly concluded that an audit expectations gap was in existence (for details, see Humphrey 1997). Currently the expectations gap is no longer limited to Anglo-American countries (USA, UK, Ireland, Canada, Australia and New Zealand) as it surfacing in countries like Italy, Spain, Japan and South Africa. Many of the issues and debates about the audit expectations gap revolve around five main issues namely: audit assurance, audit reporting, auditor independence, regulation of auditing and auditor liability. The rest of this section will review each of these issues in turn.

¹ In the USA (Cohen Commission (1974), Metcalf Committee (1975), Moss Committee (1976) Canada (Adams Committee) and the UK (Accounting Standards Committee's corporate report 1975, DTI investigations in 1970's, and Auditing Practices Committee 1980).

2.2.1 Audit Assurance

A major concern with assurance is related to auditors' responsibility for the detection of fraud, which seems to be as big a debating point as it used to be in the 1890's (Chandler and Edwards, 1996). Since its emergence until the 1940's, the corporate audit function had the detection of fraud as its primary objective. During that period whenever a major financial scandal or corporate collapse unfolded debates about the value of auditing surfaced and lawsuits against the auditors sometimes followed. However, in the post-1940s era, detection of fraud was no longer a main auditing objective, with the emphasis being on whether the financial statements presented true and fair view. Humphrey *et al* (1993) saw the profession as being behind this change rather than it being a response to changes in the business environment or users' needs.

Minimising auditors' responsibility for the detection of fraud, however, did not end the criticism of auditors when major corporations collapses. The huge effects of financial scandals and corporate collapses on the public welfare around the world seem to make the detection of fraud an issue that won't go away. The public still perceives auditor success and failure largely through the frequency of such scandals and the auditors' apparent success or failure rate at detecting major fraud. These perceptions of the users of financial statements can be supported by research findings on the audit expectations gap. Surveys of users of financial statements regularly show that auditing is seen as a certification of the soundness of the financial statements. However, the accounting profession generally refutes such notions of certification, claiming that the public misunderstands the auditing function and should be educated about such claim. This perception, though, might not just be the outcome of ignorant public but also can be seen as being assisted by the profession. This can be seen when auditors promote auditing as crucial element against the fight against fraud when it advances their self interest while disclaiming such objective when it doesn't serve their interest (Sikka *et al*, 1998).

“The “common sense” association of fraud detection with audits was amplified by early auditing writers who assisted the accountancy profession in securing its social standing. Subsequently, as audits by professional accountants became institutionalised, the priority of fraud detection became downgraded, at least in the professional literature.” (Sikka *et al*, 1998, p.318).

The profession sees the detection of fraud as the responsibility of the management. John Shutkin, Peat Marwick’s associate general counsel, said it is not practical for accountants to take responsibility for rooting out managerial messes and evildoings. He said that given current auditing standards “you can perform an audit entirely consistent with Generally Accepted Auditing Standards and not detect fraud that exists”. “That’s simply the way life is” (Forbes, August 21, 1989, p.51). Humphrey *et al* (1993) found it contradictory that the profession publicly acknowledged the limited capacity of auditors to detect fraud while at the same time offering “forensic auditing” for extra charges. Further, while the profession publicly denies any responsibility for fraud detection, it seemed to be continuing to employ audit techniques that seems to be directed towards detecting fraud.

In recent years, the debates and concerns about the auditing function that usually emerge in the aftermath of the financial scandals have led to changes in auditing standards (Vanasco, 1998). For example, in the USA, the American Institute of Certified Public Accountants (AICPA) issued standard No. 53 in 1988, *The Auditor’s Responsibility to Detect and Report Errors and Irregularities*, as a part of the audit expectation gap standards. The standard was seen as “cosmetic at best” as it failed to change the perception’s of auditor responsibility towards fraud (Albrecht and Willingham, 1992, p.102). It did not lead to a change in the way audit conducted and it did not limit auditor’s liability (Albrecht and Willingham, 1992). The AICPA’s Auditing Standards Board (ASB) issued in 1997 Standard No.82, *Consideration of Fraud in a Financial Statement Audit*, in response to the concerns of the Public Oversight Board (Journal of Accountancy, April 1997) about an “eroding of public confidence in the audit function” (The Accountant, September 1998, p. 13). This standard merely clarifies the auditor's responsibilities towards the issue of detection of fraud (Mancino, 1997).

However, despite the changes in auditing standards, the auditor's duty regarding the detection of fraud remains similar. For instance, Porter (1997) concluded from an examination of auditing standards in five Anglo-American countries (Australia, Canada, New Zealand, UK, and USA), that the auditor's duty to detect fraud was little different. The auditor's duty is limited to planning and performing the audit to provide a reasonable expectation that material misstatements will be detected. This limited role has been criticised and regular calls have been made for fuller detection responsibility:

“...the expectations gap should be met the other way around-by accountants providing the audit that the public wants and apparently thinks it is getting already... Fraud detection must become a primary objective, not an incidental by-product, of the audit.” (Kaplan, 1987, p.4).

The controversies in relation to fraud have extended to the issue of the auditor's duty to report fraud to third parties. Unlike the issue of detection of fraud, Porter (1997) found that there is discrepancy among the five Anglo-American countries in reference to reporting fraud to third parties. Auditors in Canada, New Zealand and the USA have a "limited and narrowly defined" duty to report fraud to third parties (p.42). On the other hand, audit standards in the UK and Australia require auditors to report material fraud to third parties albeit with some difference in the "tenor" of standards - the former being affirmative with the latter adopting a more cautious "reluctant" tone (Porter, 1997, p.42). The International Federation of Accountants (IFAC) (1999) believes that it would be "unreasonable" to require the auditor to report on acts of corruption "without the requisite legal infrastructure being enacted, the equivalent obligations being placed on other business professions and institutions and the public being supportive of the requirement".

In recent developments in the UK, the APB's Audit Agenda (1994) proposed that companies should commission periodic forensic audits. The Audit Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) has also raised the issue of forensic audits and made several recommendations for the government, regulators, the accounting profession, company directors and business organisations to tackle the issue of fraud. The report suggested that for

the profession to meet reasonable public expectations it needs to undertake several steps including the re-examination of the auditor's role in the detection of fraud and be prepared to assume a more active role (for details, see ICAEW, 1996b). For a more recent response in this direction, the APB's recently published report on the auditor's role with respect to fraud provides a useful analysis of the complexity of the underlying issues (see APB, 1998).

Calls have also been made for auditors to provide other forms of assurance (see European Commission, 1996; Humphrey, 1997; Percy, 1997). These could include assessing and reporting on management performance, internal control (ICAS, 1993; APB, 1994) and going concern. The UK accounting profession proposed to offer several assurances if the government would agree to limit its legal liability (FT, 2/5/1996, p.9). The Fédération des Experts Comptables Européens (FEE) concurs that wider assurances would be difficult to provide given the failure of the European Commission to limit auditor liability (Accountancy Age, 31/10/1996, p.2). Although professional bodies thought that it would be unreasonable to provide guarantees of no fraud, on occasions they have given some support to auditors reporting on the effectiveness of internal control in minimising the possibility of fraud taking place (ICAS, 1993; APB 1994) although current corporate governance regulations do not require auditors to report on internal control effectiveness. GAO (1996) argued that "auditor reporting on the effectiveness of internal control is fundamental in successfully addressing the public expectation gap for fraud" (p.10). While the accounting profession in the USA supports calls for reporting on internal control it has not linked this issue to fraud detection and the Securities and Exchange Commission (SEC) has yet to support such calls (GAO, 1996). Recently in the UK, the Turnbull Committee, which was set up by the ICAEW, finalised a consultation paper (ICAEW, 1999) proposing that the board directors of listed companies carry out, at least once a year, a review of the company's internal control and report to the shareholders that they have conducted such a review. The review is expected to go beyond financial risks and cover all kinds of risks. The consultation paper, however, did not require the auditors to express an opinion on the effectiveness of the internal controls.

2.2.2 The Audit Reporting

Since the 19th century there has been a difference in opinions concerning the form of wording to be used in audit reports (Chandler and Edwards, 1996). Several changes have been made to the form and content of audit reports to tackle perceived misunderstandings of the message provided by the audit report. In the USA in 1988, the short report format used for forty years² was replaced by a longer audit report as a part of attempts to close the expectation gap. The longer audit report served mainly to clarify the respective roles of the auditor and the management in preparing the financial statements. However, it struggled to change the users' perceptions of auditing (Jaenicke and Wright, 1992). In the UK, the APB introduced in 1993 a longer audit report as a response to the expectation gap. Empirical research by Innes *et al* (1997) showed that while the expanded audit report in the UK have improved users' perceptions in some aspects (*e.g.* auditor's independence) it served to widen the gap in other aspects such as fraud. They believed that the "expansion of the report also serves to increase users' perceptions of the usefulness of the audit without any additional audit activity being performed" (p. 714). However, others questioned the impact of such changes as they give the readers of the report no more information about the results of a specific audit (for a discussion see Humphrey, 1997). Changing the audit reporting format can be seen to have a double edged status "as the more specific the professional communication becomes the more they undermine the mystical qualities of professional expertise and judgement" (Humphrey, 1997, p.18). Concerns with and calls for changing the terminology used in the audit reports dates back at least to late 1960's when William Roth, then Chairman of the AICPA committee on Auditing Procedures, saw the label "present fairly" as widely misunderstood and claimed that the term "GAAP" was meaningless (for details see Previts and Merino, 1998). Ironically, the same labels that were criticised in the 1960's are still being used in the current financial statements and

² This short report format introduced in 1948 was no longer referring to the examination of internal control and to a detailed audit of all transactions. Changes were introduced in 1973 to this short report highlighting the scope of audit and the nature of auditing procedures (for details see Previts and

there seems little intention on the part of the profession to change them. The APB in the UK (1992) did propose the introduction of a free-form audit report as a way of improving the communication between the auditor and the shareholders. Percy (1997) has made similar calls, advocating a “discursive” form of reporting that explains in layman’s language what is reported and what kind of assurance is provided. Hatherly *et al* 's (1998) experimental study on the usefulness of a free-form report found that it significantly changes users' perceptions of the audit process - enhancing the “value and credibility of the audit” (p. 30). However, there has been no official attempt in the UK to put such a reporting system into operational practice.

2.2.3 Auditor Independence

“Many auditing firms act as recruitment consultants for companies, hiring the very directors who then hire the auditors. A highly undesirable situation now exists. Auditors provide all kinds of services to companies; these include, printing T-shirts, badges, laying golf courses, tax avoidance schemes, creative accounting schemes, insolvency, advising banks to put companies into receivership and preparing profit forecasts. The auditors are explicitly acting as extensions of company personnel and finance departments. They are party to the creation, recording and execution of transactions; and yet they claim to independently audit the resulting transactions. This is clearly impossible.” (Mitchell *et al*, 1993, P. 15)

The main force behind the creation of the audit function was to use the service of an independent professional to report on the way the management was running the owners' companies or organisations. Therefore if an auditor was not independent or not perceived to be independent from client management then the value of auditing seemed questionable. Not surprisingly doubts about the auditor independence have prevailed for a long time given the role the management play in appointing the audit firm for both audit work³ and non-audit services. The later type of services has been responsible for much of the controversy about auditor’s independence in recent years. Mitchell *et al* (1993) claimed that audit

Merino, 1998).

³ It is usually the case that the appointment of auditors is approved by the shareholders at the general annual-meeting. However, the role of shareholders is only a ceremonial one where they usually rubberstamp the management choice of auditors.

firms provision of ever expanding non-audit services to their audit clients is compromising their independence. The non-audit services represent a very high proportion of audit firms' income in many parts of the world. Many of the audit firms in the UK derive larger fees from non-audit work than from audit work. 33% of FT-SE 100 companies paid their auditor more for non-audit fees than for audit fees in 1995 (Accountancy, October 1996, pp. 18-19). Ezzamel *et al's* (1996) examination of a sample of quoted companies in the UK has revealed that "non-audit work for large audit clients provides a major source of income for audit firms (amounting to as much as 87% of total audit fees in 1992/1993" (p. 13). In the USA, Palmrose's (1988) analysis of a sample of public and closely-held companies obtaining non-audit services revealed that only 13% of these companies did not acquire from their auditors some nonaudit services (p.67). Moreover, regulators have concerns about auditors providing too much non-audit services to their clients. For example, a governmental agency in Norway fired KPMG from the audit of Fokus (a Norwegian Bank) because they offered too many advisory services. KPMG's total fee was NOK 4.4m while merely NOK 1.4m related to audit work (Rudd, 1992). Several countries (*e.g.* Italy, Japan, Kuwait) around the world prohibit auditors from providing non-audit services to their clients, while it is restricted in other countries such as Netherlands, France, Germany.

The argument against auditors providing non-audit services to their audit clients rests in the belief that the huge financial stakes from audit and non-audit services might entice auditors to approve inappropriate accounting methods. There is also concern that auditors will be reluctant to criticise the work of their firm's colleagues who offer consulting work to their audit client. Advocates of providing non-audit services to audit clients claim that it improves the auditor's understanding of the client's business, which ultimately improves the quality of the audit. The research on the impact of non-auditing services on independence produces conflicting results. Some of the researchers have shown that providing non-audit services to audit clients is impairing independence. Briloff (1985) responded to the profession's claim that there are no hard cases demonstrating conflict between non-audit services and auditor independence by illustrating a

few examples of what he sees or claims to be conflict “in fact”. Mitchell *et al* (1993) claimed that DTI investigation reports examining collapsed companies have cited the selling of non-auditing services as a factor in audit failures. Bartlett (1993) study showed that CPA’s and bankers regarded an audit firm to be more independent when that firm provides audit services only. Firth (1997) analysis demonstrated that companies that have higher agency-cost (*e.g.* large number of shareholders, high debts to total assets) would acquire smaller purchases of non-audit services from their auditors. Beattie *et al* (1999) concluded, from their survey of the independence of auditor in the UK, that financial directors and audit partners perceived economic dependence and non-audit services as a major threat to the auditor's independence. Other researchers, however, have argued that providing non-audit work to audit clients enhances auditor independence while others claim that evidence shows that it does not impair independence. Goldman and Barlev (1974) claimed that the auditors who provide non-audit services to their audit clients are less susceptible to threats of dismissal as a result of the client’s reliance on the auditor. Grout *et al* (1994) argued that actions such as prohibiting the sale of non-audit services to audit clients might be counterproductive as it “eliminates synergy and thereby reduces the value of incumbency” (p.331). Craswell (1999) concluded from his examination of the impact of non-auditing services on the auditor’s reporting decision that providing non-audit services had no impact on auditors’ reporting preferences.

A contributory factor to the polemical nature of debate over non-audit services is the lack of disclosure of data about audit and non-audit fees in many parts of the world. It is a statutory disclosure requirement in just a few countries - for example, in Australia, Norway and UK. Bartlett (1993) attributed such a state of affairs to a failure to define independence adequately.

Given the inconsistent evidence on the impact of non-audit services on auditor independence, competing calls for both prohibiting and permitting such services are still often in evidence. Several accounting researchers have called on the accounting profession to stop offering consulting services to their audit clients in

order to maintain their independence (Kaplan, 1987; Briloff, 1985; Mitchell *et al*, 1993) - arguing that the firms should give a priority to their audit work as other organisations can provide consulting services. Providing non-audit work to audit clients is seen as leading to unfair competition as a result of the audit firms monopoly over the audit function. Therefore, Mitchell *et al* (1993) called for opening the doors to other corporations to provide audit services given that audit firms have the opportunity to compete against consulting firms. Such calls have also come more recently from a Dutch government sponsored committee which recommended opening the audit market to non-accountants (European Accounting Bulletin, 12/9/1997). Nevertheless, many of the accounting professional bodies (e.g. ICAI, 1992; APB, 1994; FEE, 1996; AICPA, 1997) oppose prohibiting auditors from providing consultancy.

The issue of auditor independence is not only about the negative aspects of auditors selling consulting services to their audit clients. Providing non-audit services to audit clients has been blamed for the creation of what is known as "lowballing". The lowballing tactic refers to a situation where an audit firm sets its audit fee at less than cost in early years with the hope of setting off such losses in the future by selling their audit clients a portfolio of management consultancy work. However, even here there are counter-arguments that banning lowballing could harm independence (see, for example Grout *et al*, 1994). IFAC revised its code of ethics (first issued in July 1996) in January, 1998. This revised code did not regard lowballing as improper but rather it required that the quality of the work should not be impaired (IFAC, 1998, p. 55-56).

A long relationship between the client and the audit firm has also been seen as a major concern for auditor's independence, creating too cosy a relationship between the audit firm and the management. Consequently, auditor rotation has been heralded as an important way of securing auditor's independence. FEE (1996), however, is not in favour of statutory rotation of auditors, sighting research in the USA that suggests that most of audit failures occur in the first 2 years of an appointment. Furthermore, the proposal of both the European Commission (1996) and European contact group (1996) to rotate auditors

internally, as a way of tackling the cosy relations concern, was rejected by FEE. The Institute of Chartered Accountants in Ireland (1992) also did not favour auditor rotation, citing high initial costs for the incoming auditor – costs which increased the likelihood of failure to detect major fraud. Arruñada and Paz-Ares (1997) examination of the impact that the mandatory rotation of company auditors has on audit cost and quality made them conclude that, on both issues, rotation is counterproductive. They concluded that mandatory rotation increased the cost of audit, reduced competition in the marketplace, decreased the auditor's ability to detect fraud in the initial audits and, overall, harmed auditor independence (for a discussion of the arguments on both sides, see Catanach and Walker, 1999). Despite the profession's stance against audit rotation and the inconclusive evidence on its effectiveness, countries like Germany have adopted a rule (effective from 2001) requiring auditors of stock listed companies to be rotated internally every seven years.

Recent concerns about auditor independence in the USA led the SEC and the AICPA to establish, in May 1997, the Independence Standards Board (ISB), a body moulded on the Financial Accounting Standards Board (FASB), to set standards for auditor independence. The SEC authorised the ISB to write independence standards for public companies and develop guidance on specific auditor independence issues. The chairman of the ISB, William Allen, explained the motivations behind the establishment of the new body indicating that

“the reason that the ISB came about was that the SEC had set few specific guidelines for auditor independence, the AICPA saw a need for standards, and Big Six chief executives feared the prospect of over-regulation” (The Accountant, May 1998, p. 19).

In October 1997, a white paper (AICPA, 1997) was submitted to the ISB on behalf of the AICPA in response to the ISB's chairman "request for educational materials bearing on the conceptual framework for protection and enhancing auditor independence" (p.1). The AICPA claimed that moves for a change from current system for securing independence were motivated by the failure of the current system to serve the public interest rather than in response to audit quality or a lack of auditor independence. The paper claimed that few legal claims against

audit firms allege lack of independence for audit failures and that there was no evidence from the claims that providing non-audit services to audit clients impairs independence. Rather the AICPA maintained that the more non-audit services provided to audit clients the higher audit quality is going to be and the higher the benefits for the clients and public. Accordingly the AICPA argued that the new conceptual framework for independence should not consider the relation between non-audit services and independence as a result of the lack of empirical evidence to support such relation. The paper proposed that the ISB should take into consideration "economic and other determinants of auditor independence" (for details see AICPA, 1997). It asserted that accounting firms are inclined to safeguard their independence given their economic interest in their reputation. This argument echoed Moizer's (1997b) belief that the independence of a self-interested auditor is enhanced by the fact that dishonest reporting leads to legal costs and loss of reputation which result in loss of income. Moreover, the AICPA's white paper highlighted the importance of considering the economic aspects of not only the audit firm but also of the individual auditor in designing safeguards for enhancing independence. The AICPA's white paper raised controversy with its proposal that the ISB should only consider auditor independence "in fact". The paper claimed that auditor independence in appearance should only be considered after conducting comprehensive research on the issue of auditor independence in appearance. The ISB did not adopt the AICPA's white paper as a basis for developing its independence standards. Rather the white paper led to a heated debate about independence in the USA (for some of these debates see Carmichael, 1998; Elliott and Jacobson, 1998; Carmichael, 1999; Kinney, 1999). The ISB (1999) issued its first independence standard, *Independence Discussions with Audit Committees*, requiring auditors of companies under the securities acts to confirm their independence to the company's audit committee or the board of directors on annual basis. In this confirmation, the auditor would also offer to meet with the committee or the board to further discuss his independence. In Europe, FEE, on behalf of the European Commission, recently issued a new code for auditor's independence aiming at harmonising the independence rules across the European Union.

2.2.4 Audit Regulation and Liability

The self-regulatory role of the profession was called into question at an early stage in the history of the accounting profession (see Lee, 1995, Chandler and Edwards, 1996). Generally the fall out from financial scandals led to calls for reviewing and occasionally changing the regulation of the profession. Most of the debates about regulation focus on the issue of monitoring the performance of the profession and disciplining members for substandard work. The monitoring function is under the control of the profession in the USA and UK. In the USA, the quality of audit firms is monitored through a peer review system. Under that system audit firms are required, at least once every three years, to engage independent peers to review its quality control system. The Public Oversight Board supervise and report on the peer review program. Briloff (1993) questioned the SEC's belief in a peer review process that issued "clean opinions" for reviewed firms which later turnout to be inadequate. Fogarty (1996) criticised the peer review program for focusing on the performance of audit firms and failing to examine the performance of individual auditors. In the UK, the monitoring function is divided between the Joint Monitoring Unit (JMU), which covers the chartered institutes of England and Wales, Scotland and Ireland, and the ACCA monitoring unit, which covers the Chartered Association of Certified Accountants (ACCA) and the Association of Authorised Public Accountants (AAPA). In 1993, at the time of the KIO case, the JMU revealed that the majority of audit firms had unsatisfactory levels of compliance with the standards set by the DTI and JMU (e.g. Chartered Accountants 55%, Certified Accountants 55%, Authorised Accountants 65%, for details see FT, 3/2/93, p.22). Nevertheless, Moizer (1994) concluded, from his examination of the audit monitoring process in the UK, that self-regulation was "being operated conscientiously" but would be more effective if an independent review board were to examine the findings of the monitoring units (p.5). However, he highlighted that the JMU and ACCA monitoring bodies were only really concerned with compliance with auditing standards/regulations and were overlooking issues concerning the inherent quality of audit (e.g. were auditors not only complying with standards but the making the best judgement).

Disciplinary mechanisms of auditors in the USA are entrusted to the SEC and state professional boards. Briloff (1993) believed that small audit firms are more susceptible to the SEC's disciplinary actions than large audit firms. In the UK, the investigation and disciplining of auditors has been delegated to the Joint Disciplinary Scheme (JDS). The JDS was seen as reluctant to punish disgruntled professionals, being criticised for the long time it takes before disciplining auditors. It also was criticised for presenting its verdicts in "semi-judicial language" with no historical background and failing to reveal where the disciplined auditors were working at the time of their verdict. However, more recently its decision on Astra Holdings has addressed some of these concerns, providing a verdict in a clear language with historical background and sighting where the disciplined auditors worked at the time of the decision (for details see FT, 20/8/1998, p.9). The ICAI's (1992) commission of inquiry into the expectation of users recognised the degree of concern about the disciplinary process (*i.e.* secretive, lengthy, reluctance of professional bodies to make the findings public). However, it reaffirmed its preference for self-disciplinary procedures. Doubts have also been expressed about the dual role of professional bodies acting as a regulator and promoter of the interest of the profession. Willmott *et al* (1993) concluded from their examination of the governance studies of ICAEW in the 1980's that it was difficult for professional bodies to reconcile/balance its role as a promoter of members' interest with those of the public. Self regulation is seen as protecting the profession from external regulation and preserving the status quo as the profession seems to only act when it faces the danger of government intervention (Byington and Sutton 1991, Lee, 1995). The role of self-regulators of the accounting profession has often been seen as one promoting the profession rather than improving its quality. Fogarty *et al's* (1997) examination, for example, of the data gathered by the state accountancy board in Ohio as a part of proactive practice review showed that less than 10% of the report submitted by accountants (presumably as their best work) were error free. Presentation of their findings to the state board, however, resulted in no action by the board but rather raised doubts about their research findings. Cooper *et al* (1996) saw the government's desire to promote the UK

auditing profession in Europe led it to ignore the needs for strengthening state regulation. They also saw the eighth directive being constituted as a mechanism for promoting the UK auditing profession rather than as a basis for promoting best regulatory practice and improving audit quality.

Calls have regularly been made in the UK for independent regulation of the profession (see Humphrey, 1997). Some researchers see the professional bodies as unfit to act as regulator and want an independent regulator to be established (Mitchell *et al*, 1993). Some audit firms have even made similar calls. Nick Land, Senior partner at Ernst & Young, said “The present regime of self-regulation by various separate bodies which have little or no contact with each other is inherently incapable of countering public criticism of the auditing profession.” (FT, 9/5/1995, p.20). Recently the Labour government in the UK issued a consultation paper (DTI, 1998) for an independent regulation of the profession in fulfilment of their manifesto promise in the 1997 election. The paper proposes the establishment of a new body, the Foundation, that will legally own the Review Board, the Auditing Practices Board (APB), Investigation and Discipline Board (IDB) and Ethics Standards Board (ESB). Members of Foundation, who have to be from outside the accounting profession, will be nominated by non accountancy bodies (e.g. Bank of England, London Stock Exchange). In turn, the Foundation will appoint members of the four boards, making sure that at least 60% of their members are independent of the profession (representing consumers and wider public interest groups). The profession will no longer be controlling ethical issues related to the profession as these will be the duty of the new ESB. Similarly, investigation and disciplining of members in relation to major audit failures will be conducted by the new IDB that will replace the JDS. The Review Board will scrutinise both the activities of the three boards under the umbrella of the foundation, together with the activities that will still remain under the control of the professional bodies (i.e. monitoring, training, qualification, registration and other types of disciplinary actions not covered by the IDB). The DTI's paper acknowledges the concerns about the independence of the new body given that the profession will be funding that body. Accordingly,

the DTI believes that setting up the appropriate funding safeguards is necessary to overcome this problem.

Although the independent regulation of the profession has been heralded as a major step in improving the performance and accountability of audit firms, it seems doubtful that such development will be capable of regulating the international accounting firms. The global nature of auditing firms, which many already seen as multinational firms, question the ability of national institutions to regulate the profession. In the UK the profession is seen by some researchers/politicians as incapable of disciplining international audit firms in the UK (Mitchell *et al*, 1993). Existing regulatory systems were designed to regulate small profession rather than international accounting firms such as the Big Six (Baker and Hayes, 1997). Therefore, it seems that the feeling of the ICAEW's 2005 working party (ICAEW, 1996a) that the regulation of the profession would be more appropriate at an international level.

Auditors' liability is another aspect that has strongly dominated the debates on regulation. Financial scandals throughout history have led to lawsuits against the auditors. Cases against the auditors for negligent work in the UK came as early as 1895 in *London and General Bank Ltd.* (Taylor, 1961) and in USA as early as 1931 in *Ultramares Corp. v. Touche, Niven & Co.* The courts have instituted a process of expanding and limiting the auditor liability throughout these years (Napier, 1998, Siliciano, 1997). In the landmark case of *Caparo v. Dickman*, the House of Lords in the UK limited the auditor's liability to the shareholders as a group. Several landmarks rulings have influenced the auditor's legal liability in the USA (*Ultramares Corp. v. Touche, Niven & Co* limited auditor's liability in 1931, *Rosenblum Inc. v. Adler* expanded auditor's liability in 1983 while *Bily v. Arthur Anderson* limited auditor's liability in 1992 - for more details see Siliciano, 1997). While the majority of auditors tend to settle their claims out of court, the few cases that are heard in court focus on the scope of audit and causation and not on issues of auditor's negligence (Gwilliam, 1997).

In the last decade, financial scandals and audit failures have placed the profession under an increasing string of lawsuits for improper audits around the world.

Subsequently the liability claims have led the auditing firms to launch a campaign to minimise their legal liability. The audit firms portrayed their legal liabilities as a doomsday risk and claim that they are being pursued because they are seen as having “deep pockets”. Walker (1993) claimed that “auditors see themselves as victims - poor, innocent bystanders who just happened to be in the wrong place at the wrong time”(p.28). They don't see the quality of their work as the reason behind such claims. The auditors have been depicting themselves as victims of greed and mechanism for investor's insurance against business risks rather than as a deficiency in the work and quality of auditing.

“Claims against auditors are not, on the whole, driven by professional malpractice, or for that matter by the existing state of law regarding the standards of liability. Claims arise from the economic hazards of the clients audited, fuelled by the opportunism, greed and talent of specialists in suing the audit profession” (Murray quoted at United Nations, 1996, p.1).

The profession claims that the joint and several liability role is not fair given that the auditor usually pays 100% of claims while he might be responsible for only 1% of the claims. Many of the legal claims against auditors have been seen as frivolous lawsuits (also see Palmrose, 1997). The Big Six audit firms have maintained that the growing numbers of legal cases against them makes it difficult for them to acquire appropriate insurance coverage. The finding of Moizer and Hansford-Smith (1998) seems to support the claim of the Big Six as their research showed that Big Six audit firms can only obtain partial insurance coverage for some type of risks, while non-Big Six audit firms can receive full insurance coverage. They attributed the difficulty of obtaining full insurance coverage to the fact that payments for auditor liability have been infrequent and that the amount of damages awarded to the plaintiffs is unpredictable. The accounting profession also claims that the difficulty of obtaining insurance coverage to cover the huge claims against them might lead to the collapse of a firm (as it did in the USA with Leventhal & Howarth) and that this fear lead many auditors to leave the profession and also makes recruitment of new auditors more difficult (FEE, 1996; Dalton *et al*, 1997). IFAC commissioned London Economics (LE) in late 1997 to undertake an independent economic study (LE,

1998) of audit liability regimes. The focus of the study was on four main issues. These include: 1. the reliance of institutional shareholders and others on the auditor as risk insurance in the case of fraud or collapse rather than exercising their role in the corporate governance process; 2. the rejection of some clients on the basis of the difficulty of auditing them, which in turn restricts their access to capital markets; 3. the use of defensive audit practices by audit firms to limit such liability, and 4. Whether the threat of liability has a role in improving audit quality. LE (1998) claimed that professional indemnity insurance and LLP status are not effective in limiting liability as the former might lead to the deep pockets syndrome while the latter does not protect the assets of the firm. Consequently, LE (1998) claimed that there is an economic case for replacing joint and several liability with proportional liability and imposing a statutory cap on audit liability.

The auditing profession is campaigning to limit audit liability both nationally and internationally. The main changes sought *inter alia* are replacing the joint and several liability concept with a proportionate liability, placing a statutory cap on auditor liability, enabling the auditor to limit his liability by contracting with the client and allowing the auditor the freedom of organisational options⁴. Nationally they have teamed up with politicians to lobby their position and gain concessions⁵. At an international level, they have the attention of global

⁴ In addition to the major amendments sought above, IFAC (1995) identified the following: Provide disincentives for plaintiffs filing frivolous lawsuits; adopt a statutory requirement for professional advisors and directors of companies to have adequate insurance cover.; limit auditor responsibilities to third parties; strengthen privity standards; and reduce the statute of limitations (for details, see IFAC, 1995).

⁵ In 1994 in the UK, accounting firms and professional bodies had 16 Members of Parliament on their paying list as consultants, including prominent figures such as the former Prime Minister, Edward Heath, who acts as a consultant for Arthur Anderson. (The Accountant, December 1994, p.1 & p.8) Moreover, they employed Ian Greer Associates, a lobbying company close to the former minister Neil Hamilton (who was involved with cash for question affairs), to lobby their cause in parliament. In America, they contributed \$2.3 million to support House and Senate candidates in the 1994 election (Shields, 1994).

organisations such as the United Nations (UN), International Federation of Accountants (IFAC) and Fédération des Experts Comptables Européens (FEE). These organisations are communicating the same arguments advanced by the audit firms that their role and duties are misunderstood and unfairly criticised. Moreover, decreasing the liability of audit firms is being promoted as in the public interest (IFAC, 1996, FEE, 1996). IFAC (1996) claimed that "...holding all auditors liable for damages to an indefinite number of persons for an indefinite amount of money, is, ultimately, not in the public's best interest". Using the argument of "public interest" is not something new in the profession, for example Lee (1995) showed that the accounting profession, since its formation in the UK and USA, has used the public interest argument to promote and protect its economic self-interest.

Summary of Arguments For and Against Limiting the Auditor's Legal Liability

Advocates of Limiting Legal Liability	Opponents for Limiting Legal Liability
<ul style="list-style-type: none"> • Legal claims against the auditors are motivated by 'Deep Pockets' rather than the quality of audits • Auditors unfairly targeted as they pay 100% of damages while they might be 1% responsible • Auditors have difficulty in obtaining indemnity insurance which makes audit firms susceptible to bankruptcy • Audit firms claim that many people are leaving the profession while it's difficult to recruit new people as a result of concerns over liability 	<ul style="list-style-type: none"> • Legal liability safeguard auditor independence • Usually courts limit auditor legal liability to the company or shareholders and therefore it is difficult to claim against auditors even if negligent (Caparo Case) • The auditors overstate their legal liability and it is difficult to verify their figures and claims • Many of the legal cases are initiated by audit firms against each other • Many countries are now providing more protective organisational models (e.g. LLPs) • Auditors prefer to settle out of court rather than defend their position • Introduction of new laws that have already limited auditors' liabilities

Acemoglu and Gietzmann (1997) saw imposing legal liability on auditors as possibly being essential to ensure their independence but emphasised that care must be taken in imposing a proper level of liability. They claim that setting the auditor's liability "too high" might lead to the collapse of the audit market, while

setting it "too low" might lead to compromising auditor independence (p.372). Power (1998) argued that while auditors want to limit their liability they don't want to go too far in lowering public expectations about what the audit process can deliver. He saw highly protective legal judgements, as Caparo, may be eroding the value of the audit product.

Some of the research findings on auditor liability undermine the profession's case for limiting liability. Palmrose (1994) analysis of 227 cases filed against auditors between the period of 1960-1994 with "complete outcome"⁶ has revealed that in 88% of cases auditors were joint defendants and contributed, on average only 21% of payments. She also concluded that in 53% of the cases, the defendants pay between \$1million and \$5 million. The analysis showed that in almost half the cases, auditors did not pay any damages (48%) and when they are required to pay damages, the amount almost always (91% of the cases) was less than \$10 million. Palmrose claimed that it appears that when auditors are required to contribute to defence payments, they most frequently (63% of the cases) contribute less than 10%. More often than not auditors are non-contributors or secondary contributors to the total amounts paid to plaintiffs. Palmrose also observed that when auditors pay 100% of the total defence payments, these tend to be in the lower range (less than \$10 million). The analysis also suggests that auditors are not the only defendants with resources, thereby undermining the claim of "Deep Pockets". Auditors tend to be non-contributors or secondary contributors even when total payments are large. The study showed that the dismissal rate for cases against the auditors (at 48%) was is higher than that of other defendants (26%). The high dismissal rate against auditors supports Siliciano's (1997) claim that "for years the accounting profession enjoyed a relative immunity from liability under the *Ultramares* rule that was unmatched by any other potential defendant class" (p.349). Fuerman (1999) concluded, from his analysis of 446 securities lawsuits filed against companies in the USA during

⁶ Palmrose (1994) defined "complete outcome" as cases where the complete outcome of the cases known, which is either settlement with plaintiffs to avoid litigation, adjudication (court decisions on

the period 1992 to 1995, that "nonculpable auditors were not routinely named defendants" in these lawsuits (p.331). Furthermore, a Law Commission in the UK, established to report on the possibility of reforming the law of joint and several liability, concluded that "the current systems protect the interest of the victims and launching an action under joint and several liability is difficult for victims to prove anyway" (DTI, 1996). Professor Andrew Burrows, the head of the team that conducted the study, said "the accountants' case for reform was flawed, that it was based on 'myths', and if successful would undermine an historic protection for the victims of professional negligence" (FT, 7/11/96, p. 16). Different courts in different countries are also proving very reluctant to extend auditor's legal liability to third parties. This is clearly seen in the Caparo case in the UK, which is being used, by other courts in Anglo-American countries as the basis for their decisions to limit liabilities to third parties (e.g. Australia, Canada,). Some researchers have also questioned the motives of the profession's liability campaign. In the UK, Mitchell *et al* (1994) argued that "there is no economic, moral or ethical case for giving further concessions to the auditing industry" (p.2). Cousins *et al* (1998) believe that the liability claims are being used to deflect attention from concerns about the performance of audit firms.

"Recurring audit failures might have persuaded the industry to improve the quality of its work, compensate injured stakeholders and even consider returning the audit fee. The reverse has happened. The auditing industry is campaigning for even more liability concessions to protect it from possible lawsuits resulting from its own failure." (p. 6).

Cousins *et al* (1998, 1999) saw the evidence presented by the profession as selective and not representative. They claim that liability figures provided by the profession are unverifiable, overstated, include liability for consulting figures and in many cases relate to audit firms suing each other. Sikka and Willmott (1995) illustrated that DTI reports in the UK have revealed a web of allegations by audit firms against each other⁷. The Big Six's adoption of lowballing tactics has also

motions for dismissal, summary judgement, and trails) or judicially approved settlements.

⁷ A recent example is the collapse of Barings Bank Coopers & Lybrand in London and Singapore is being sued by Ernst & Young, the group administrator. Coopers & Lybrand - Singapore is also being

been blamed for some of their legal liability problems - suggesting that such problems are self-inflicted. BDO Stoy Hayward, for instance, criticised the Big Six in this respect:

“It is ironic that in the drive to gain new business, the giant accountancy firms have chosen to compete by cutting audit fees at a time when the public expectations of auditors are not being met and the rate of litigation against these firms is rising rapidly” (Accountancy, June 1995, p.13).

The current campaign is enjoying some success in some regions in relation to specific calls for limiting the auditor's liability. Auditors are now having the chance to incorporate as Limited Liability Partnership (LLP) in the USA and Canada, while draft laws for LLP's have just been introduced to the parliament in the UK. New laws and regulations limiting the auditor's liability have been introduced (e.g. the Private Securities Litigation Reform Act was introduced in the USA in 1995) or are under consideration (e.g. the Standing Senate Committee on Banking, Trade and Commerce in Canada recommended the adoption of proportionate liability as a replacement for joint and several liability). However, it could be argued that the position of the audit firms is best described by Lee's (1992) claim that “they protest too much”. A vivid example supporting Lee's argument can be seen in the USA where the failures of numerous Savings & Loans organisations provided the motive for the accounting profession to launch anti-litigation legislation (International Accounting Bulletin, October 25 1995, p.7). In 1995, the American congress passed the Private Securities Litigation Reform Act, overriding President Clinton's veto. This new law requires proof of fraud to bring a legal action and diminishes liability for secondary defendants, such as accountants, who were not knowingly part of a corporate fraud. The act also contains stiff penalties for those who file frivolous actions (The Accountant, August 10, 1997). Moreover, audit firms now can be formed as Limited Liability Partnerships (LLP) in forty-seven states. Richard Murray (Deloitte & Touche Tohmatsu International's liability insurance expert) believes that concerns about

sued by Price Waterhouse, the administrator of Barings Futures Singapore (BFS). Moreover, Ernst & Young and Price Waterhouse are suing Deloitte & Touche Singapore for BFS audits in 1992 and 1993 (International Accounting Bulletin, 6/8/97).

US litigation crises threatening the future of the big audit firms are justified, but suspect "the worst may well be over.....Every Big Six firm has at some time or another, been the subject of allegedly well substantiated rumours that their existence is threatened by litigation. But it hasn't happened and I have no reason to believe that it's going to happen in the future" (International Accounting Bulletin, May 26 1995, p.11). However, the American audit firms feel that all of these changes are not enough and favour legislation that would limit class action lawsuits to federal courts. These firms also want the law to clarify that they would only be found liable for conduct that is intentionally fraudulent (International Accounting Bulletin, August 6 1997).

Analysis of the profession's campaign and its supportive research shows how the profession is rather selective and contradictory in presenting its case for limiting liability. Much of the professional and academic research that supports limiting auditor's liability fails to highlight the fact that many of the legal cases are filed by audit firms (in capacity as liquidator) against other audit firms. It is easier for audit firms as a liquidator to file suits against auditors than for individual shareholders or other stakeholders given the limitation of Caparo decision (Napier, 1998). The Big Six also fail to acknowledge that many of their controversial legal suits against them are related to non-audit services. For example, E&Y-USA was hit in late 1997 by the largest-ever-damages claim brought against a US accounting firm of \$4bn (a claim related to consulting work for the failed clothing store chain Merry Go Around, rather than for audit work (IAB, 17/12/97). Calls for limiting auditor liability claim that legal cases are nothing to do with the quality of audit work but, rather, are motivated by greed and misunderstandings of the audit function. Investigations of financial scandals, however, undermine these claims. For instance, GAO (1989) investigated auditors' work for 11 out of the 29 S&L's that failed in Dallas-Texas between 1985-1987. GAO (1989) concluded that in "6 of the 11 S&Ls, the CPA did not adequately audit/ or report the S&Ls' financial or internal control problems in accordance with professional standards" (p.1). Concerns for the public interest are usually advanced as arguments for limiting liability - although, the profession's ultimate goal in the UK of replacing joint and several liability was

seen by the law commission (DTI, 1996) and Peter Mandelson, the then DTI Secretary, as not in the public interest.

Notwithstanding the contradiction between the claims of the profession and those of opponents of limiting liability, contradiction are also evident among the profession itself. London Economics (1998) study claimed that legal liability does not improve the quality of audit, while the AICPA's white paper to ISB (AICPA, 1997) argued that auditor liability safeguards independence and makes redundant restrictions on providing non-audit services. Further, its study, labelled as an independent study of auditor liability, was seen as "biased and lacking intellectual rigour" by professional bodies such as ACCA in the UK. The ACCA's head of technical services, Roger Adams, indicated that "the paper produces a stream of theoretical arguments that are not underpinned by hard empirical evidence." (Accountancy, July 1998, p.17). The biases of the LE study can also be seen in the way it neglected the issue of auditor suing each others and that legal liability claims also related to non-audit services and ignored the limitation of auditor liability to the company (according to the Caparo rulings) in the UK.

2.2.5 The Profession's Response to the Audit Expectations Gap

The debates that are identified as the audit expectations gap have captured to a large extent the problems with auditing and the feelings that it is unable to deliver what it should be doing. The debates and problems seem to be triggered by major corporate scandals throughout history, which regularly calls for more assurance in terms of fraud detection and reporting on internal control. Changes in the form of the audit report have also been introduced in the aftermath of financial scandals. Debates about auditor independence usually surface as a result of financial scandals, as do discussions about the legal liability of auditors and talk of changes in auditor regulation. The profession's response to the audit expectations gap debate can be characterised as actions mostly driven by professional self interest rather than public interest. The popular response for the profession is one of blaming the victim, *i.e.* claiming that the public misunderstands the role of the audit function and should be better educated about

it (see Liggio, 1974; ICAI, 1992.). Introducing new standards in an attempt to close the audit expectation gap is another action pursued by the profession. Baker (1993) saw the issuing of the nine Audit Expectation Gap standards in the USA in 1987 as designed to foil any attempts by Congress or the SEC to change the self-regulation of the profession. He doubted the effectiveness of such standards in terms of reducing the conflict between the auditor's duty to the public and the need to satisfy audit clients.

The profession over the last hundred years has played an active role in limiting its responsibility. It seems paradoxical that given the level of audit scandals around the world the accounting profession, rather than providing what the public wants from auditing (*e.g.* fraud detection, non-ambiguous audit reports), is calling and campaigning for limited legal responsibility. This negative response from the profession, however, is criticised as being nothing new.

“Because of the limitations of the procedures at hand, auditors came to the conclusion that they were no longer responsible for detecting fraud. And over time, the number of other things for which they decided they weren't responsible grew—and grew. Finally, auditors arrived at the conviction that they aren't responsible for anything.” (Walker, 1993, p.28).

Many of the profession's efforts to address the expectations gap show that it responds to the concerns raised by the gap without making much change to the auditing function. Educating the public about auditing, issuing audit expectations gap standards and limiting audit liability do not entail changes in the way auditing is conducted. Fogarty *et al* (1991) labelled the profession's response as a strategy of “doing nothing”. They concluded that this strategy of doing nothing requires extraordinary effort but it revealed a profession able not only to survive but also prosper. Henderson's (1997) analysis of the response of the Australian profession to the expectation gap, revealed the adoption of a variation of this strategy in the 1970's and 1980's. In the 1970's the profession kept silent on the issue, blaming no one until the confidence crises in auditing had passed. In the 1980's, successive professional committees were appointed to examine the expectation gap issue until the crisis withered. While the strategy of doing nothing might indeed be crucial for the survival of the profession,

however, it seems to fail to bridge the expectations gap.

Initially the issues or problems identified in the expectations gap gives the perception that the problems are contemporary. The profession claims that constantly changing public expectations and its endeavour to meet these expectations are the main culprits. As Shaun O'Malley, (then) Chairman and senior partner at Price Waterhouse wrote

“Some observers have suggested that public expectations are a constantly moving target. Any effort on the profession's part to meet these expectations at a given point in time seems to generate newer and even more unrealistic expectations. The resulting disappointment produces more criticism of the auditor's performance, more litigation, and more pressure for even further expansion of the auditor's responsibilities” (O'Malley, 1993, p. 85).

However, these problems generally seem to be fairly constant if one looks at the historical analysis conducted during the 1980's and 1990's. Briloff (1993) highlighted the continuity of the profession's problems in his testimony to the American congress in 1985 under the title “Plus ca change, plus c'est la même chose”. He explained his title to the congress noting that it

“...was the third occasion when I was invited by that Congressional Committee to present my views regarding the effectiveness of the accounting profession in the fulfilment of the responsibilities vested in it by society, and the effectiveness of the securities and Exchange Commission in the fulfilment of its oversight role.” (p. 73).

Briloff (1993) showed that the same problems and issues he testified on in 1976, 1982 and 1985 were still persisting in the 1990's but in higher magnitude and with more significant implications. The profession's control over the audit expectations gap debates and its management of these debates to its own advantage has been blamed for the persistence of such gap. Power (1997) has argued that the audit expectations gap is an asset for the profession. In controlling the audit expectations gap debates, the profession can blame unreasonable audit expectations for the concerns with auditing rather than deficiencies in that function. Moreover, the profession's limited response to the expectations gap, which usually do not entail changes to the audit function, can be used to depict the profession responding to the changes in users' expectations.

Besides the claim that the profession is controlling the expectation gap, others blame the profession for the creation of the expectation gap. While Liggio (1974) attributed the expectation gap to an education problem, he acknowledged that the profession is partially responsible for the creation of the gap.

“...It is not fair to blame only the user of the financials for this misunderstanding—for this expectation is aided and abetted by the profession. The accounting profession helped create these expectations when, in the mid-1930’s, it successfully tried to have its report (opinion) on the financial statements of a company considered as a “certificate.” (Liggio, 1974, p. 29).

Other researchers have also argued that the profession is behind the creation of one of the important element of the expectation gap, *i.e.* the liability crisis.

“What auditors know and what different parts of society expect and desire auditors to be capable of knowing will not always, or ever, coincide. This means that the question of auditor liability will never be decisively solved, that pressures always exist to push the auditor in new directions, that auditors are constantly tempted to create expectations of what they can achieve,...” (Power, 1998, p. 79).

Miller (1999) blames the "moral and ethical degradation of the accountancy profession" for the liability problems (p.355). In addition, Sikka *et al* (1998) acknowledge the role of the profession in creating the expectation gap but they believe that other factors impact on auditing. They have argued that it is impossible to eliminate the audit expectations gap given the difficulty of agreeing on the meaning of audit. They illustrated through the examination of the history of association of auditing to detection and reporting on fraud in the UK that “pressures to refine or revise the meaning of audit are closely linked to the social, economic and political developments of the time” (p. 320).

2.3 Growth of the Auditing Function

Power (1994) argued that auditing has never been placed under so much criticism. Yet the profession is more dominant in communicating its point of view. A classic example can be seen in the issue of auditor liability. The profession has dominated the auditor liability debate depicting itself as the victim of a deep pockets syndrome whenever major financial scandals arises. It is

becoming very difficult to argue against the profession's claims and campaigns given the fact that these pursued in global contexts. Auditor liability has become an international problem and one that has to be resolved in a global context. International organisations have taken an interest in the problem of auditor liability. For example, the United Nations organised a symposium on auditor liability in 1996, IFAC conducted international survey of auditor liability in 1996 then followed it by commissioning London Economics to undertake what is depicted as independent research on the issue. FEE undertook its own study of auditor liability in 1996 while the European Commission in its Green Paper in 1996 concluded that it was difficult to legislate on auditor liability at the EC level but then, after pressure from the profession, it agreed to launch a detailed investigation of the auditor liability. The profession's power can be seen in the case of PW and E&Y in the UK where they took a major role in getting LLP law to be enacted in Jersey. Cousins *et al* (1998) saw the two firms as trying to "hold the parliament to ransom", to force the government to introduce a LLP law in the UK (p.38).

The dominance of the profession is most visibly expressed in its ability to thrive despite all the audit scandals and attendant worries about the quality of the audit function. The last three decades have witnessed considerable expansion in the work and revenues of the Big Six (Big Eight before 1989) accounting firms around the world. The annual fees of these firms was about \$44bn in 1996 (see Table 2-1). National Economic Research Associates⁸ (NERA) concluded in its report published in 1992 that the Big Six in Europe were the largest in terms of fees and in terms of staff. The study revealed that the Big Six audited 100% of the top 200 businesses in Belgium, Italy and the Netherlands and controlled more than half the audit work in Germany and Portugal. In 1996, the Big Six also controlled most of the audit market in countries like the UK, the USA, Japan and Germany (Nobes and Parker, 1998, p.447). There has to be some suspicion that

⁸ NERA was commissioned in 1989 by the European Commission/Union's competition directorate to help the European Commission assess policy options (such as auditor rotation, providing non-audit

audit markets are becoming saturated, while the trend in international corporate mergers and acquisitions creates fewer large clients and puts audit firms under pressure to keep their audit clients. This saturation in the audit market has made the Big Six pursue the middle tier audit market in countries like the USA and the UK to guarantee their revenue growth. Peel (1997) study of auditor concentration in the UK showed an increase in the Big Six's concentration in the audit market for listed companies reaching 78.4% in 1994/1995 and 47.9% for public unquoted companies. His analysis also revealed that the Big Six in 1994/1995 were auditing a substantial 58.2% of companies in the UK middle market (£5m to £200m sales range). Belkaoui (1985) reported a similar pattern in the USA in the 1980's.

Table 2.1 - Revenues and growth of the Big Six Worldwide

Name	1996 Revenues (\$/million)	1995 Revenues (\$/million)	1994 Revenues (\$/million)	1996 Growth rate(%)	1995 Growth rate(%)
Anderson Worldwide	9,498.5	8,134.1	6,700.0	16.8	20.9
KPMG	8,100.0	7,500.0	6,600.0	8.0	13.6
Ernst & Young	7,800.0	6,900.0	6,015.0	13.0	14.2
Coopers & Lybrand	6,800.0	6,200.0	5,500.0	9.7	12.7
Deloitte Touche Tohmatsu International	6,500.0	5,950.0	5,200.0	9.2	14.4
Price Waterhouse	5,020.0	4,460.0	3,975.0	12.6	12.1

Source: International Accounting Bulletin, 21/12/1995, p.7 and 13/12/1996, p.8.

Another strategy for the Big Six to maintain growth is to pursue international expansion in 'virgin' markets - where they did not practice before. These firms are now offering their services in virtually all parts of the world from the former communist countries in Europe to communist China⁹. The expansion of the Big Six from developed capitalist countries to such new regions is part of their plan to create a global audit market. The growing strength of the harmonisation effort for accounting standards is seen as beneficial for both international accounting firms and individual accounting practitioners (Chandler, 1992). Harmonised practice and lower barriers to entry would give auditors the opportunity to practice in almost any country they wish to work in. This opportunity to lower

services to audit clients etc..).

⁹ Price Waterhouse was the first Big Six firm to establish full fledged member firm in communist

barriers to accounting practice is strongly emphasised in Europe (FEE, 1996, EC, 1996, ICAEW, 1996a). Calls towards an international audit qualifications is seen by some of the Big Six as necessary for the free movement of auditors around the world. Recently, the World Trade Organisation (WTO) adopted the *Disciplines on Domestic Regulation in the Accountancy Sector* (WTO, 1998) directed at removing barriers for trade in accounting services in countries committed to the General Agreement on Trade in Services (GATS). The regulation, prescribes guidelines on licensing and qualification requirements and procedures that should be considered to remove any restrictions on freedom of practise.

Despite the international growth of the Big Six, NERA's study controversially concluded that these firms were not "genuinely considered international firms but rather networks that share resources". Nevertheless, recent developments suggest that audit firms are closer to becoming global audit firms. The ICAEW's 2005 working party (ICAEW, 1996a) prediction that the Big Six will globalise further and emerge as the Big Five or Four is gaining ground as recently four of the Big Six were in the process of merger sighting globalisation as their motivations for the merger. Coopers & Lybrand and Price Waterhouse succeeded in gaining the approval for their merger from regulators around the world creating the world's largest accounting firms in July 1998 with combined fees for both organisations exceeded \$13bn. The newly merged firm cited the increasing globalisation of their clients as being behind their move. The combined firm claimed that it "will have the global reach, the global strength, and the integrated management structure to meet the future challenges and opportunities our clients will face" (C&L, 19 September 1997, <http://www.us.coopers.com/news/091897.html>). On the other hand, the merger plan for KPMG and E&Y was called off by E&Y as a result of client and regulatory pressure. Nick Land, E&Y-UK's senior partner said "There is no doubt that, around the world, regulators were going to take a very tough view of both of these mergers. Part of that was the client reaction, which was never brilliant in the UK - clients were ambivalent or neutral about it at best - but it had

China in December 1996 (International Accounting Bulletin, 23/1/1997, p.1).

spread to other countries and has fuelled the increase in regulatory concern.” (The Accountant, March 1998, p.5). Accordingly, KPMG pursued another medium for becoming a global audit firm. KPMG’s chairman, Colin Sharman, told partners from around the world that “for years we have been talking about being more global. Now we are going to make it happen.” Mr Sharman created a global leadership organisation and, tellingly, the top jobs are not held by partners with a national role (FT, 17 September 1998).

Multi Disciplinary Partnerships (MDP), also known as the one-stop shopping service (and identified in the ICAEW (1996a) report as characteristic of the future of accounting firms) are already taking place. Audit firms providing legal services is the fastest form of MDP in Europe. MDP are already in place in countries like Germany (where it is legally possible) while in other countries changes in the law are being made. For example, in the UK the Law Society is under pressure from the labour government and the Office of Fair Trading to remove a ban in its rules on the forming of the MDP (IAB, 17 December, 1997). Also the French government has appointed a former minister to assess the possibility of legalising MDP (The Accountant, September 1998, p.5). In January 1998, PW’s global network of affiliated law firms covered 38 countries, with PW Russia’s law department being one of Moscow’s leading firms (European Accounting Bulletin, 22/1/98). Even the in USA, it seems the grounds are prepared for the establishment of MDP’s - given that the landmark case filed by Texas lawyers against Arthur Anderson accusing it of engaging in the unauthorised practice of law in the state was dismissed by the Texas court (The Accountant, September 1998, p. 5).

It is important not to view the rise in auditing revenues in absolute terms as auditing is decreasing as a percentage of the total revenues of the Big Six firms. Hanlon (1996), for example, documented the decrease in the contribution of audit to the total income of audit firms in the UK and Europe, a development caused by the growth rate in management consultancy and corporate finance. Currently the Big Six are rated at the top of the ten best consulting corporations around the world (see Table 2-2). It has been predicted that these firms will grow further in

this field in the future (see ICAEW, 1996a) - especially given the advantage that these firms have in using their close relationship with their audit clients to provide additional consulting services. Of additional significance is that audit itself seems to be assuming a more consulting orientation at the leading edge of audit practice.

Table 2.2 - The World's Ten Largest Consultancies Ranked by Revenues

Firm	1996 Revenues (\$/million)	1995 Revenues (\$/million)	Growth rate(%)	Effective date	Number of consultants	Number of partners	Total staff
Anderson Consulting	5,302.0	4,224.0	25.5	Dec 96	37,389	1,036	44,801
Ernst & Young	2,010.4	1,523.0	32.0	Sep 96	10,657	n/a	n/a
McKinsey & Co	2,000.0	1,800.0	11.1	Dec 96	3,994	587	7,527
KPMG International	1,836.0b	1,544.0b	18.9	Sep 96	10,763	888	11,888
Deloitte & Touche Consulting Group/DTTI	1,550.0	1,200.0	29.2	Aug 96	N/a	n/a	10,000
Coopers & Lybrand	1,422.0	1,221.0	16.5	Sep 96	8,511	564	10,298
Arthur Andersen	1,379.6	1,169.5	18.0	Aug 96	N/a	n/a	n/a
Price Waterhouse	1,200.0	964.0	24.5	Jun 96	8,900	470	10,300
Mercer Consulting Group	1,159.2	1,056.4	9.7	Dec 96	N/a	n/a	9,241
Towers Perrin	1,001.3	867.9	15.4	Dec 96	6,500	635	6,888

Source: Management Consultant International, 16/7/1997.

2.3.1 Re-engineering the Audit Function

The last few years have seen a growing public recognition by senior members of the profession that audit needs to change. Gerry Acher, Head of the ICAEW's Audit Faculty and Head of Audit at KPMG put the need for change very clearly:

“During the last two decades, the auditor has fallen away from being the company's key adviser and in many companies no longer sits at the top table. But this must be reversed; auditors, if they are to provide a service, add value and act as an adviser must earn their way back to the top table. But they cannot do it alone.” (KPMG Press Office, 1996).

Similarly, Jon Madonna, the former Chairman of KPMG, stressed that audit firms have to adapt to this new reality.

“The traditional service revenue is declining. It's a fact, okay? You can't get enough revenue from this stuff to exist 20 years from today. The only way you can do it is you've got to do new stuff. Okay? This is the deal: All of these firms, including ours, are almost 100 years old. We have

been in the same business all 100 years. This business is really in big change, okay? So now there are three options. You can deny it. Or you can profitably wind down. Or you can change. Those are the three options. Okay? It is very difficult for people to accept that, very difficult.” (Quoted in Financial World, 27/9/1994, p. 30).

The ICAEW’s 2005 working party on the future of chartered accountants also believes that income and employment opportunities in traditional auditing will fall. One clear dimension in the response of the large accounting firms has been to seek to re-engineer the audit function, with what is referred to as *Value Added Audits*. Philip Laskawy, the international chairman of Ernst & Young, explains the concept:

“The idea is to help the client improve the way they operate their business as part of the audit process, mainly focusing on market intelligence and business processes. So we give the client good advice on how they can be more efficient or better at what they’re doing. That’s not an additional consulting service. That’s part of the audit.” (Quoted in Financial World, 09-27-1994, p. 30).

The UK audit profession adoption of the added-value audit strategy is seen as an attempt to make audit ‘sexy’ (Accountancy Age, 27 March 1997, pp. 12-17). The added value audit has a number of different dimensions including changing the audit mentality from ‘find and fix’ to ‘anticipate and prevent’, providing both internal and external audit functions, moving the audit scope beyond the accounting department to the business as a whole, changing the focus from the balance sheet to a business-wide examination (Accountancy Age, 27 March 1997, p.12-17). The ICAEW’s 2005 (ICAEW,1996a) working party expects the Big Six to grow faster than the underlying economy by exploring the opportunities in added-value areas such as tax planning, corporate finance and business advice.

This promotion of added value audits probably had its roots in the mid to late 1980s (for a discussion see Humphrey and Moizer, 1990). Since then, and aided by developments in risk based methodologies, that added-value dimensions of the audit have not been seen as ‘bolted-on’ free extra services, but coming directly from the business focus/orientation of the audit. Auditors have become more concerned with understanding key risk areas and key business processes in going

about their audit work. At profession-wide level during the late 1980s/early 1990s, many of the development reports exploring future development possibilities were rather narrowly concerned with audit expectations gap's related issues including attempts to enhance auditor reputation and deter change in the regulatory environment. For instance in the UK, the APB's (1992) consultation paper "The Future Development of Auditing" was issued in an attempt to address some of the controversial issues incorporated in the audit expectation gap (e.g. independence, liability). Similar understanding can be seen in the 1993 conference held in London on "The Future of Auditing Practice and Regulation"¹⁰. However, as with the promotion of value-added audits, recent studies/reports reflect a broadening in focus.

Official reports (e.g. see ICAEW, 1996a, AICPA, 1997, CICA, 1996, CICA, 1998, ICAA/ASCPA, 1997, ICAA, 1998) no longer seem to be concerned primarily with the audit expectations gap, nor are they aiming at improving the reputation of the auditor and fend of intervention by regulators. Rather these reports appear more concerned with redefining auditing and exploring new opportunities for growth for accountants beyond financial auditing. These studies attribute the change of focus to their claim that the audit market is static in many western countries and that rapid growth in this market is unlikely in the future. The effects of competition and cost cutting exercises on audit fees are also being identified as a source behind such change. The advance of information technology and the need for providing assurance on the accuracy of information is also a major reason. The reports can be categorised into two groups: reports concerned with the future of the profession in general, while other reports are focusing on new opportunities in new "assurance services". The first type of reports are more concerned with the forces that are going to influence the future of the certified or chartered accountants and what their role will be in the future, especially in the first two decades of the new millennium. The discussion of

¹⁰ The main topics in the conference programme included among others: evidence on the audit expectations gap, strategies for eliminating the expectations gap, regulation of the profession, fraud and the auditor, reforming the audit report.

these issues was instigated in the UK by a consultation paper undertaken by the ICAEW's 2005 working party. Similar debates in the USA, Canada and Australia have been promoted through vision projects or taskforces. These "vision" reports or projects have tried to identify a mission statement (the needs the profession serves and the core competencies it possesses) and a vision statement (identifying the market forces and competition that is going to shape the future). The vision projects in the USA and Canada were based on the findings of focus groups, interviews and questionnaires, while the Australian assurance project is based on the assessment of the other vision reports/studies and the ICAEW's study. Regardless of the name of the report or project or the way it gathered, the reports seem to address similar issues. They identify the prominent drivers for change (*i.e.* growth in information technology, static growth in the audit market, change in work patterns, globalisation or internationalisation of business). The implications for accountants are highlighted both in terms of sectors and discipline. The studies also explore the key opportunities for growth in the future (*e.g.* growth in internal auditing, new types of multidisciplinary audits, new assurance services etc.).

New assurance services are one of the key opportunities that have been examined by an assurance committee in the USA and by a task force in Canada and Australia. The reports highlighted a shift from auditing to business or information assurance services. The AICPA (1997) assurance committee, known as the Elliot Committee after the name of its chairman, and the CICA (1998) Task Force on Assurance Services are setting the agenda for this shift. The joint Assurance Services Task Force to the Institute of Chartered Accountants in Australia (ICAA) and the Australian Society of CPA's (ASCPA) have adopted the American agenda. The AICPA report predicated that even though financial audit is no longer a growth area, it is important to provide a "door" for new assurance services. It highlights that in order to use auditing as a background for promoting these services it would be useful to enhance the image of auditing in detecting fraud and illegal acts to promote the reputation of the auditor as an obvious choice for providing the new services. These reports view the development in

information technology and electronic commerce as creating demand for assurance services in terms of the accuracy of information and the legitimacy and reliability of the electronic commerce provider. The profession acknowledges the fact that unlike statutory auditing, accountants do not have a statutory monopoly over assurance services. Accordingly, they feel that it is imperative for the profession to establish itself as the obvious provider of assurance services given their access to audit clients and their claimed reputation for independence, concern for the public interest and quality control systems in place. The profession feels that it is important to acquire new competencies in order to be competing for the new services. The need for new competencies and assurance services require change in the education curriculum. The assurance committee felt that users of the financial statements wants more than traditional periodic, historical, cost based financial statements. They want real time/continuous, perspective, value based and comprehensive (including relevant non-financial) data and therefore audit firms needs to develop assurance services around the needs of the users. The report sees the focus of assurance shifting from reliability to relevance. The AICPA (1997) identified six core opportunities while CICA (1998) identified nine opportunities, with both institutions already setting up committees for *Web Assurance* and *Eldercare*.

The profession seems to be promoting itself as the best provider of such services based on what are quite controversial and highly debated qualities (*i.e.* reputation for independence, concern for public interest, quality control system - matters which have all been included as a core elements of the audit expectations gap). This questionable position might explain the recent tackling of the independence issue in the USA and the establishment of the Independence Standards Board, the AICPA White Paper to the ISB highlighted the issue of new technology and new services as a reason for needing to address the issue of independence. Concern for the public interest is another debatable issue that the profession promotes as one of its strengths. This claim stands in contrast to the recent campaigns where the profession strongly calls for abolishing the joint and several liability law despite such changes being opposed by the Law Commission in the UK (DTI, 1996) for being against the public interest. Advancing the public interest to

promote professional self interest has been well documented in historical analyses of the profession (e. g. see Willmott, 1989; Hanlon, 1996). Indeed, professional studies have highlighted the importance of limiting auditor liability in order to grow and provide new services. This might explain the surge in the profession's campaign to limit liability in an inherently riskier environment where the demand for faster, online corporate reporting. It might well be that the legal liability campaigns of the profession go beyond the current litigation problems to cover the potential liability difficulties that might emerge from providing new assurance such as *Web Trust* (for discussion of auditor liability for *Web Trust*, see Pacini and Sinason, 1999).

Much of the development and debate on the future of the profession and the assurance services are limited to Anglo-American countries, with no such debates taking place in other contexts. This highlights the fact that many of the profession's services are designed in Anglo-American contexts and only subsequently applied to other contexts that might have different cultures and needs. The profession seems like it is on a discovery mission for what it is going to be the role of professional accountants. This discovery process is an ongoing one that has not stopped with the publication of the recent studies and reports. The AICPA published its assurance report only on an electronic format in the Internet as it is going to update it on a continuing basis. The same can be seen with the work of the CPA Vision Project in the USA, which is based on the Internet, with people commenting and introducing their ideas on a continuous basis.

Many of the new developments seem to be introduced by the audit firms to sustain revenue growth rather than in response to public interest demands for change in audit technologies. It is questionable to what extent the re-engineered audit is being demanded by the auditor's clients or the users of financial statements. Some changes have not always been unanimously supported by Big Six firms. For example, Rodger Hughes, partner at Price Waterhouse, believes that "this over selling of audit is a product of the recession is not in the interest of the profession as it creates more confusion about the audit and widens the

expectation gap” (Accountancy Age 27 March 1997, p.12-17). Humphrey *et al* (1992) saw audit reforms as a protective measure aiming to safeguard the status quo and showed how the profession promoted these extra services as an extension to an accepted product rather than as response to a defective product. Hatherly (1997) interpreted the re-engineered audit as a supply-sided phenomenon which is used merely as a vehicle for the big auditing firms to show off their skills; he said “after all, if executives want consultancy services they would surely prefer to buy as required rather than face a compulsory purchase order by their statutory auditors” (Accountancy Age, 17/4/1997, p.17). Indeed it is predicated that if these new services do not add any benefits for the clients it will fail.

“If what you are planning to do truly adds value for the clients, you can benefit from creating that additional value. If it doesn’t do anything extra for the clients and just benefits you, then it is almost certainly unsustainable, and will fail.” (Maister, 1997 p. 179).

The proposed changes in the auditing and assurance function tend to affect certain key dimensions of the audit function. The value-added audit seems to shift the role of auditing from compliance based to more consulting-advisory services. This change in role is affecting the most fundamental role of auditing, *i.e.* auditor independence. Klarskov Jeppesen (1998) argued that combining auditing and consulting under the process of the re-invention of auditing makes auditor independence no longer possible. These changes and transformations in the auditing function makes difficult to understand what is the auditing and where it is going.

Regardless of the position and role of auditing, the never-ending issue of the expectation gap would appear to have become less dominant in recent years. The large audit firms appear relatively immune to the negative publicity created by audit scandals. This immunity has been attributed to the decentralised way these firms are organised in one country (Kaplan, 1987), that is if one firm in the same country has been acting unprofessionally that would not be taken as representative of its work in other countries. Moizer’s (1997a) study of auditors’ reputation in five countries revealed that top tier audit firms tend to be associated

with a higher quality service in most of these countries. He also concluded that top tier audit firms make an economic difference either directly in the form of higher fees or indirectly in the form of more favourable market prices for audited companies. Other research by Moizer (1998), which compared corporate management's satisfaction levels with auditors in the UK in both 1987 and 1996, revealed that auditors are still highly regarded for the service they provide. Accordingly, the Big Six are growing and dominating the audit market around the world despite clear conceptual worries with the status of auditing in the academic literature.

2.4 The Lack of Evidence on the Work of the Big Six, Especially in Non Anglo-American Contexts

The above discussions have shown how the development of the accounting profession has been besieged by doubts and criticisms of the profession in several key areas throughout most of the last hundred years or so. Despite all the audit scandals and the persistence of the audit expectations gap, the accounting profession increasingly represented via the Big Six firms, has been constantly growing in many parts of the world. The Big Six have expanded into new regions such as Central and Eastern Europe to overcome the problem of stagnated audit markets in the developed western world. This market stagnation also seems to have led to the re-inventing or re-engineering of auditing. The current and expected future development in information technology has led the accounting profession to explore and contemplate the future of the profession and what type of services it is going to provide.

While audit firms are supposed to make the work and operations of corporations and organisations transparent, they elect to disclose very little about their operations and results. These firms work behind closed doors would only publish limited information about their work and their results. For instance, recently in the UK, the Big Six has even stopped disclosing the annual table showing each firm's income. However, a few audit firms (KPMG, Ernst & Young, BDO Stoy Hayward and Pannell Kerr Forster) have set precedents by

publishing, for the first time in the UK's history, full financial statements. KPMG's publication was in compliance with the requirement for incorporating its audit section as a limited liability company "PLC-Style".

KPMG senior partner Colin Sharman said, "The very high percentages in favour of financial disclosure by and auditing of large accountancy firms is clear indication that clients want openness. No one criticised KPMG when we revealed our financial information and maybe others should be considering following our lead. Clients have a right to expect financial disclosure from the very people who inspect their own books. Employees, too, have a right to know a firm's full financial performance" (<http://www.kpmg.co.uk/uk/about/press/961014b.html>).

The publication of the financial statements of the other three firms was interpreted as an attempt to fend off rumours about the viability and position of these firms (FT, 5/12/1996, p.11; The Accountant, January 1997, p.12). However, once LLP is enacted in the UK, all audit firms that chose to become LLPs will be required to publish its financial statements. The secrecy of some of the Big Six is obsessive to a degree where the spokesperson of Arthur Andersen, even refuses to identify the countries in which the firm operates, claiming it is proprietary information (Shields, 1994).

The literature clearly shows that there is still a great deal that remains to be understood about auditing in practice and the audit firms that conduct it. Hopwood (1996) argued that despite the overriding importance of auditing to the accounting profession and its regulation, auditing "remains a relatively poorly understood phenomenon" (p.217). He thought that most of the research on auditing either focused on the economic aspects of auditing or its technical aspects highlighted in the professional pronouncements. He believed that it would be more fruitful to study "audit in action" focusing on the wider "organisational, regulatory and societal contexts in which it functions" (p.218). There are a number of research papers in Anglo-American contexts that challenge the profession's claim of neutrality, professionalism and care for the public interest. Some of this research has questioned the findings of audit judgement research (for a summary of audit judgement research see Trotman, 1998) that hypothesises that the auditing process to a large extent is a cognitive one. Instead, the auditing process is seen as one that also involves "gut feel"

(Humphrey and Moizer, 1990; Pentland, 1993). Power (1995) also argued that the professional audit judgement process is influenced by social factors, as the approval of peer groups is essential to accept an action as a professional judgement. Humphrey and Moizer (1990) similarly found that audit planning activities are mythological as they were less scientific and more rationalistic than was widely believed. Pentland (1993) saw audit mechanics or rituals as a way for the auditing engagement team, the audit firms and the investing community to believe in the numbers or to "get comfortable with them" (p.620). The ritualistic nature of the auditing process was also seen as a way of hiding professional conflicts of interest and providing legitimacy for the profession's controversial actions (Mills and Bettner, 1992). Other research has questioned the profession's commitment to serving the public interest (Willmott, 1989, Sikka *et al*, 1989), its claims of a liability crisis (Cousins *et al* 1998, 1999; Green, 1999) and the independence of auditors. Hendrickson (1998) argued that the auditor was never independent.

"In my view, auditors were not independent of their clients in the basic relationship either in fact or in appearance when Congress passed the Securities Act of 1933 (The Truth in Securities Act). Nor are they independent of their clients today and for the same reason: the basic auditor-client relationship creates a direct conflict between the auditor's professional responsibilities to investors and the public and their opportunities for personal gain." (Hendrickson, 1998, p.501).

Few case studies have investigated the development of auditing in practice, with even fewer case studies being conducted in a non Anglo-American context - although several accounting journals have started to develop such studies in recent years (e.g. *European Accounting Review*, *Accounting, Organizations and Society*, *Critical Perspectives on Accounting*, *Accounting, Auditing and Accountability Journal*, *International Journal of Auditing*).

The current domination and spread of the, Anglo-American originated, Big Six in audit market of many parts of the world is seen as one of the main factors behind the global domination of the Anglo-American accounting model (Briston,

1989)¹¹. The strategy of the Big Six to expand into a new or virgin audit markets will most likely lead to further expansion of the Anglo-American model. The involvement of the Big Six in devising audit laws in Eastern Europe might also lead to the spread of the Anglo-American model - as Seal *et al* (1996) have acknowledged regarding the role of the Big Six in advising the Czech government on setting laws. Moreover, the strong UK/US influence on the major international accounting organisations (*e.g.* IASC, IFAC) is also seen as responsible for the spread of the Anglo-American model. However, even if one assumes that the Anglo-American model is fault free and satisfying the expectations of users in Anglo-American context, that does not provide sufficient justification for adopting it into other contexts. Assuming that the Anglo-American model is relevant to other parts of the world seems to ignore the economic, societal and political factors in such different countries. While the main types of users of financial statements around the world maybe similar, their needs are different in each country. Accounting and auditing practices also play different roles in corporate governance processes in various countries around the world. Vanasco's (1996) survey of the issue of independence in several countries led him to conclude that the effectiveness of auditor independence might be hindered in the different cultures. Indeed difference in culture and accounting practice among the members of the European Union was attributed to the failure to harmonise independence rules in the Eighth Directive (Evans and Nobes, 1998). The disagreement over the issue of Anglo-American domination can also be highlighted within members of the European Union, such as the preference in Germany for the application of the prudence principle. If Western countries in the EC are in disagreement over the principle then it is no wonder if some of the Anglo-American models and concepts are not accepted in other parts of the world such as in Asia and Arab countries.

Further, the Anglo-American model of accounting is riddled with problems and

¹¹ This spread is also attributed to other factors such as British colonialism, the UK professional accounting institutes influence on the accountancy bodies in former British colonies, economic aid

criticisms in Anglo-American countries (where this accounting model was conceived to cater for particular economical and social needs). Therefore, applying or moulding the Anglo-American accounting model into different contexts should not be taken at face value. A good example can be seen in the vague British concept known as “True and Fair View”. Britain fought hard to include it in the European “Fourth Directive”, without having a definition of it in either the Companies Acts, Accounting Standards, Auditing Standards or Professional Pronouncements (Walton, 1993). In addition, no body in Britain seems to know exactly what the term really means, with auditors having reservations about the phrase and believing that it is likely to be applied inconsistently by the European community member states (see Higson and Blake, 1993). Consequently, if a developing country wants to benefit from the Anglo-American model then they should examine the experiences of non Anglo-American countries in adopting that model and what lessons can be learned. Evidently, more studies are needed to examine the audit function and international audit firms in non Anglo-American contexts, especially given the fact of Anglo–American domination and the ICAEW’s 2005 working party’s (ICAEW, 1996a) anticipation of the further spread of the Anglo-American model in the future.

The last few years have seen an increase in calls for better understanding of the work of the Big Six in non Anglo-American countries and in regions where auditing has just recently been introduced. Hopwood (1996), furthermore, highlighted the limited number of studies on the internationalisation of auditing. Research on the role of auditing and audit firms in non Anglo-American contexts started developing with the emphasis on such issues in a number of various European countries (mainly examined in the *European Accounting Review*). The increased importance of the auditing function and the need to focus on the international aspects of that function led to the launch of the *International Journal of Auditing* in 1997. Recent examples of this type of research can be seen in studies on the development of the auditing profession in Greece. In his

agreements (Hove, 1986) and registration in the US stock exchange.

examination of the Greek auditing profession between 1945-1955, Ballas (1998) argued that it did not emerge in response to the needs of the capital market, as is usually the case in Anglo-American countries. Rather it was established by the Greek state to promote its interests - the Greek government believing auditing was a useful mechanism for economic and political control. Caramanis (1999) examined the conflict between the Big Six and the local firms over the liberalisation of the audit market in Greece. He concluded that the Big Six's lobbying of the Greek Government was the major reason behind the liberalisation of the audit market in the early 1990's, as the Big Six firms (previously) were restricted from performing statutory audits. Caramanis (1998) found that the Big Six were not viewed as better in Greece. He also argued that the liberalisation process changed both auditor behaviour and audit practice in Greece, placing more emphasis on providing consulting services and less on public audit functions. There have also been studies recently of the emerging accounting profession in the Central and Eastern European countries. Cooper *et al's* (1998) examination of the entrance of one of the Big Six audit firms in Russia showed a process of nationalism and imperialism. The North American firms sought involvement in Russia to serve their multinational corporations that invest there while the Europeans saw the expansion as an opportunity to invest in new markets. Auditing in Central and Eastern Europe countries has also been the focus of other studies such as those focusing on various issues relating to auditing in the Czech Republic, including the development of the profession (Seal *et al*, 1996), the quality of auditors (Sucher *et al*, 1998), the changing role of audit (Sucher and Zelenka, 1998). However, very few, if any, of these studies focus on auditing in the Middle East and the Gulf States. Needles' (1997) examination of international accounting research published in the *International Journal of Accounting* during the period 1965-1996 showed very little research in that journal about accounting in the Middle East (only nine throughout the period - and just one article about accounting in Kuwait in the period of 1986-1996). There is virtually no published research on the audit expectations gap or any of the major issues that constitute the gap in this geographical region. Most of the research on auditing in the Gulf States tends to focus on comparative studies (e.g.

Al-Hussni,1989) and empirical studies (e.g. Al-Mudhaf, 1990). Further, the only research on auditing and the accounting profession in Kuwait that has adopted a critical perspective have been presented in conferences (Fakhra, 1996a, 1996b, 1999).

2.5 Conclusion

The chapter has sought to capture the key dimensions of debates on auditing expectations. It has tried to illustrate the problematic nature of the audit function throughout history, especially in the aftermath of major financial scandals, and discussed the form and content of the so-called "Audit Expectation Gap". The profession's long-standing response to the gap has been to blame the public for misunderstanding the role of auditors and call for better education and methods of communications to be improved. The profession typically seems either to disclaim more responsibility (e.g. limiting auditor liability) or embark on simplistic measures (e.g. changing the format of auditor report), which regularly get shown to be ineffective in terms of reducing/removing the gap. In the profession's defence, it has to be said that empirical research and surveys often give conflicting results or arguments, with the subject seeming to be one of endless debate but limited action. This may be a direct reflection of a lack of available information on the practice and impact of audit work- and the profession desire for audit to remain a relatively 'mysterious' function. It might be even argued that the profession is now well capable of living with the audit expectations gap. After all, the negative publicity of corporate collapses and the talk of an expectations gap has not restricted the global growth of the audit function (and the revenues of the Big Six audit firms) throughout most of the developed world. Thus, while there are growing doubts about auditor independence (see Hendrickson, 1998; Hopwood, 1998; Klarskov Jeppesen, 1998) or concerns over the real nature of any claimed liability crisis (See Lee, 1992; Cousins *et al*, 1998) the profession is seeking to expand and develop with a re-engineered audit function, placed under a broad umbrella of professional services (seeing attempts to acquire law firms in different parts of the world as a part of multidisciplinary firms). The profession is active in studying the future of

the audit function and role of assurance service. Expanding into emerging audit markets (e.g. China, Eastern Europe) has become an increasingly popular strategy for audit firms to sustain their growth rates.

This chapter has argued that the profession and its major firms are expanding into such regions and providing new services without a clear independent vision of what auditing is really achieving. A lot of research has highlighted the social, political and economical aspects of the audit function and questioned claims that auditing is a technical, neutral, professional task. Nevertheless, many research issues still remain relatively unexplored in relation to auditing and the work of audit firms in practice. This is especially so in non Anglo-American contexts and emerging democracies with very recent audit histories. To date, most of this latter research has focused on auditing in European countries (mainly on Western Europe), with very few, if any, studies focusing on the role of auditing and the accountancy profession in the Middle East in general and in the Gulf region in specific. There is a need for better understanding of auditing in this region, especially given the economic power of countries in this part of the world and the clear differences in culture and social traditions.

The literature on the history of auditing has shown that doubts and criticisms of the profession are usually felt in the aftermath of corporate scandals. In many of the financial scandals the mythology of the audit function has failed to live up to the expectation of the public. In this study, the collapse of the Kuwait Investment Office's investments in Spain in 1992 will be examined in order to enhance the understanding of the work of auditing firms in a non Anglo-American context. The focus will be largely on the role of auditors in Kuwait (the main investor in the case) but also to lesser degree on the auditors in the countries that played a major role in the investments (that is Spain and Britain). Examination of the British experience in auditing provides a useful benchmark, given Britain's long history of democracy, with accounting and auditing used as corporate governance tools and the profession being self regulated.

The re-introduction of democracy in Spain in the mid 1970s, after the death of General Franco, allows the opportunity to study auditing in a newly established

democracy. Spain's membership in the European community and the adoption of the fourth directive was met with very positive attitudes and the beliefs that financial reporting would be more transparent and there was little sign of major audit expectations gap. However, this attitude seems to have changed after a string of recent financial scandals in Spain (e.g. Grupo Torras, Banesto, PSV) and talk of an audit expectations gap has started to emerge (Garcia Benau and Barbadillo, 1996). Therefore, the Spanish connection is especially useful, showing the audit function in a developed nation with a non Anglo-American model and where the perception of auditing is shifting from positive to negative. Unlike Britain and Spain, Kuwait is a developing nation and a new democracy in the Gulf region. Therefore, it provides an additional comparison, and offers the opportunity to see what role is being played by and expected of auditing - and to what extent Anglo-American traditions of corporate governance are being followed. In practice, the thesis will examine the people's perception of auditing and auditors after the scandal of KIO's investments and other scandals and corporate collapses of recent years, assessing the extent to which there is an audit expectations gap Kuwait. The study will also explore the role of auditors in both the private and public sectors in Kuwait (i.e. the Audit Bureau and Audit Firms), as both types of auditors were involved in the KIO case.

Chapter 3

Research Methodology

3.1 Introduction

There is an extensive range of texts that address the different research methodologies in accounting and other fields. There are books that discuss research methods in general (Bell, 1991, Robson, 1995). There are those that discuss specific methodologies, such as case studies (e.g. Hamel *et al*, 1993, Yin, 1994, Stake, 1995), while others discuss research methodology in specific fields. Gill and Johnson (1991) focused on research methods for managers while Ryan *et al* (1993) concentrated on those in the field of finance and accounting. Rather than listing the relative strengths and weaknesses of all the available research methods (something which is adequately covered in existing methodology texts), this chapter seeks to clarify the basic aims of the research undertaken here and the reasons for selecting the various research methods.

The chapter starts with an outline of the aims of the study and discusses how these are addressed through both qualitative and quantitative research methods – in the form of a detailed case study and a major questionnaire survey. The chapter details the construction of the case study and summarises the approach taken with the questionnaire survey (more details about the questionnaire are provided in Chapter 9). The methodological strengths and the limitations of the study are considered, with the final part of the chapter reviewing a range of problems encountered in conducting the research.

3.2 Aims of the Study

The literature survey in the previous chapter has shown that despite the growth of auditing in recent times it still remains a problematical phenomenon with very little known about it beyond the claims of what it supposedly can deliver. Hopwood (1996) argued there is little understanding of the audit function in practice and called for more studies of auditing in action in different national settings. The main focus of audit research has been on Anglo-American countries (Australia, Canada, New Zealand, UK, USA). Accordingly, Garcia Benau and Humphrey (1992) have called for more studies of auditing in non-

Anglo-American context, while Christiansen and Loft (1992) highlighted the importance of examining the increasing internationalisation of the auditing function. Such calls have produced studies of auditing in its international context in Europe and, to a lesser extent, in Asia (see Sakagami *et al*, 1999; Ping Hao, 1999). Despite such development, very few studies have used case study research. This study hopes to contribute to the limited research on auditing in practice through a detailed case study of the collapse of KIO's Spanish investments. The case is also useful in examining auditing in the non Anglo-American contexts of Kuwait and Spain. Studying auditing in a Kuwaiti context is not limited to the case study but extends to the questionnaire survey of the audit expectations gap in Kuwait. This examination of the audit function in Kuwait will contribute to the limited research on that function in the Middle East in general and in the Gulf states in particular. Indeed, it is surprising that very little research on auditing in the Gulf region has been conducted given the economic power of the Gulf states, the nature of Islamic society and the worldwide nature of the investments being made by Arabian corporations. The case study will also examine auditing in Spain, a non Anglo-American country, that returned to democracy in the mid 1970's and embraced auditing in the late 1980's. It will be interesting to analyse how auditing has fared after the positive way statutory auditing was received in the late 1980's.

The focus of the case in relation to the role of auditing and auditors starts with a documentation of the role of the different auditors in Kuwait, Spain and London. This will involve exploring what auditors did or did not do before the scandal?. The literature shows that corporate collapses usually lead to debates about auditing and audit firms. Consequently it will be useful to see if such findings can be seen in Kuwait and Spain after the financial scandals in both countries in the early 1990's. This will address the perceptions and responses of the public, government and media to the role of auditor from the collapse of KIO and other organisations in Spain and Kuwait (e.g. Were they blamed? Were they criticised by the press? Were they sued?). The study will also examine the role of the accounting profession and the responses of the Big Six international firms to the

fallout from the scandal (e.g. How did they react to the collapse? How did they defend themselves?). Further, the involvement of the Kuwaiti Audit Bureau and external auditors in the operations of KIO provides an opportunity to explore the role and the comparative status of the public and private audit. The case will reflect on what auditors delivered in practice and the extent to which this differed from people's general expectations of auditors.

3.3 Chosen Research Methodology

Humphrey (1997) identified three approaches to audit theory - philosophical, market based and critical, stressing the value of moving beyond procedural perspectives on auditing. Moreover, Dillard (1991) advanced the critical social science perspective to study crises in accounting. In undertaking this thesis, I have adopted a critical perspective in the sense of not accepting claims of auditing as a neutral, technical process and maintaining a desire to question official perceptions of auditing. This study seeks to achieve such a task through multiple research methods. It uses both an international case study and a questionnaire survey. The case study is well suited to examine the claim made for auditing and what it achieves. The fact that the work and action of auditing firms is difficult to observe and often can only be seen when financial scandals and audit failure unfold, makes a case study an appropriate way of examining the role of auditing in an international context. Additionally, the questionnaire survey will present an empirical examination of the issue of the audit expectations gap in Kuwait. It will be an interesting tool to see how auditing and audit firms are perceived in Kuwait in the aftermath of major corporate scandal. Hooks (1991) argued that the sole use of an empirical research method is unable to explain social behaviour. Accordingly, the dual use of both quantitative and qualitative research methodologies is useful in overcoming the shortcomings of an exclusive reliance on one type of methodology.

3.3.1 An International Case Study

Much of the Big Six's work is based on their claims to expertise and professionalism. However, these claims are often challenged or look questionable

when audit scandals unfold. These scandals offer the opportunity of examining the audit function in its operational settings, taking into account the social, political and economical aspects of auditing. Lee (1993) felt that corporate failures are useful to emphasise general points about auditing. However, he thought that given the limited number of complete court cases it is “wrong and potentially misleading” to make judgements solely on press reports (p. xiv). Lee’s arguments could repudiate the use of scandals as a valuable source of information for studying auditing practice, given the fact that many financial scandals are settled out of court. However, in contrast, Stamp (1980) considers financial failures to be a very important source for studying the secretive audit function. He saw such secrecy as keeping very low the likelihood of discovering audit failures. Consequently, examination of audit scandals can serve to improve auditing given the amount of information available from the investigation of the failures; information which would otherwise not have been available. Erickson *et al* (2000) seem to agree that audit failure provides a research opportunity that otherwise wouldn't be possible. They argued that their ability to examine auditor deposition testimony and audit working papers (papers usually not available for examination by researchers) in civil legal cases against auditors of the failed Lincoln Savings and Loan, made their case study “uniquely suited to provide insights into important unanswered questions” (Erickson *et al*, 2000, p. 3). Knapp (1996) saw the examination of case studies as a part of teaching students about the real life outcome of audit failure for society and the profession. Frecknall Hughes *et al* (1998) argued that incorporating audit scandals into the auditing curriculum can serve to expose students to a “more realistic picture of the audit function in practice” (P.89). Stamp (1980) felt that studying audit scandals enabled the mistakes of the past to be avoided - a point emphasised in other editorial/commentaries in the professional press:

“...anyone who has been following the corporate collapses and financial scandals of the last eighteen months cannot avoid a sense of *déjà vu*. It is inevitable as it is right that questions are bound to be asked. How could a set of respected professionals be made so irrelevant, so malleable by just one man, however remarkable? The problem is that for all the accountancy profession, all questions in relation to corporate governance

and the role of the auditor have been asked before. And yet neither the leading firms nor the leaders of the institutes seem prepared to do anything beyond muttering platitudes to try change the situation. How many billions must disappear, how many huge companies crash before accountants and auditors act decisively?...Events say the profession should act decisively to put its own house in order. Recent history suggests it will do nothing of the sort” (opinion in *Accountancy Age* on the scandal of Maxwell, 12/12/91, p. 14).

“It has long been held a truism that those who ignore history are doomed to repeat the mistakes of the past. With this in mind, it would seem appropriate at the end of the 20th century to retrace the development of the public accounting profession in the United states to see what guidance the past may offer to the future.” (Wallace Olson, former president of the AICPA, the CPA Journal, July 1999).

Recently case studies in accounting have become more widely accepted and used as a research method in accounting, especially in the field of management accounting and control. The case study is seen as a mechanism for exploring an alternative perspectives on accounting. In his definition of the characteristics of a case study approach, Yin (1994) argues that it investigates contemporary phenomena within a real life context; in situations where the boundaries between phenomena and context are not clearly evident and multiple sources of evidence are used. However, there is a recognised shortage of case study research in accounting (Scapens, 1990, Ryan *et al*, 1992) and in auditing in particular (Hopwood, 1996; Ashton and Cianci, 1998). Furthermore, Humphrey and Scapens (1996) argued that many critical accounting case studies has been based on research disciplines outside the accounting research. They indicated that case studies can move beyond the illustrations of a particular social theories to a bigger role in terms of developing social theories of organisational accounting practice

The KIO scandal can be seen to be a case study with much potential in that it offers the opportunity to study auditing and work of the international audit firms in a truly international context, covering countries such as Spain, Kuwait, and UK. The analysis of the case was conducted using different sources. These included interviews with key figures close to the KIO scandal and its investigation, the financial statements of Grupo Torras and major subsidiaries,

the reports of the official investigation of the KIO affair in Kuwait, Spain and Britain. and press reports of the case in Kuwait, Spain, UK and other countries.

3.3.1.1 Interviews

The secrecy that surrounds the operations of KIO/KIA meant that a great deal of information about these institutions and their operations was not publicly available. Numerous researchers (Al-Awadi, 1975, Al-Temeemy, 1993, Al-Ebraheem, 1991) have sighted the difficulty of analysing KIO's operations and strategies given the fact that KIO operations have always been one of Kuwait's precious secrets. Given this, interviews with key officials about the collapse of KIO case was seen as an important method to clarify and gather information that is not publicly clear or available. Securing interviews with people close to KIA/KIO was not simple given the secrecy of these organisations and the ongoing nature of legal procedures in Spain and London against the former managers of KIO and GT - both parties in the legal cases preferred not to comment until the cases were resolved. Despite these difficulties, interviews were secured with eleven people with current (i.e. at the time of the interview) close involvement with KIA/KIO or were involved in investigations of KIO/KIA. This was done mainly through informal channels (i.e. friendships or personal recommendations) and in most cases anonymity was guaranteed. However, some of the people interviewed were reluctant to disclose much information, sighting their unawareness of certain issues, while others claimed that they didn't remember some of the issues. A common observation among a number of interviewees was that they knew little about the role of auditing and that of the external auditor at KIO (especially the role of the external auditor before the establishment of KIA). This put considerable emphasis on obtaining information from other sources including official investigations, judgements.

The former senior managers of KIO had been expected to be the most informed people about the history and the role of the external auditor of KIO given their long employment in the London office. However, it was not possible to secure interviews with some key former managers of KIO and Grupo Torras who were being legally pursued by GT in Spain and in Kuwait. Communication was made,

after a lengthy exercise to find his contact address, with the lawyer of a former manager about the possibility of conducting an interview. The lawyer indicated that his client would need information as to whom I had already interviewed as a prerequisite for me being granted an interview. His request was denied as I had promised to preserve their anonymity. In order to clarify the role of the external auditor of KIO and KIA, KPMG-London, was contacted. KPMG- London, however, was also reluctant to grant an interview or to disclose even the simplest information about their audit of KIO/KIA (e.g. Were they the auditors of KIO?, If so, from what date?) citing client confidentiality and referring me to KIA in Kuwait (this issue is discussed in more details in Chapter 8).

Interviews were also conducted in Kuwait to explore certain general aspects concerning the role of the auditing profession in Kuwait. These interviews were conducted randomly with a qualified auditors from the Big Six, medium audit firms, small audit firms and the Audit Bureau. The topics for discussion included the history of the accounting profession, the perception of the Big Six in Kuwait, competition in the Kuwaiti audit market, the quality of services provided by audit firms, perceptions of the Audit Bureau and views of the laws governing the work of audit firms. These topics were also discussed with a number of financial controllers at various companies, commercial loans lending officers, and a representative from the Ministry of Commerce (the profession's regulator). 19 interviews were conducted in relation to this part of the study.

3.3.1.2 Additional Information Sources for the Case Study

In constructing the KIO case study, sources of information have been drawn from Kuwait, Spain and the UK – in three different languages. Reports of the official investigations of KIO's investments conducted by the Kuwaiti Parliament in 1993 and the Kuwaiti Audit Bureau in 1993 and 1994 have all been examined, as have the financial statements of Grupo Torras and selected subsidiaries before and after the collapse of the group. Additional sources has involved examining the sanctioning reports of the Spanish auditor of GT (published by ICAC the Spanish regulatory body) and the legal judgements of the High Court and the House of Lords on whether the British/English courts have jurisdictions to hear

the civil case filed by Grupo Torras against the former managers and other parties alleged to have played a part in misusing group funds. These judgements spell out the full legal allegations made by Torras against the former managers and others (including accountants and accounting firms). The study also considered the legal judgement of the case filed by Grupo Torras against the former managers of KIO and GT that was handed out in the last few months of writing the thesis.

Published information in newspapers printed in Kuwait, Spain, England and USA was used as an additional major source of data for undertaking the case study. The difficulty of relying on newspapers rests in the belief that they usually have political or other specific agendas and consequently try to promote one position over the other¹. Nevertheless, the newspapers can be reliable when considering the official documents and occasionally confidential documents which they obtain and publish in full (e.g. the resignation letter of former members of KIO's board - see appendix 1). In addition, the Kuwaiti newspapers' publication of the full transcripts of parliamentary sessions each week can be a credible source of data. Moreover, the interviews conducted by the press with key figures responsible for the collapse of GT can directly communicate the point view of these individuals, something that otherwise wouldn't be possible given their reluctance to talk to researchers. Furthermore, the accuracy of information reported was checked with primary and secondary sources whenever possible. For example, the accuracy of some of the transactions reported in the press were discussed in the interviews. Financial figures reported in the press were checked with those in the financial statements.

Researching the case study was made rather difficult by the lack of academic papers or books about KIO and its operations. The huge scale of the scandal did

¹ This can be seen in Spain where the Kuwaiti members of the new management team of GT perceived some Spanish newspapers (El-Pais) to be supportive of KIO's position or to have aversion to de la Rosa (Diario 16) while others (El-Mundo, Expansion) were seen as supportive of de la Rosa and critical of KIO (for more details see the FEAC, 1993b). This can also be vividly seen in Kuwait. For example, after the parliament's questioning of the Kuwaiti finance minister in July 1997, the merchants' backed

not stimulate much additional independent analysis. A Kuwaiti author has contributed to the issue with a series of three one sided books (Al-Hajiri, 1993a, 1993b, 1995)², although these have tended to be a visible justification of the work of the former managers and a personal attack on the new managers. In the same sense, Whittington's (1993) book about De la Rosa and KIO, was very critical of the new managers of KIO and sought to convey De la Rosa's argument that the new managers are the main reason behind the collapse of GT. A Spanish book on De la Rosa (see Pérez and Hocajo, 1996) took a more critical view of his actions. However, as with the other books there is a worry as to the balanced nature of arguments put forward and all of them spend little, if any time, discussing the role of audit.

3.3.2 Questionnaire Survey

To complement the specific findings emerging from the case study, a questionnaire survey was designed to obtain more general reflections on the KIO case and to examine the issue of the audit expectation gap in Kuwait. The questionnaire was circulated to four separate groups - auditors from audit firms, auditors from the Audit Bureau, users of financial statements and financial directors. The questionnaire survey addresses three main issues. First, it seeks to examine expectations of the audit function in Kuwait and the role of auditors from both audit firms (private sector) and the Audit Bureau (public sector). Secondly, it explores specific issues relating to the KIO case and people's perceptions of the role of auditors in the KIO scandal. Finally, the questionnaire explores attitudes toward different proposals to improve corporate governance in Kuwait. The questionnaire comprises four main sections: Audit Firms, Audit Bureau, KIO Case, future of Corporate Governance in Kuwait. The Audit Firms section includes issues such as the role and quality of external auditors and the auditing process, legal responsibility of auditors to shareholders, the status of the statutory requirement for two independent external auditors in Kuwait and the

daily newspaper, Al-Qabas, reported in 16/7/1997 that the questioning was a success while the Al-Sabah backed, Al-Watan, reported the questioning as a failure.

regulation of audit firms. The Audit Bureau section addresses the role played by the Bureau and how successful it is at different activities. The KIO section addresses issues relating to the collapse of KIO's investments in Spain, including the respondents' familiarity with KIO's auditors, the degree of information made public about KIO's activities, why KIO was audited externally and whom they consider to be the most independent auditors in Kuwait. General questions are also asked about the KIO scandal and who was perceived to be at fault for the collapse of Grupo Torras. Finally, the questionnaire seeks views on ways to improve the future of corporate governance in Kuwait.

3.4 The Strengths and Limitations of the Study

A major strength of the study lies in its international span. The KIO/GT case covers the work and reactions of auditors in three different countries. The study also manages to combine a detailed analysis of audit practice in a case of international scope and significance, with a questionnaire survey exploring perceptions and implications of the scandal in Kuwait. The survey generated a very good response rate of 45%, adding strength and validity to its findings. The survey is also noteworthy as it allows for a comparison of views on the work of auditors in the private and public sectors. Overall, it stands as the first empirical survey of auditing and the audit expectations gap in Kuwait. The significance of the study is enhanced further by the wide range of methods which have been used to generate research findings. Behind the case history and survey construction, lies a very considerable amount of work interviewing key players, analysing academic and professional articles on auditing, corporate governance and broader social traditions (in three different languages) and reviewing in detail a range of official regulatory reports and court judgements.

The study has some limitations. It might be argued that the KIO case is a one off but many of the issues in the case are, nevertheless, evident in other scandals in Kuwait and other parts of the world. For instance, strong management

² There is a belief that the former managers used a fake author name to produce these books to attack the character of the new managers and promote their image.

influencing the audit process is a common theme in many of the audit scandals. Such recurrent themes raise conceptual questions about general standards of audit practice. The study did not attempt to visit Spain given the difficulty of conducting interviews in Spanish, but has sought to compensate by a detailed documentary evidence of the GT affair. One limitation of the questionnaire survey is that there was no ex-ante view of auditing in Kuwait before the collapse of the KIO case. This makes it difficult to say if the audit expectation changed in Kuwait after the scandal. However, the survey is useful in showing what people generally think of auditing, private audit firms and the Audit Bureau in the aftermath of the scandal.

3.5 Problems Encountered Researching the Case

The involvement of members of the elite families in the KIO's scandal and the secretive tradition of KIO was a problem for the conduct of the research. While undertaking the case study of KIO, I encountered discouraging attitudes from many people in Kuwait. At one point in time, an official from my sponsor, Kuwait University, told me "don't get us into trouble". Other senior KIA official told me that the KIO scandal is "a mine-field" while some volunteered to provide me with publicly available legal documentation but then appeared to have second thoughts and tried to avoid me. At one point, a very senior KIA official, when he saw my questionnaire survey, accused my supervisor of using me to do research on behalf of the former managers of KIO. The case usage of Spanish materials to examine the KIO study led to a lengthy translation process using scanning equipment and translation software (from Spanish to English). This task was a cumbersome and lengthy process which also required the use of specialised dictionaries. Difficulties were also experienced in attempting to acquire several references and sources. For instance, the parliament has gathered a number of documents about the KIO case from their investigation of the KIO affair in 1993. Communication with the parliament was made for copies of, or access to, these materials. However, the parliament only provided very limited and not very useful materials sighting that the rest are confidential (despite some of them being publicly available in the UK - e.g. see, Monopolies and Mergers Commission

Report, 1988). The restriction of information was not restricted to KIO affairs but was seen in other issues relating to audit firms. For example, the Fatwa and Legislation department at the Ministry of Justice conducted an investigation in the mid 1980's on the collapse of the unofficial stock market, known as the Al-Manakh Crisis. This investigation was reported to have found several audit firms involved in unprofessional practices. Communication was made with the head of the investigation team about the report but he indicated that he couldn't release the report and suggested that I should contact the Cabinet Assembly about it. The Secretary General of the assembly told me that it does not have contact with the public and he reverted me back to the head of the investigation team for a copy. The poor organisation and availability of data makes the task of researching auditing and the accounting profession not a simple task. Al-Rashed (1996) asserted that examining the accounting profession in the Gulf Cooperation Council (GCC) is a "mission impossible" due to the lack of statistical data on the profession. This seems to be the case, as when I contacted the Ministry of Commerce in Kuwait, the profession's regulator, it did not have information about the profession at hand. It took the ministry two months to prepare me a simple table showing the number of registered auditors in Kuwait. In putting together this thesis, I have sought to overcome such difficulties to the best of my abilities and economic/political resources. The case material in chapters 7 and 8 still leave some questions unanswered but in the circumstances this was inevitable. That said, the case material possibly stands out as the most detailed and broad ranging assessments of the KIO/GT affair currently in the public domain. Together with the questionnaire survey it allows for some detailed and timely reflections on the role and the advancement of auditing in non-Anglo-American contexts.

3.6 Conclusion

This thesis seeks to contribute to the limited studies on auditing in practice in non Anglo-American contexts, with the collapse of KIO's Spanish investments being used as a vehicle for examining auditing in Kuwait and Spain. The involvement of members of the royal family in the scandal of KIO and the secretive nature of KIO have not made the research task an easy one. The litigation proceedings filed

in Madrid and London between KIO/GT and its former managers likewise did not help in terms of access. The study tried to overcome the complexity and the difficulty of acquiring facts and information about the KIO through interviews, press reports, financial statements and reports of official investigations. It is difficult to acknowledge one correct and absolute view on the KIO case, the primary purpose of the study has been to use the available sources of evidence to explore the context within which auditing is being practised in developing democracies such as Kuwait (and to a lesser extent, Spain) and the implications of the case for the case for future operations of such a system. The study's combination of qualitative and quantitative research methods offers the best possible way, in the circumstances, of studying the details of audit practice in actions and considering the key policy issues regarding the accountability of audit in Kuwait and the shape and significance of corporate governance in Kuwait.

Chapter 4

The Economic, Political and Social Development of Kuwait

4.1 Introduction

The state of Kuwait is situated in the North east of the Arabian Peninsula with an area of 15228 sq. km. Its northern border is shared with Iraq and the Western and Southern borders are shared with Saudi Arabia. In addition, a neutral zone between Saudi Arabia and Kuwait was partitioned in 1966, giving Kuwait an additional 2590 sq. km of land. The 199-km gulf coastline borders Kuwait from the east. There are ten Kuwaiti islands¹, none of which are populated. The population of Kuwait in 1995 was approximately 1.58 million, 41.6% of whom are Kuwaitis.

The foundation of the nation of Kuwait can be traced to the early eighteen century when a clan of the Anaizz tribe emigrated from the northern part of central Arabia to Kuwait, which was under the province of Al-Hasa² at that time (Abu-Hakima, 1983). Kuwait later secured its independence from Al-Hasa, with the first tribal election for sheikhdom being conducted in 1756. The first sheikh, Sabah the First, was chosen from the Al-Sabah family, who have ruled the country ever since. During the eighteenth century Kuwait strategic harbour, which provided a land route for Indian imports to Syria via Kuwait, grew in prominence, gaining much trade from ports in Iraq, the Persian occupation of Basra and its harbour from 1776-1779, and conflicts between Britain and Persia (Al-Ebraheem, 1980). The development of the Kuwaiti harbour enabled Kuwait to prosper, with people duly migrating to it from neighbouring countries. Moreover, the Persian occupation of Basra and a widespread plague encouraged the migration of Iraqi merchants (and their capital) to Kuwait. The British owned Eastern India Company shifted its business from Basra to Kuwait as a result of the disputes between Britain and the Ottomanian Empire by the late 1770's (Assiri, 1994). Britain also switched its desert post from Zabiari³ to Kuwait in

¹ One of the islands, Failaka, was densely populated in the pre-gulf war period.

² Al-Hasa is a province in Saudi Arabia.

³ A town in Southern Iraq.

1775. This shift marked the first official relations between Britain and Kuwait (Al-Ebraheem, 1980).

Kuwait's harsh weather and infertile land made the sea its major source of income in the eighteenth century. Kuwaiti traders sailed from Kuwait to India and Africa to trade in pearls, dates, and gold. Diving for pearls was prominent in Kuwait while fishing was common too (but able to satisfy local consumption - Khouja and Sadler, 1979).

The Kuwaiti-British relations flourished in the nineteenth century, with Sheikh Mubarak, Kuwait's ruler, signing an agreement in 1899 with the British Empire that turned Kuwait into a British protectorate. This agreement was the result of the Kuwait sheikh's concern with his position if a proposed joint plan went ahead for Turkey and Germany to build a railway from Central Europe to the harbour of Kuwait. The British were not enthusiastic about another country competing and controlling the gulf area and the trade route to India. The agreement required Kuwait to seek Britain's permission before leasing, disposing or giving concession to any individual power of land in the sheikhdom. British consent was also required from Kuwait before it could receive agents or representatives of foreign governments (for the full text of the original agreement see Abu-Hakima, 1983). Even though, an agreement existed, there was no official declaration by the British government stating that Kuwait was under its protection until 1914 with this coming after the outbreak of the first world war, in which Sheikh Mubarak joined the British in their fight against the Turks in Mesopotamia⁴. This recognition stated that Kuwait was an independent government under the protection of the British empire. Before he died in 1915, Sheikh Mubarak established what is still the current system in Kuwait, whereby a new ruler is chosen from his descendants (Khouja and Sadler, 1979).

There were several negotiations for oil drilling concessions in Kuwait during the ruling period of Kuwait's tenth ruler, Sheikh Ahamed Al-Jaber. But, none of

⁴ An ancient region in part of what is now Iraq.

them were successful until 1934, when the Anglo-Persian Oil Company (British) and Gulf Oil (American) secured a joint concession and established the Kuwait Oil Company (KOC) with initial capital of £50,000. KOC signed a 75 year agreement with the Sheikh of Kuwait; entitling Kuwait to annual royalties on any oil extracted (Khouja and Sadler, 1979). The exploration started in 1935 and oil was discovered in 1938, but drilling ceased between 1942-1945 due to the outbreak of the Second World War (Al-Ebraheem, 1980). The first Kuwaiti oil shipment was in 1946 and quite rapidly, oil took over from pearling, seafaring and fishing as Kuwait's major source of income (Khouja and Sadler, 1979). Kuwait granted other oil drilling concessions after the end of World War II.

Six days after the declaration of Kuwait as an independent state on June 19th, 1961, Iraq claimed Kuwait as an Iraqi territory and was intent on capturing it. However, the Kuwaiti government swiftly signed a protection agreement with the British government a week later, which was followed by British soldiers being sent to Kuwait to deter Iraq from its aggression (Joyce, 1998). In 1961, the Kuwaiti dinar replaced the gulf rupee⁵ as the official currency of Kuwait (Al-Bahar, 1986). The high cost of acquiring the rupee and the fluctuations in its exchange rate made Kuwait think of issuing its own national currency. A basket of undisclosed foreign currencies (with the dollar believed to have had the highest share) was used to set the exchange rate of the Kuwaiti Dinar currently equals (1KD = £2). In 1962 an election was held in Kuwait to establish the Constituent Assembly and to draft Kuwait's constitution. Having achieved its purpose, the Constituent Assembly was superseded in 1963 by the first Kuwaiti elected Parliament, starting a democratic system of government in Kuwait. Two

⁵ Prior to the First World War several currencies were changing hands in Kuwait such as the Indian rupee, the gold English pound, and the Ottomanian lire. Nevertheless, the significance rise of the trade relations between Kuwait and India after the First World War made the Indian rupee the official currency in Kuwait. The high demand for the Indian rupee prompted the Indian government to introduce a special rupee for the Gulf countries in 1959 (Al-Bahar, 1986).

years later, in 1965, Kuwait was recognised as the one hundred and eleventh member of the United Nations.

Kuwait has grown enormously from the 1960's to the 1990's and is now one of the richest countries in the world. The huge wealth of Kuwait has made it susceptible to attacks by Iraq and history repeated itself in August of 1990 when Iraq invaded Kuwait and claimed it as an Iraqi province. However, the world community stood up to this aggression from the beginning. Twenty-six countries participated in the allied forces that ended the suffering of Kuwaiti citizens, who for seven months were hostages to the terror and aggression of the Iraqis. The aftermath of this occupation left Kuwait in turmoil, with 613 oil wells set alight by the Iraqi troops and the raging fires causing one of the biggest environmental disasters in the world. Most of Kuwait's infrastructure was destroyed or looted, while the psychological problems of the Kuwaiti citizens are tremendous. More than 200 Kuwaitis were killed, while more than 600 are still hostages in Iraqi's prisons (Al-Ebraheem, 1992).

The brief historical background discussed above highlights the key events in the history of the state of Kuwait. The rest of the chapter will discuss key elements about Kuwait's society, political life and economy that will assist in understanding the different influences on Kuwaiti corporations (such as KIO and KIA). This review will also help in understanding the environment that audit firms function in and the role they play. Accordingly, this chapter will assist in understanding the general environment in which the KIO scandal was unfolding. Thus, this chapter will begin with a discussion of several issues related to Kuwaiti society. These include the social make-up of Kuwait, the role of 'Wasta' in different aspects of everyday life in Kuwait and the employment characteristics of the Kuwaiti society. Public policy of Kuwait is examined through an analysis of the nature of executive, legislative and judicial power. Different aspects of Kuwait's economy will be studied, including the role of the public and private sectors in the economy and the role of the oil sector. The characteristics of the government financial policy and recent budget deficit will be discussed. These will focus on where KIO and its parent KIA, while the recent remedies to tackle

the budget deficit will also be discussed (highlighting privatisation moves and other efforts to tackle the budget deficit. The chapter will also address different major issues in Kuwait's history such as the Al-Manakh Crisis.

4.2 Kuwait's Society

4.2.1 Social Strata

The rapid growth in Kuwait's economy, as the result of the discovery and production of oil, and the need for development of the country attracted foreign workers to emigrate to Kuwait - workers who were badly needed to cover for the shortage in labour. The lack of control on the flow of foreign immigrants has created an imbalance in Kuwait's population. The total population increased from 206,473 in 1957 (55% of who were Kuwaitis) to approximately 2.2 million in 1990, 27% of who were Kuwaitis (Al-Saadoun, 1993, p.34). Accordingly, Kuwaiti nationals became a minority group in their own country (see Table 4.1).

Table 4.1 - Kuwait's Population During the Census Years (1965-1995)

Year	Kuwaitis	Kuwaitis percentage	Non-Kuwaitis	Non-Kuwaitis percentage	Total
1965	168793	36%	298546	64%	467339
1975	307755	31%	687082	69%	994837
1985	470473	28%	1226828	72%	1697301
1995*	665820	42%	920163	58%	1575983

* Preliminary Results

Source : Ministry of Planning, 1995, p.25.

The Iraqi invasion caused the population to decrease substantially in Kuwait. After the liberation of Kuwait, the government intended to balance the population so it set a target population of 1.2 million. The population was close to the government target in 1992 when it reached 1,398,059, with Kuwaitis accounting for 43% (the highest proportion of Kuwaiti nationals since 1957). This target has now been exceeded significantly with the population reaching 1.8 million in 1997 (Kuwaitis representing 41%). The non-Kuwaitis have been mainly been dominated by Arabs from different nationalities and Asians.

The Kuwaiti nationals are distinct from other nationals in terms of the economical and social rights they enjoy. In economic terms, only the Kuwaiti

nationals have the right to buy and sell real estate, buy stocks of shareholding companies. Non-Kuwaitis can only establish a business if they have a Kuwaiti partner. In social terms, Kuwaitis enjoy a generous welfare system of free health, education and cheap housing. Kuwaitis have long been guaranteed employment in the public sector. In the aftermath of the Gulf-War, non-Kuwaitis no longer have access to free education and recently are required to buy health insurance. However, all residents in Kuwait enjoy subsidized services (e.g. electricity, water, telephone, fuel prices) and do not pay any kind of direct taxes.

Although Kuwaiti nationals present a united group that is distinct from other nationals in terms of the privileges and rights they enjoy, they are divided in terms of their influence and the rights they exercise. Crystal (1992) identified several factors that create division in Kuwait society (family, class, tribal, sectarian, gender) and felt that the class and sectarian divisions are the most significant ones. The class division has its roots in Kuwait's pre-oil society where three main groups existed. The ruling class represented the ruling Al-Sabah family who was responsible for running the country, collecting tax and upholding regulations. The Merchants were the owners of ships, employers of sailors and lenders for the small ship owners and to the Al-Sabah family to some extent. They represented the main source for employing people and for paying taxes to the ruling family. The wealth of merchants and their importance as a source of income has tightened the relations between merchants families and the Al-Sabah family. The third class consisted of sailors, pearl divers and other workers who were heavily dependent on employment with the merchants for their livelihood, as the role of the government in the economy was limited.

The discovery of oil changed Kuwait's class structure. Crystal (1992) argued that oil created a rentier economy that changed "class structure by making access to the state rather than access to private property the determinant of wealth" (p.73). The huge oil revenues that started to flow directly to the government secured the independence of the ruling family from the merchants and made the family a stronger class. The growth in oil revenues led to the government establishing more ministries and departments to assist in Kuwait's development process.

Consequently, Kuwaiti citizens who worked for the merchants sought employment with the government, shedding their previous class identities for new ones as bureaucrats and technocrats (Crystal, 1992). The merchant class, while weakened in the post-oil Kuwait, drew on its previous power and wealth to secure the most senior governmental positions and jobs. Merchants subsequently started to act as agents for foreign companies that were trying to sell their products in Kuwait (Al-Saadoun, 1984). Their control on import activities in Kuwait, where the dependence on foreign goods was substantial, led to enormous increase in their wealth. Moreover, the assumption of high posts in the government enabled them to gain insider knowledge of the forthcoming laws and spending plans of the government - a knowledge which they used to their benefit (Al-Saadoun, 1984). Such a position has benefited them in terms of the government's strategy known as the Land Purchasing Programme. The enriched government sought to distribute the oil wealth among Kuwaiti citizens and to stimulate private investment. To achieve this goal it adopted, in the 1960s, the Land Purchasing Programme, where the government bought the houses and land of its citizens at much higher prices than their market value, even though there was no shortage of land. It is widely believed that a substantial number of the merchant class who were holding high positions in the government were able to establish better negotiation positions for their properties and for those of their kinship. Benefiting from insider information, these officials acquired properties that the government was planning to purchase and then sold them to the government at profit.

Crystal's (1992) other divisions in the Kuwaiti society include: family - ruling family vs. the others; sectarian - Sunni vs. Shia Muslims; tribal - long settled in Kuwait vs. settled in last several decades and gender - male vs. female. The divisions on these lines have some effect on issues such as employment, 'Wasta' and other political rights (e.g. women do not have suffrage yet). Kuwait's religion is Islam and the constitution promulgates Islam as a major source for legislation in Kuwait. Virtually all Kuwaiti nationals are Muslims, with the majority being Sunni Muslims while Shia Muslims represent around 30%. Lately there have

been two unsuccessful attempts by the assembly to restrict the source of legislation to Islam only (one in 1986 and the other in 1994). The teachings of the Quran and Sunnah⁶ are not strictly adhered to in Kuwait's business life. Quran strictly emphasised and prohibited the use of usury (interest) in everyday transactions. Despite this the government and the business community in Kuwait are dealing in interest⁷. Although Islamic banks and investment companies are slowly being accepted by the West⁸, there is only one Islamic bank and a limited number of Islamic investment companies in Kuwait.

4.2.2 Kuwait's Magical Vitamin *W*

Wasta, also known as "Vitamin *W*", refers to the act of knowing someone in any governmental or private organisation who will be willing to furnish your demands from these organisations either legally or illegally. It is not clear when this kind of practice surfaced in Kuwait for the first time but it is widely used in the everyday life of Kuwaitis. All of Kuwait's social classes have access to *Wasta*, although the rich and elite families have access to more powerful *Wasta*.

Wasta in Kuwait has the effect of magic in all activities that take place in Kuwait. Securing good business contracts with the government requires *Wasta*. Employment in highly paid prestigious organisations such as Kuwait Petroleum Corporation and Kuwait Investment Authority requires strong *Wasta* regardless of the applicant's qualifications. Traffic violations, some of which carrying short term jail sentences, can be waved or downgraded to lenient sentences if the violator was backed with a strong *Wasta*. The application of *Wasta* is also felt in everyday transactions such as government ministries helping to speed up the processing of applications for passports. Usually it would take more than one day to issue a new Kuwaiti passport but with *Wasta* this could be done in a matter of hours. Under the heading of "Healthy doses of vitamin W are vital", the

⁶ *Quran* is the holy book of the Muslim religion. *Sunnah* the actions of the prophet Mohammed and his sayings which followed as a supplements to the Quran.

⁷ The Kuwaiti government claimed that soon it will start collecting Zakah (a type of taxation that the Quran imposes on all Muslims) from public companies.

Financial Times wrote its guide for doing business in Kuwait (FT, Survey of Kuwait, 8/7/1991, p. XIX), advising readers that it:

“...is vital to establish lasting relationships with Kuwaitis who have the right business contacts: the local word for this is *Wasta* or “Vitamin W” to some expatriates.....”

Although senior government officials always publicly deny the existence of *Wasta*, it is widely spread. It undermines law and regulations, putting influential people almost “above the law”. Reliance on *Wasta* as a criteria for employment in some organisations does not provide these organisations with the best qualified people. Government corruption and inefficiency can also be attributed to the spread of *Wasta*. Neither the government nor the parliament has shown any significant will to fight and eradicate *Wasta*. Also it is unlikely that Kuwaiti citizens will abandon *Wasta* as they feel socially obliged to adopt it for the benefit of their own family and friends.

4.2.3 Employment in Kuwait

The Kuwaiti labour market is predominately compromised of non-Kuwaitis for the last two decades. The total work-force estimates before the Iraqi invasion in 1990 was put at 874,022 with Kuwaitis at 121,647 and non-Kuwaitis at 752,373 - 14% and 86% respectively. The limited contribution of the Kuwaiti nationals to the labour market (about 35% for the census period of 1970-1985) can be linked to factors such as the small size of the Kuwaiti population, the high rate of the young age group, and the small participation of women (the average for the period between 1970-1985 census was 8%). The absence of an employment strategy has been seen as contributing to unlimited and unrestricted immigration of foreign workers (Al-Quisi, 1993). The majority of the Kuwaiti nationals in the labour force are employed in governmental ministries and organisations (see Table 4.2).

⁸ Citibank one of the biggest American banks is to finalise their plan to establish an Islamic bank in Bahrain by the end of this year.

Table 4.2 - Kuwaiti and Non-Kuwaiti Labour Force (1994)

	Kuwaitis	Rate	Non-Kuwaitis	Rate	Total
Total Population	681526	37%	1148595	63%	1830121
Male	337934	30%	690782	70%	1128716
Female	343592	49%	357813	51%	701405
Total Work-force	163320	17%	820557	83%	983877
Government	153432	62%	94837	38%	248269
Private Sector	9888	1%	725720	99%	735608

Source- Financial Times, 23/5/1995.

The popularity of government employment is credited to the social presumption that manual jobs are demeaning and clerical work for the government is more prestigious and offers higher pay than that of the private sector. All Kuwaiti nationals are guaranteed employment regardless of their qualifications and the need for their services.

“Kuwait faces a shortage of educated managerial personnel. Although professional recruitments are becoming more common, traditional employment still tends to be based on family affiliation, friendship, or right of birth. Thus, objective employment criteria tend to be rare.” (Pomeranz and Haqiq, 1985, p. 154).

Researchers have argued that the government’s strategy of guaranteed employment has adverse consequences. Al-Sabah (1984) argued that such policy “has resulted in the distortion of the price of labour, made industrial employment less attractive and discouraged industrial investment” (p.8). Employees of the government have a secure job, as they will not be fired even if they are inefficient or redundant. Ironically, occasionally unproductive and problem employees are promoted as a way of disposing of them - as revealed from Tetreault's (1995) study of Kuwait Petroleum Corporation, one of Kuwait's most prestigious organisations. She noted that

“A number of managers lamented the fact that problem workers are often promoted because this may be the only way for a supervisor to get rid of them. At the same time, able and dedicated workers lose their enthusiasm

because their supervisors seek to keep them and yet have no way other than promotion to reward them for their efforts.” (Tetreault, 1995, p.175).

Al-Quisi (1993) has argued that the lack of balance between reward (salaries and wages) and effort has made employees less productive and less likely to seek employment in the private sector. It has also led to foreign employees taking control of vital sources of production. The dependence on government as the major employer in Kuwait has played a major burden on public expenditure and income especially, in recent years when Kuwait has run a budget deficit.

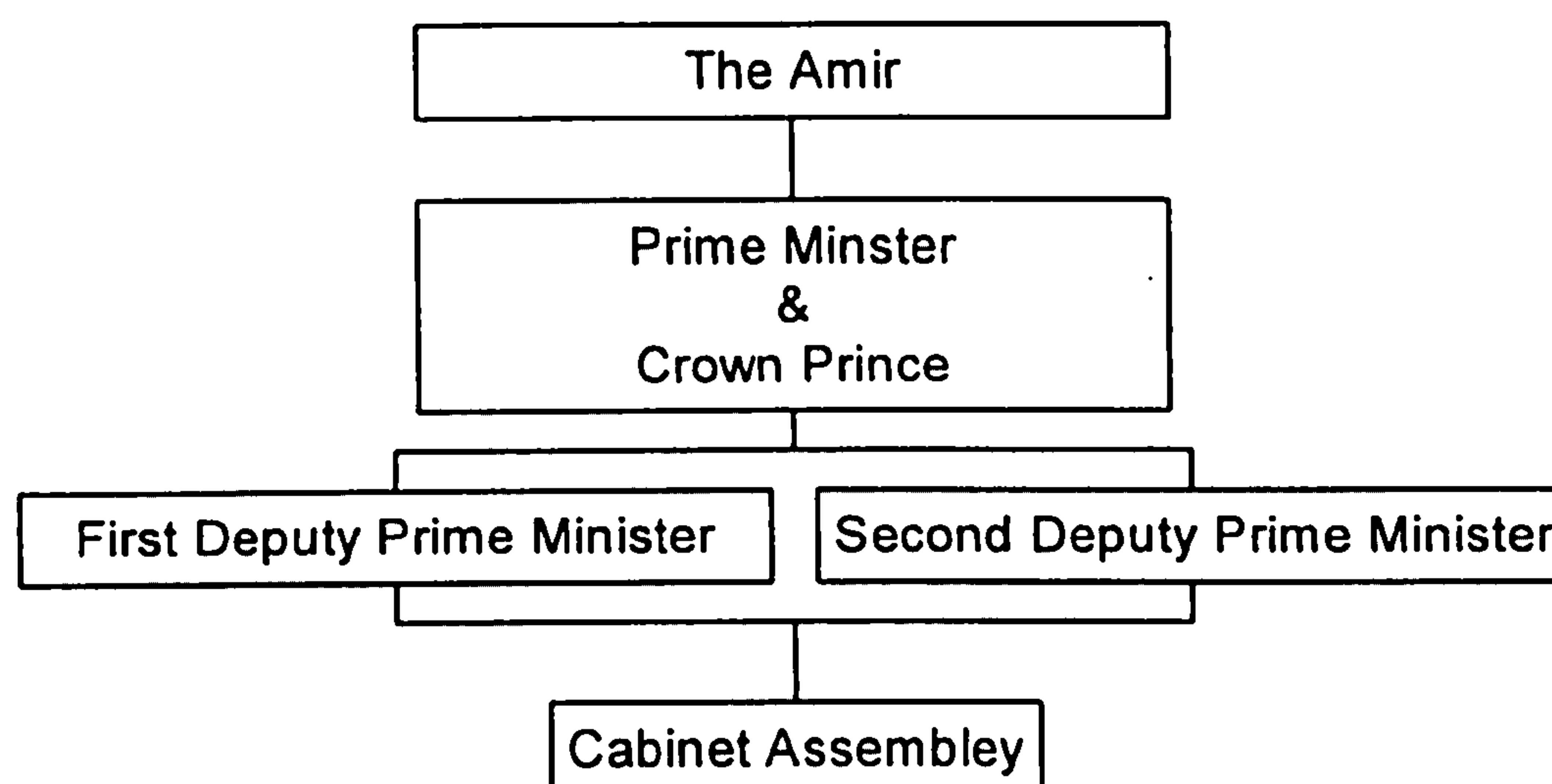
4.3 Kuwait’s Political Scene

Kuwait is a hereditary monarchy with executive power, legislative power, and Judicial power. The Amir acts as the head of the executive power and participates with the parliament as head of the legislative power. Legal judgements in different legal cases are issued in the name of the Amir.

4.3.1 The Executive Powers

The Amir exercises his executive powers indirectly through his Prime Minister and ministers (see figure 4.1). He elects the Prime Minister, whom always has been the crown prince of Kuwait, and then the Prime Minister on his part elects the ministers who are later approved by the Amir. The constitution propagates that the Amir is immune and inviolable as the Prime Minister and the ministers are accountable for their actions to parliament and the Amir (Assiri, 1994).

Figure 4.1 Executive power in Kuwait



Source: Assiri, 1994.

unofficial parties or groups⁹. Kuwait's constitution provided the parliament with huge powers. One of the most important privileges is that no law will be enacted unless approved by both the parliament and the Amir. The parliament also has a controlling influence say on the financial affairs of the country. This role is exercised largely through the Kuwait Audit Bureau, who reports directly to the assembly. The Kuwaiti government lacks the authority to acquire a loan, or give a loan, or guarantee a loan unless it is authorised by the parliament. The proposed general budget must also be approved by the parliament. Furthermore, the parliament can raise questions, discuss public issues, form an investigation committee, question public officials up to the ranks of Prime Minister, and exercise motions of no confidence in ministers, though they cannot do the same for the Prime Minister.

Kuwait has always been the most democratic state in the Gulf region. Kuwait had its first general assembly in 1961 while the other gulf countries to the present day either do not have such an assembly or have dissolved it or have a consultative one, whose members are chosen purely by the government. Substantial powers were provided to the Kuwaiti assembly as they have the power to approve laws, act as a protector of Kuwait's public capital, and have the power to investigate important matters and exercise motions of no confidence in the ministers. The print media in Kuwait is the most independent in the region, with newspapers able to criticise openly the government - a privilege that rarely can be found in other countries in the region. On the other hand, Kuwait might not be considered a fully democratic state by western standards. The right to vote is restricted to Kuwaiti men over 21 years old and descendants from ancestors that lived in Kuwait before 1920. Women and Kuwait men from the "second class" (where ancestors migrated to Kuwait after 1920) are prohibited from voting. Several countries in Europe (such as France and Switzerland) were

⁹ The seven groups that provide members of the parliament are as follows: Members of the Parliament Dissolved in 1986, the Democratic Forum (Left-leaning and Arab nationalist), the Constitutional Alliance (Merchants), the Popular Islamic Congress (Sunni Moslem), the Islamic Constitutional Movement (Sunni Moslem), the National Islamic Coalition (Shia Moslems) and a group of independents (FT, 8/7/1991, p. V).

considered democratic even though women did not have the right to vote until after the Second World War (Birch, 1995). Nevertheless, in Kuwait about 25% of the population is eligible to vote and Kuwait's assembly has been dissolved twice in an unconstitutional fashion before the Gulf-War. The constitution indicates that if the parliament is dissolved by the Amir, a new election must be held within two months, otherwise the dissolved assembly can reconvene. However, in both cases, the assembly was dissolved for more than 5 years in clear disregard for the constitution.

4.3.3 Judicial Power

Court verdicts are announced in the name of the Amir. The main sources for the law in Kuwait are Islamic and foreign laws. The constitution established judicial power in Kuwait as independent of both executive and legislative power. However, the judicial system is criticised for being not independent, as the Courts all under the control of the Justice Ministry – which appoints the judges and assigns legal budgets. The system has also been criticised for being dominated either by non-Kuwaitis, whose future depended on their compliance with the wishes of the regime, or young Kuwaitis, who don't have sufficient experience (Tetreault, 1995). Attempts have been undertaken to guarantee the independence of the judicial system, never been implemented as a law.

4.4 The Economy of Kuwait

4.4.1 The Role of the Kuwaiti Private and Public Sector

4.4.1.1 Pre-Oil Role

The economic development of pre-oil Kuwait relied on the contribution of the private sector. The private sector, which was heavily controlled by merchants, was responsible for creating employment opportunities for Kuwaitis mainly through pearling, trading, and fishing. Taxes levied on the private sector represented the main source for governmental spending. Furthermore, it also played a role in the management of the country through participating in consultations required by the government (Al-Saadoun, 1993). The role of the public sector was limited, basically performing the role of absent as it only took

The cabinet ministers consist of nineteen ministries with some of the ministers heading more than one ministry at some point in time. The vital ministries of foreign affairs, defence, interior, and communication usually are headed by members of the ruling family. The heads of other ministries have usually been drawn from members of Kuwait's elite or rich families in Kuwait. The Kuwaiti constitution allows the appointment of elected members of parliament as ministers (but the highest number of members of parliament to become ministers was six in 1992). Government ministers participate in parliamentary discussions and vote on proposed laws and regulations. However, the constitution requires that the number of ministers does not exceed two-thirds of the number of Members of Parliament.

The cabinet ministers carry out the duties of the government on behalf of the Amir. The cabinet meetings are confidential and the decisions made by means of unanimous voting by the attending ministers. Duties of the cabinet include planning the general strategy for the country, signing treaties, enacting regulations, approving the employment of higher officials and carrying out the executive affairs of the country. Presentation of the Amir's proposals to the parliament and the ratified proposals by the parliament to the Amir are also duties of the cabinet (Assiri, 1994).

4.3.2 Legislative power

Before its independence in 1961, Kuwait's legislative powers were restricted to the ruling family, with some input from the consultative assemblies established in 1921, 1938, and 1939. In December 1961, a Constituent assembly was elected to draft Kuwait's constitution. In 1963 Kuwait's first election for parliament took place. Since then, there has been eight parliaments, with the parliament being unconstitutionally dissolved in 1976 (for five years) and then in 1986 (for eight years). Each parliament has a duration of four years, with 50 freely elected members. Official political parties are prohibited, although there are about seven

over the role of protecting Kuwait. The relation between the government and the merchants was described as follows:

“The rulers were expected to organise the defence of society against attacks from the bedouin or pirates, while the merchants, who owned most of the communities’ wealth, in the form of trading and pearling dhows, were expected to finance the sheikhs through taxes and loans. In return, the merchants would be consulted by the rulers on all important affairs of state.” (Field, 1981, p. 85).

The major source of income was diving for pearls which were then a precious merchandise. Kuwait’s annual revenue from pearling was estimated at £1,688,888 (Al-Fara, 1974, p.69). A ten month season of trade trips was the main source of living for Kuwaitis. Kuwaitis sailed from Kuwait to India and Africa, trading in things such as pearls, dates and gold. They imported to Kuwait timber and mangrove poles for building.

4.4.1.2 Post-Oil Role

The discovery of oil in Kuwait in 1938 and the shipment of oil in 1946 changed the roles of the private sector and public sector. The government, through its rulers, was no longer in need of tax income and loans from the merchants. The private sector role was starting to weaken as the trade trips and Kuwait’s function as a transit port lost their values as result of the establishment of the Suez canal. Another factor was that the discovery of cultured pearls rendered uneconomical diving for pearls. However, the major vehicle behind the fading of the role of the private sector was the discovery of oil. The Kuwaiti people started to seek employment with a government that offered higher wages and jobs requiring less effort.

The government started to acquire all the important national assets. It started with the oil sector, which in the beginning was both a private and public sector, then a transportation sector, and finally stakes in public companies and the real-estate sector. Accordingly, Kuwait appeared to be a capitalist country while in fact it was more government controlled. Kuwait in effect possessed the disadvantages of both systems - on the one hand a freedom to adopt laws and

regulations and on the other a monopoly by government and a spread of mismanagement (Al-Saadoun, 1993).

The government fully owned Kuwait's oil corporations, all utilities institutions, held large stakes in almost all share holding companies, owned some governmental companies such as Kuwait Airways and undertook foreign investment through the Kuwait Investment Authority and other Kuwaiti organisations. The government's monopoly position made it the main contributor to the economy. Furthermore, the government made the private sector more dependent on its functions through contracts set up by the government. In addition, the government has institutionalised the notion that it will step in and help the private sector whenever they encounter problems - encouraging the private sector to indulge in activities without properly assessing the risks involved. This notion has left the government problems and the liabilities of particular sectors of the economy.

The government policy of providing jobs for all Kuwaitis as a means of distributing the oil wealth made Kuwaiti employees totally dependent on the government for their jobs. Recently, the government ministries and their organisations employed 94% of the Kuwaiti work-force. This staggering number has inflicted a huge financial burden on the budget, with wages and salaries figures estimated at 29% of total government expenditures. For example, it was estimated that 75% of the Housing Authority Budget was being spent on wages and salaries (Al-Seyassah, 26/5/95).

Table 4.3 - Salaries and wages spending out of the government budget

Financial Year	Value in KD	Percentage of Total Expenditures
1978-1979	329 million	19%
1986-1987	757 million	44%
1989-1990	883 million	29%
1995-1996	1180 million	29%

Source: Al-Ebraheem, 1993; Al-Qabas, 2-5-1995.

Kuwaiti's economy to a large extent is dependent on oil production, its contribution to the GDP in the last decades is estimated at 67% while it

represents 69% of Kuwait's total revenues. There are some unfavourable effects of such dependence not least the scenario of oil being depleted in the future (although it estimated to last for more than 100 years). In addition, it's difficult for the government to control fluctuations in oil prices, oil demand, and foreign exchange rates. Accordingly, the government has been trying to encourage the development of other sectors in the economy, include manufacturing, real estate, and community and social services.

The government has also pursued a strategy of foreign investments as an alternative source of income, investing in Europe, USA and Eastern Asia through KIA and KIO. The foreign investments' revenues have proven to be very rewarding in the 1980's, exceeding the oil revenues for the first time in 1985/1986. The \$100bn of Kuwait's foreign investments were reduced by 60% as a result of the cost of exiled governments spending during the Kuwait's occupation. Further, a big scandal broke in 1992 over Kuwait's investments in Spain, (known as the KIO/GT scandal. This will be thoroughly examined later in the study.

4.4.2 Kuwait's Oil Sector

During the period from the discovery of oil in 1946 until 1960, Kuwait's income from oil came through royalties and taxes on oil revenues. The 1960's represented Kuwait's first attempt to establish national oil companies such as Kuwait National Petroleum Company (KNPC) and Kuwait Oil Tankers Company (KOTC) in 1960. Both were listed in the stock market and jointly owned by the government and the private sector. During the 1960s, Kuwait was one of the co-founders of the Organisation of Petroleum Exporting Countries (OPEC), an organisation that played a vital role in the global oil market. The oil producing countries need for a collective policy against the monopolistic oil companies, who were then controlling the oil market, was the main reason for the emergence of OPEC. It failed to realise its objectives or exercise power until the early 1970's, when it increased oil prices.

In 1968, another organisation that Kuwait co-founded with Libya and Saudi Arabia was called the Organisation of Arab Petroleum Exporting Countries (OAPEC). The goals and aims of OAPEC were somewhat different as OAPEC was established with the aim of using oil revenues to achieve the political and economic aims of the Arab countries. Kuwait started to nationalise oil fields in the 1970's when it nationalised KOC, the jointly owned British and American company. It also nationalised the stock market listed, Kuwait National Petroleum Corporation (KNPC) and Kuwait Oil Tankers Corporation (KOTC). It also terminated the concession of the American Company (Aminoil).

In 1980 as the Kuwaiti government became the sole owner of oil, the Kuwait Petroleum Corporation (KPC) was established. KPC and its subsidiaries in Kuwait and abroad handle all of Kuwait's upstream and downstream activities. Kuwait's upstream activities of oil exploration and the production of crude oil were undertaken in the 1960's. However, its downstream activities of refining, delivery, and marketing of petroleum products to final consumers were only pursued from 1983 when Kuwait acquired refineries and sales outlets in consuming countries such as the Netherlands, Denmark and UK (see Mergers and Monopolies Commission, 1988). The annual revenue of KPC's budget, which is not included in the government budget, has been larger than that of the whole government budget every year since 1985/86 (Economic Intelligence Unit, 1994).

“There is no doubt that since mid-1987 at least, Kuwait had apparently favoured low oil prices as the policy which would serve best the long-term economic interest of OPEC members and other exporting nations. There is a plethora of statements made by Kuwaiti officials which supports this proposition. The argument is simple. Low prices would increase demand and raise, or at least stabilise, the share of oil in world energy consumption. They would discourage investments in other sources of energy, particularly gas and nuclear, they would relax the will to introduce and implement energy conservation measures, and more importantly, they might sustain the expansion of the world economy, bearing in mind that economic growth is the most powerful determinant of increases in the demand for oil.” (Mabro, 1994, p. 242).

The above quotation represents Kuwait's strategy before the invasion of Kuwait. The Iraqi invasion had terrible consequences on the oil industry in Kuwait, with

613 oil wells set on fire, and most oil refineries destroyed. Kuwait put out the oil fires in record time and oil production reached pre-war production in 1994. Kuwait, which holds 9.4% of the world's oil reserve, now more than ever is looking at oil as a source of income to finance the budget deficit and to rebuild Kuwait's foreign investments. Currently Kuwait is looking into developing virgin oil fields in the north, near Iraq, as a joint venture with foreign companies utilising the latest technology in developing these fields and seeking to enhance to enhance Kuwait's security. Kuwait is also looking into navigating new markets in Asia, such as the recent establishment of oil refineries in India and Pakistan. Kuwait's reliance on oil as a source of income is still substantial. 63.1% of Kuwait's GDP in 1965/66 contributed to oil but this dependence still persists, with 43.3% of GDP being contributed by oil in 1993.

4.4.3 Financial Policy and the Budget Deficit

The General Budget Department in the Ministry of Finance assumes the task of preparing the annual budget. Since 1938 the government outlines its annual economic programme in the proposed budget. The budget covers the financial year commencing on the 1st of July and ending on 30th of June of the next year. The cash basis is the accounting method used in preparing the budget, with the general budget being divided into three sub-budgets: (Al-Ebraheem, 1993).

1. The ministries and governmental departments budget

This budget is concerned with the financial activities of the government's ministries and departments. A law is issued for this budget showing the magnitude of the public revenues and expenditures and allowances.

2. Attached Budgets

Attached entities are those organisations that are attached to and not independent of the concerned ministry. However they enjoy managerial freedom and a special regulation as a result of their distinctive practices. For every entity a law must be enacted for its budget that shows its revenues and

expenditures. Some of these entities are the Kuwait Investment Authority (KIA) and the Kuwait Housing Authority.

3. Independent Budgets

Independent budgets represent those of organisations and entities that act in a business fashion. These organisations enjoy independent status from ministries and have a separate financial budget. A law must be enacted for the budget of every entity, showing its revenues and expenditures. The government has established such organisations either due to the disinterest of the private sector (as a result of their low financial reward) in the activities of such organisations or because of the business needs huge investment in that capital that is not available to the private sector. Moreover, the strategic role of such organisations has enticed the government to control them. Kuwait Airways Corporation and Kuwait News Agency are examples of entities that have independent budgets.

The Kuwaiti budget does not take account of the investment revenues made by the government in Kuwait and abroad. In addition, the extent of government spending on defence facilities was not disclosed in the budget until the parliament passed a law in 1993 forcing the government to include such allocations in the budget. The budget doesn't show the income from the sale of refined products or petrochemicals as these are shown in KPC's budget.

The governmental accounts consist of three accounts:

1) General Account

Oil revenues and non-oil revenues represent the main income for the general account. Funding for the budget is financed through this account. The RFFG is credited with 10% of this account annually and the account's surplus is transferred to the General Reserve fund, which is expected to finance any deficits on the general account.

2) **General Reserve Fund (GRF)**

This account was established to invest the increasing surpluses of the budget. The revenues of this account comprise of the budget surplus, interest on invested surpluses, and profits of independent organisations. Expenditures include financing the budget deficit, financing the independent organisations, meeting emergency expenditures etc.

3) **Reserve Fund for Future Generations (RFFG)**

This fund was established in 1976 as a mean of pursuing a long-term strategy of establishing an alternative source of income for Kuwait's future generations. The fund is mostly invested abroad by institutions such as KIA and KIO.

The growth in oil prices in the seventies led to a parallel growth in oil revenues and governmental spending by a rate of 1900% and 850% respectively. The economy relies heavily on government spending, which has evolved from 27% of GDP in 1969/1970 to 74% of GDP in 1989/1990. In the 1980's, oil revenues started to diminish in the light of the global recession and the deterioration of the demand for the crude oil. This decline in revenues failed to alarm the Kuwaiti government as government spending increased by 18% in the 1980s while oil revenues decreased by 48% during the same period. This situation of decreased revenues and increased spending led to the appearance of the first budget deficit at KD660m. Since then the budget deficit persistently¹⁰ arisen and is currently estimated at KD1,503m. More recently, the destruction of Kuwait's infrastructure by the Iraqi invasion served to widen the deficit.

Even though the budget deficit has been financed from the liquidation of financial reserves and from local and international borrowings, alternative approaches are encouraged. The Ministry of Finance claims it is drafting a new financial policy to improve non-oil revenues and contribute to a greater extent to the budget. This means improving sources of revenue that seem simple to collect and economically feasible (e.g. luxury taxes, real estate taxes, increasing customs

on imports). The government also introduced privatisation and offset programme as a new tool for tackling the budget deficit. Raising oil revenues through improving marketing techniques, seeking new regions abroad are also considered to decrease to deficit. In addition, 'belt-tightening' is an option that is strongly called for by the parliament and economists in Kuwait. One Kuwaiti economist made a strong and unpopular call for the government to abandon its expensive military program, which was assigned KD 3.5 billion for the next 12 years. He argued that advanced military equipment is not sufficient for a small military, (estimated at 20,000 men) to defend Kuwait. He also claimed that the cost of military job will reach KD100,000 annually while the cost of civil jobs cost only KD15,000 (Al-Saadoun, 1993, p.43).

In May 1995, The parliament rejected the government proposed budget for the financial year 95/96 that to be commences in July 1995. The rejection of the budget is due to parliament believe that the government's budget lacks any plan to cut the deficit. The government decreased the budget spending by only 1% and increased the non-oil revenues by only KD 18 m instead of the proposed KD 50m. Another blow for the government came from the parliament when it also rejected a proposal for a law that would have enabled the government to withdraw from RFFG to finance the budget.

4.4.4 Privatisation

Recently privatisation has become a trend all around the world, from the capitalist countries like the USA and Britain to the formerly Communist countries like Russia. The Gulf states have been no exception, seeing privatisation as a way out of their budget deficits. Kuwait's adoption of privatisation has been based on the recommendations of the IMF and World Bank as a means of increasing the role of the private sector in the economy.

¹⁰ The financial year 1989/90 was exceptional as the budget had Surplus of KD 174.9.

However, to date, progress has been slow in Kuwait due to the fact that the Kuwaiti economy is limited and cannot afford a rapid introduction of private capital. The low salaries offered by the private sector in comparison to those of the public sector might create labour problems for the private sector. The notion that privatisation will substantially raise the prices of the services has been a worry while concerns have been expressed over foreign organisations holding stakes in key Kuwaiti organisations. The concern that foreign organisations might hold stakes in the privatised companies and control them has raised opposition to the privatisation of strategic organisations such as oil companies.

4.4.5 The Collapse of the Souk Al-Manakh and the Difficult Debts

The Kuwaiti stock market was established in 1970 and 32 Kuwaiti companies traded there. The reasons for the emergence of the Al-Manakh crisis in 1982 might be traced to a period as far back as 1974. Accusations of illegal acts by the founders of stock holding companies surfaced in 1974 amid a heated debate between the parliament and the government. The debate resulted in the government launching an investigation of the accusations, which unravelled a wide range of illegal share dealings (for more details, see Al-Saadoun, 1984). The findings of the investigations did not result in any prosecutions – giving the impression that rich and powerful figures will not be prosecuted or fined in Kuwait. The enforcement of law was undermined as the people who broke the law were not punished.

The boom in oil prices since 1973 led to a huge surplus and savings in Kuwait. The limited absorptive capacity of the Kuwaiti economy led to a huge increase in the price of land and real estate in the period 1974-1975. In mid 1976 when the demand for, and prices of, land and real estate started to decrease a new breed of investors looking for quick returns started to speculate in the stock market. The growth of such speculation led to a leap in share prices by as much as 11 times their average nominal value. Share prices reached their highest levels in early 1977 when shares were largely believed to be un-marketable. Most of the share

transactions were conducted through forward deals, a unique system that surfaced in the Kuwaiti stock market. Beblawi gave an explanation of such deals:

“Kuwait forward deals differ from the usual forward transactions known in other markets. Rather than an agreement to sell and buy at a prearranged price on a designated date in the future, Kuwait forward sales are spot sales with credit. The seller delivers the buyer the shares on the spot and the buyer will hold them immediately; only payment is deferred to a future date (usually a post-dated cheque). For all practical purposes, forward deals in Kuwait are spot deals on credit without collateral. The forward price is not independent of the spot price; it is invariably the spot price with a premium (an interest rate or rather a usury rate) which varies between 50-150% for one-year delivery. Forward deals are used in fact as a means of finance at usury rates”

Hundred of millions of Kuwaiti Dinar's were represented by post-dated cheques and some of the post dated cheques were very short term owing to the fact the stock market become very dull (Al-Jumah, 1986, p.36). The government intervened to solve the crisis through KFTAC, spending KD 155 million on purchasing shares offered by the private sector at the lowest price. The government, also enacted resolutions to restrict forward transactions¹¹, suspended the establishment of new public-subscriptions for share-holding companies, and prohibited increases in capital of existing companies. The government established the idea that if investors were taking risks, it has the duty to, and will, intervene to protect them (Beblawi, 1984).

The suspension of public offerings of new stock holding companies and the rigid requirements for listing on the Kuwait Stock Exchange led to the emergence of Al-Manakh¹² in 1976 as an unofficial secondary stock market. In Al-Manakh,

¹¹ The government introduced four conditions without no undertakings of forward transactions would take place:

- 1- The period of settlement should not exceed 12 months
- 2- The buyer should immediately settle part of the total value of the transaction
- 3- The shares continue in the possession of the seller until the forward date and the settlement of the price in full.
- 4- The contract be registered upon completion at he department of securities at the Ministry of Commerce (Al-Jumah, 1986, p.40).

¹² Al-Manakh is the name of the building where the shares of the Kuwaiti closed companies and gulf companies were traded.

shares of Kuwaiti closed companies and gulf companies¹³ were changing hands through forward transactions (post-dated cheques) at staggering rates in mid 1981. Al-Manakh was a classical example of chaos and disarray as no governing body was regulating the transactions and the laws of the Kuwaiti Stock Market were not being implemented. The shares of the gulf companies were traded illegally before their incorporation. The huge profits out of the gambling-like speculation appealed not only to the average Kuwaiti citizen but also to high officials and members of the ruling family (the Minister of Justice who was also a member of the Al-Sabah family was forced to resign to avoid a motion of no confidence from the parliament over the accusations of his son's involvement in Al-Manakh). No list of Al-Manakh debtors has ever been published – although a substantial number of Kuwaiti companies and government owned companies (KIC) were involved in Al-Manakh dealings. In 1983, financial statements of the Kuwaiti and gulf share-holding companies showed that these companies had invested in forward cheques and stocks about 104% and 85% of their respective capitals (Al-Saadoun, 1984, p.77). The Summer of 1982 represented the end of Souk Al-Manakh when two investors failed to meet their obligations, causing the system of forward transactions to collapse - creating what are known as Al-Manakh Crisis.

One Kuwaiti economist asserted that the real crisis would have been if the Al-Manakh market had not collapsed. The collapse of Al-Manakh has revealed that 6000 persons and companies were involved in forward transactions. The number of investors registered in the clearing company was 5,509, while the total number of post-dated cheques reached 28,878 with one investor holding alone 5,000 cheques (see Purdy, 1982, p.7). The value of the post-dated cheques was estimated at 26.7 billion KD.

Since the collapse of Al-Manakh the government established more than one organisation to solve the crisis and it also introduced more than one scheme to

¹³ Kuwaitis registered most of these companies in the gulf countries to avoid the government prohibition on the establishment of new public share holding companies.

settle the crisis. A handful of debtors settled their debts in 1986, which led the government to initiate the Difficult Debts Settlement Programme No. 1 after the dissolution of parliament in 1986. This programme offered 15-year pay off period but failed to resolve the matter. The government issued law 32 in July 1992 which enabled it to purchase KD 5.9bn (\$19.7bn) of personal and corporate debts from the private sector. In return for debt the bonds issued to commercial bank. This move was seen as a way of preventing the 6-year dissolved parliament, which was going to be elected again in three months, from repealing the law. Accordingly the government bought the debts and issued bonds to the banks so that the parliament could not do anything about it. Since this time the parliament has launched different programmes to get debtors to repay amounts owed to the government. These schemes have offered a range of discounts and benefits for debtors to settle early but there continues to be a large amount of debts unpaid and questions are repeatedly asked as to the legitimacy and equity of continually revising laws regarding such repayments. There has been long standing worry that the government is soft on financial law breaking and will always try to bail out unwise investors especially when investments are carried out on a large scale.

4.4.6 The effect of the Iraqi Invasion on Kuwait

The Iraqi regime is still holding 600 Kuwaiti citizens hostage in their jails and denies their existence. The families of these people are suffering tremendously as they are not aware of their whereabouts. The government tried through the United Nations and the Red Cross to free them but their efforts were not fruitful.

The destruction of Kuwait's infrastructure was enormous. The oil fields the major source of income for Kuwait was set on fire and refiners were bombed. Power stations and water desalination plants were destroyed. Other sectors were devastated by the Iraqi invasion with the total estimates of the invasion costing about \$59,983 million.

Kuwait was forced to liquidate up to \$60bn of its foreign investments that were held by KIA and KIO to finance the government in exile and the military effort to

liberate Kuwait. Kuwait made its first foreign borrowings in December 1991 when it acquired \$5.5 billion from a consortium of 81 International banks. The first repayment was due on June 12th, 1995 with an instalment of \$800 million. In addition, Kuwait acquired credit lines of \$10 billion from USA, Japan, Canada and other European countries in 1992.

Table 4.4 - The Main Expenses of the General Budget Resulting from the Iraqi Invasion during the period 1/8/1990 -31/12/1991

Type of Expense	(Million Dollar)
1- Cost of financing military operations	24000
2- Cost of putting out oil fires	1500
3- Cost of removing mines	704
4- Emergency plan	1000
5- Support for the financial co-ordination of the gulf crisis	3700
6- Cost of living for Kuwaitis abroad	1000
7- Amiri grant	383
8- Write off the real estate loans	3497
9- Write off the social loans	40
10- Accruals for Public Housing Authority	2333
11- Retrospective salaries payments for Kuwaitis	1823
12- Write off of consumer loans	1293
13- Accruals for Ministry of Electricity and for the Ministry of Communication	277
14- Accruals for government properties	27
15- Exchange for pensioners' salaries	1713
16- Cost of salaries raise	1333
17- Cost of social care	60
Sub total	44683
Lost revenues from asset sales	3200
Lost revenues from oil production	12100
Total	59983

Source: Al-Ebraheem, 1993, p. 256.

Kuwait's feeble, defenceless status, especially after the Iraqi invasion and the continued threat of Iraq, made it more dependent on powerful countries like USA, UK, France. This dependence made it difficult for Kuwait to undertake decisions that might be unpopular with these allies. The oil price is one of the situations where Kuwait will be sensitive to the interests of these countries.

A positive outcome from the Iraqi invasion is the return of the Kuwaiti democratic experience after a 5 year period of absence. Kuwait gained its

rightful borders, which were looking to settle with Iraq since its independence. Kuwait's alliance with the USA as a protector of its solidarity made Kuwait less intimidated by Iraq.

4.5 Conclusion

The future of Kuwait will be shaped by the ability of the government and the parliament to undertake essential reforms in the economic life of the country. The budget deficit is a challenging and serious problem that requires a clearly defined strategy to curb it. Although, the government claims that it plans to balance the budget by the year 2000, its inability to cut the huge spending levels raise some concerns. Further, the government's attempt to boost the budget's non-oil revenue has not materialised yet.

The Kuwaiti parliament can play a major role in balancing the budget. However, it has failed so far to take the unpopular decisions to approve imposing taxes and other fees. The parliament's disapproval can be attributed to the unpopularity of such a measure with the Kuwaiti citizens. In addition, some parliament members believe that the government should reform its corrupted management style and cut spending levels before they approve the introduction of new fees. Acting as a watchdog over the government's actions, the parliament may control government spending and push for a balanced budget.

The development in the international oil market will also play a major role in Kuwait's future. Kuwait's ability to market its oil in new regions will play a major role in its economy. Securing stable and high revenues from oil will contribute to rebuilding Kuwait's portfolio of foreign investments.

Promoting the development of other sectors in the economy is fundamental. Success of the privatisation programme will be very significant to Kuwait as it will balance the role of the private and public sector in the economy. Expanding the role of the private sector will also increase the absorptive capacity of Kuwait's economy and repatriate Kuwaiti capital from abroad.

Chapter 5

The Development of Accounting and Auditing in Kuwait

5.1 Introduction

This chapter explores the historical development of accounting and auditing in Kuwait. Appreciation of such a process of development is an important element to understanding contemporary perceptions of auditing and its role in processes of management and accountability in KIO/KIA. This chapter starts by discussing the development of accounting over four distinct periods. The first period covers the development prior to the discovery of oil until 1959 when accounting was in its simplest form and there wasn't any kind of regulation of accounting practice. The second period spans two decades from 1960 to 1979, a period during which many of Kuwait's institutions and organisations were established, and which saw the first attempt to regulate the Kuwaiti accounting and auditing profession. The third period stretches from 1980 to 1989, when Kuwait experienced its biggest financial problems. This period also witnessed the introduction of a special examination for accountants who wanted to practice in Kuwait and the limiting of practising rights to Kuwaiti accountants. The final period, from 1990, considers some of the issues related to the development of auditing in Kuwait after the war, however the main discussion about this period are examined in chapter 8 as a part of the reflection of the KIO scandal on auditing in Kuwait. The chapter closes by considering the nature of accounting education in Kuwait and discussing the various social factors affecting the accounting profession.

In constructing this historical review it was necessary to supplement reviews of the existing literature with information obtained from interviews with representatives of large, medium, and small sized auditing firms, officials from the Ministry of Commerce, and the auditor of Kuwait's Audit Bureau. This was done to overcome the scarcity of available literature on the subject. Additionally, some information had to be specially commissioned from the Ministry of Commerce. The ministry, even though it was the regulator of the accounting profession, does not keep any systematic form of statistics on auditing firms and auditors in Kuwait, and only provided the information as a response to my special request.

5.2 The Development of Accounting in Kuwait

5.2.1 The Undeveloped Period (Before The Discovery Of The Oil - 1960)

This period in Kuwait was characterised by its simplicity, the small scale of business activity and the dependence on foreign sources, such as India and Britain, for trade, protection and education. Accounting was in its simplest form in this period. The single entry method was used for registering quantities sold and purchased by merchants (Shuaib, 1974). The foundations of accounting in Kuwait can be traced to the Indian Commercial Law (Hasan, 1984, p.22, Al-Mousawi, 1986, p.83). Accounting was called Blanguo in Kuwait, the Indian word for accounting, with most of the early accounting practices being based on Indian methods of accounting. Also the accounting principles of neighbouring countries were adopted (Bazie¹). There was no statutory requirement for auditing at that time and accountants were not required to register with any professional body.

Prior to the 1950's ownership of enterprises in Kuwait was characterised by single (or family) ownership. These kinds of establishments were not seen to require the services of an auditor, as the owner (or one of his trusted relatives) was also managing the company and handling its accounts. Historical reports of accounting before the discovery of oil are scarce but it has been argued that British companies introduced the first auditors in to Kuwait, as they did in Iraq and Egypt (Jones, 1981). The British Bank for the Middle East was established in the early 1940's in Kuwait. The bank utilised the services of the international accounting firms (Al-Hajeri, 1992). Bazie suggested that the bank might have used the service of Whinney Murray in Iraq.

Kuwait's economic development in the early 1950's led to the establishment of the first shareholding company in Kuwait. These kinds of corporations distanced

¹ Mr Bader Al-Baize was the first Kuwaiti accountant to be registered in Kuwait. He is a senior partner in Arthur Anderson.

the owners from the management of the organisation. Owners voluntarily chose to hire auditors to attest to the credibility of the manager's financial statements. The National Bank of Kuwait (NBK) made history in 1952 as Kuwait's first stock holding company. The British managers of NBK sought a sophisticated accounting system for the bank, hence they hired Russell & Co., a London based accounting firm, to design the accounting system of the Kuwaiti bank. Having accomplished their task, Russell & Co. returned to London, turning down NBK's solicitations for establishment of a permanent office in Kuwait to audit the bank and any other related corporations that might be set up in the near future. At that time, the founders and managers of the bank had felt that it was crucial for NBK to be audited by an international accounting firm if it was going to set up relations with foreign banks, as such banks usually liked to see the financial statements of their counterparts audited by such firms. The problem for NBK was that no qualified auditing firm was present in Kuwait at that time.

NBK duly approached a branch of the British accounting firm Whinney Murray & Co. (WM) in Basra-Iraq and WM opened their office in Kuwait in 1952 with clients such as NBK, the *British Bank for the Middle East*, and *Crane Makanzie*. The latter were established in Kuwait long before 1952 but they were audited by WM's branch in Basra. Oil companies working in Kuwait at that time were also a client of WM. The partners of WM were British and gradually businessmen and enterprises started to use the accounting and consulting services of WM in Kuwait. The absence of Kuwaiti accounting regulation and principles led to WM adopting British accounting regulation and principles in their work in Kuwait. The Lebanese accounting firm, Saba & Co., became the second international firm to be founded in Kuwait during the 1950's. This firm had a number of offices in several Arabian countries as a result of its association with the Arabic Bank. This connection had enabled Saba & Co. to become one of the biggest audit firms in the region at that time. After enacting the Tax Law of 1955, the government of Kuwait engaged Peat Marwick Mitchell to audit the tax accounts levied on the Kuwait Oil Company. Peat Marwick utilised some of the services of WM in Kuwait as they had not yet established their own office in Kuwait. During this

period there was no formal accounting education of any kind in Kuwait. Except for some of the Kuwaitis who learned accounting methods from India and Bahrain, most accounting education experience was gained through personal experience.

5.2.2 The Maturity Period (1960 - 1979)

The increase in the number of share-holding companies and limited companies led to the enactment of a few laws that regulated the commercial activities and auditing activities in Kuwait. The first statutory requirement of auditing was established by the *Law of Commercial Companies* in 1960. This law required share-holding companies to appoint one auditor or more to attest their financial statements. The Law prohibited the auditor from holding a position in, or doing business with, the audited company. The auditor was also given the right to examine all the accounting records of these companies whenever he desired and to attend the annual meeting and assert his opinion in that meeting with reference to his work.

The government started to regulate the accounting profession in 1962, enacting Law No. 6, *the Practice of Audit of Accounts*. Shuaib argued that the Kuwaiti government's move to regulate the profession was aimed at permitting only competent accountants to practice (Shuaib, 1974, p.73). Accountants were required by this law to be registered with the Ministry of Commerce and Industry's register of auditors. Enrolment in that register was subject to satisfying the following requirements:

1. A bachelor's degree in business or its equivalent, with some study having been in accounting.
2. Membership in one of the institutes or societies approved by the Ministry of Commerce and Industry; or having practical accounting experience of three successive years².

² The law defined experience as that gained through either one of the following. a) working in auditing firm, b) working in public or private companies, c) working in government departments, d) teaching accounting or auditing, e) practising in his own auditing firm before the enactment of the law.

3. Kuwaiti citizenship (although the Minister of Commerce had the authority to licence a non-Kuwaiti to practice accounting and auditing for the period of five years, renewable it for another period of five years).
4. A good moral character with no criminal or civil history.
5. Over 25 years of age.

Therefore, under this law accountants were required to present a bachelor degree and a proof of their practical experience only. There wasn't any requirement to pass any examination - any person possessing the above qualifications was eligible to practice. The 1962 law prohibited the accountant from involvement in any job that was in conflict with the accounting profession. The auditor was also discouraged from acquiring audit work through solicitation or means that would be damaging (such as paying commission for acquiring clients or soliciting other firms clients by offering a lower fee) to the prestige of accounting profession.

Shuaib (1978) suggested that the laws of 1960 and 1962 improved the practice of accounting in Kuwait as they highlighted the importance of accounting by imposing certain requirements for entry into the accounting profession. However, such claims have some limitations for when these regulations were enacted there wasn't any Kuwaiti accountant practising in Kuwait. The first Kuwaiti accountant to be licensed to practice was in 1967 (see Table 5.1).

Table 5.1- Kuwaiti Registered Accountants 1966-1988

Year	Number of Accountants	Year	Number of Accountants	Year	Number of Accountants
1966	0	1974	11	1982	36
1967	1	1975	14	1983	39
1968	3	1976	16	1984	40
1969	3	1977	19	1985	40
1970	4	1978	21	1986	40
1971	7	1979	23	1987	42
1972	8	1980	26	1988	48
1973	10	1981	36		

Source: Al-Mousawi (1989)

The 1960's and 1970's was the establishment of important organisations in Kuwait. These included Kuwait Audit Bureau, Kuwaiti Accountants and Auditors Association, and the Central Bank of Kuwait. The Audit Bureau was

set up in 1964 as an independent commission for financial control and was attached to the national assembly. The plan to establish the Bureau first emerged in 1954 when the government realised the need for more sophisticated methods to handle its rapidly expanding budget. An Egyptian accounting expert was hired to design and organise the Audit Bureau. The main objective of the Audit Bureau was specified as being to maintain an effective control over public funds: to safeguard them, prevent any misuse and verify their proper utilisation for the purposes they have been allocated for (Audit Bureau, 1985, p.17). Nowadays, the Bureau audits all government ministries, departments and public agencies. Moreover, institutions and organisations controlled by the government (such as the Kuwait Investment Authority and Kuwait Petroleum Corporation) also fall under its jurisdictions, together with any companies in which the government holds a 50% or more ownership stake.

In 1968 Law No. 32 was issued to establish the Central Bank of Kuwait and organise the work of the bank and Kuwait's monetary sector. The law gave the Bank with wide powers to supervise the banking and financing sectors. Their importance saw one article of the law being concerned solely with the work of the auditor in these vital sectors. The law obliged the auditor to disclose the methods and procedures he adopted in attesting and evaluating assets and liabilities. It also required auditors to furnish a copy of their report to the Governor of the Central Bank, disclosing any transactions which are not in compliance with the Law of the Central Bank or other relevant regulations. The auditor is required to verify and sign any accounts and records of the auditee whenever the Central Bank requests it do so. Furthermore, the law forbids the auditor from accepting loans from banks being audited.

The Kuwaiti Association of Accountants and Auditors (KAAA) in 1973 was established by government accountants to represent local accountants in all matters affecting their profession. The absence of any prior professional accounting organisation before was attributed by Fakhra (1996b) to inadequate education, the domination of accounting practice by non-Kuwaitis, limited and unorganised local markets, ineffective legislation and the political instability of

the 1960's (for details see Fakhra, 1996b). He also sighted the growth in the number of accounting firms and lack of strict accounting regulations behind the establishment of KAAA. On the other hand, Malallah argued that the general dissatisfaction of accountants with the government had led to the establishment of the KAAA (Malallah, 1983). The constitution of KAAA listed the following objectives:

1. Raise the professional and educational level of its members.
2. Protect the rights of members and guarantee their future when they retire or became disabled or sick.
3. Keep members informed about the recent developments in accounting.
4. Propagate the development of accounting and sponsor accounting research.
5. Participate in the development of accounting standards and regulations and try to maintain a high level of qualifications for registered accountants.
6. Cooperate with other societies either locally or internationally.

KAAA has been criticised for its poor contribution to the Kuwaiti accounting profession. El-Azma and Al-Bassam attributed this to

“...the lack of a general framework as to how accounting standards should be set in Kuwait, and of any form of co-ordination among governmental agencies and other parties concerned with financial reporting...” (El-Azma and Al-Bassam, 1987, p.348).

The lack of action on the part of KAAA in the 1970's has been attributed to internal deficiencies and to environmental circumstances prevailing during that era. Fakhra (1996a) claimed that administrative factors within KAAA, namely the part time employment of its staff, the fact the board members were not remunerated, and the lack of experienced people in the appropriate fields. He also indicated that the KAAA prepared three draft laws between the period of 1973-1980 to replace the existing law on the practice of auditing but the economic and political conditions of the time stopped them from taking place.

The KAAA's inability to address the improvement of accounting standards might be justified in that it didn't want to provoke the government who could have cut its financial assistance. KAAA's lack of legal authority to impose and issue regulations or standards led to criticisms that it had failed to guide the profession (Malallah, 1983). The persistent situation in Kuwait where accountants opt to work in the governmental sector rather in accounting firms coupled, with non-Kuwaiti accountants registering with foreign accounting societies has also been held to have hindered the development of the KAAA. Malallah (1983) claimed that governmental accountants are unaware and disinterested in the problems facing professional accountants, while the absence of qualified personnel and resources have led members to adopt a negative attitude towards the association and its activities.

The first official accounting education system was introduced by the Kuwaiti government in 1963 through the establishment of a Secondary School of Commerce. This was basically a system geared towards satisfying the needs of the public and the private sector for bookkeepers, administrators, secretaries and clerks (Shuaib, 1974, p.76). In 1967, Kuwait University established the Faculty of Commerce, Economic and Political Science. This faculty offered Kuwaitis, for the first time, the chance to acquire a bachelor degree in accounting in Kuwait. Another opportunity to study accounting in Kuwait emerged in 1975 when the *Business Institute*³ was established. The Business Institute is a two-year polytechnic that offers diplomas in different business fields including accounting. The graduates of this institute are not allowed to practice auditing in Kuwait, as they do not satisfy the legal requirement of having a bachelor study.

The 1960s saw further development of accounting firms in Kuwait, when Egyptian accounting firms initially became established in Kuwait. Even though these firms were highly regarded and successful, they did not spread in the area because they usually had one partner and would cease to exist when the partner became old or dies. Bader Bazie constituted the first Kuwaiti accounting firm in

1963. The economy of Kuwait grew substantially in the seventies as oil prices reached their highest level. The growth in the economy led to the establishment of numerous private corporations. Consequently, the number of accounting firms increased as result of the demand for their services. Also, the number of Kuwaitis starting to enter the audit profession increased substantially. Mr Bazie was in partnership with Arthur Young since 1967. In the late Seventies Price Waterhouse was established in Kuwait with Talal Abu-Ghazaleh (Deloitte, 1984, p. 42). Peat Marwick Mitchell opened an office in Kuwait in 1975. Touche Ross built a partnership with Jasem Al-Fahad in Kuwait in 1978.

5.2.3 The 'Kuwaitization' Period (1980 - 1990)

This period witnessed three important developments. First, a new auditing law was passed and a committee was set up to draft accounting standards. The two developments can be seen as contributing to the 'Kuwaitization' of the accounting profession, with non-Kuwaitis not being allowed to practice after 1986 and accounting guidelines being drafted to meet the needs of the Kuwaiti environment. This period also saw the collapse of Souk Al-Manakh, creating one of the country's biggest financial problems.

The most important development in Kuwait's auditing history was the enactment of Law No. 5 (Practice of Auditing) in January 1981 which superseded Law No. 6 of 1962. The need for this law stemmed from the concern that the auditing firms were deviating from their original practice - being involved in managerial consulting services and underwriting of corporations. Fakhra (1996a) identified other influential factors including the lobbying of KAAA⁴ for such a law (since KAAA's inception in 1973) and the growth in shareholding companies and the stock market. The law consisted of three sections. The first section discussed the general requirement for registering and practising in Kuwait. The second section

³ The name of the *Business Institute* has been changed to the *College of Business Studies* in 1986.

⁴ The KAAA wrote to the Minister of Commerce in 1973 highlighting preservation of public interest as a top priority and their plans for drafting an amendment to Law 6/1962. The letter indicated that Law 6/1962 only provided the minimum in comparison to the laws of other

listed the duties and responsibilities of auditors and the third section focused on the disciplinary actions that can be imposed on auditors in cases where they were negligent or not in compliance with the laws.

The new law increased the required experience⁵ period for Type "A"⁶ auditors from 5 years to 7 years. The experience period for type "B" auditors was also increased from 3 years to 5 years. A requirement was also introduced for 'would be' auditors to pass a specific test prepared by the Ministry of Commerce. The first test was undertaken in 1984. However, the low success rate prompted KAAA to ask the Ministry if it could prepare the exam. However, there was no response from the Ministry until the end of the 1980's (Fakhra, 1996a). The law also prohibited non-Kuwaitis from practising in Kuwait from 1986. It also approved the establishment of partnerships of more than one accountant to audit the financial reports of companies, with the stipulation that the person responsible for the audit is known and personally signs the audit report. Moreover, the legislator made it clear that the auditor is prohibited from doing the following:

1. Provide management advisory services.
2. Underwriting services for new companies.
3. Handling bookkeeping and the preparation of financial statements for their audit clients.
4. Advertising for his office or acquire any work through any improper methods.
5. Not accept a job in a stock-holding company.

Fakhra (1996a) concluded that the new law restricted access of the new accountants to the auditing profession, which was to the benefit of the practitioners of that time. His analysis of the new law and the law draft prepared

countries. The KAAA also recommended suspending the registration of Non-Kuwaitis (for more details see Fakhra, 1996b).

⁵ The required experience involved one of the following: a) work as an auditor in an auditing firm; b) work as an accountant or auditor in companies or organisations or public authorities or private authorities; c) work as an accountant or auditor in a governmental agency.

by KAAA revealed that if the KAAA draft had been adopted more qualified accountants would have been able to practice in Kuwait (see Fakhra, 1996a). He indicated that this showed the political dimension of the auditing function in Kuwait as the legislator was in favour of limiting the number of people who could pursue the audit function. Others have echoed these claims, emphasising the timing of the enactment of this law - which came a less than one month before the return of the parliament after having been dissolved for four years and a half (Al-Muhasiboon, December 1997, p.5). While the experience of professionalisation in the UK and USA demonstrate the self-interested role of profession in limiting access to accounting practice (Lee, 1995), the experience in Kuwait contradicts this situation as the government in this case was the one limiting access to the audit market.

Malallah believed that the shortcomings in Law No. 5 of 1981 was the result of lack of any direct input from the accounting firms. One of the criticisms of the law has been that it is more concerned with the length of auditing experience rather than the quality of the experience received. The failure to establish some kind of continuing education for auditors is another noted defect in the law (Malallah, 1983).

The second major development in this period was the Ministry of Commerce's establishment of the *Permanent Technical Committee for Setting Accounting Rules* (PTCSAR) in 1981 in order to improve the structure of accounting practice. The PTCSAR Charter outlined the objectives of the committee. They were as follows:

1. Establishing rules of conduct to which auditors should adhere.
2. Promulgating accounting standards and rules to be adopted in preparing financial statements.
3. Determining the minimum required financial information to be included in financial statements.

⁶ Type "A" auditors are licensed to audit all firms in Kuwait, while Type "B" are restricted from auditing Banks and Insurance companies.

4. Periodic Assessment of accounting standards and rules.
5. Conducting research to improve the auditing profession.

Every three-year term a new committee has to be chosen. While the committee does not have the authority to issue standards or rules, which are the sole right of the Ministry of Commerce, it communicates its findings to the Ministry in the form of recommendations. The first committee consisted of five members, three from the Ministry of Commerce, one from KAAA, and one from Kuwait University. The committee did not establish or promulgate any accounting standard during its first three years of sessions. One reason for this failure might be that members of the committee were directing most of their attention during that time to Al-Manakh crisis. Other reasons include governmental bureaucracy and the fact that none of the members were working full time in the committee (Al-Hajeri, 1992). In 1986 the Second PTCSAR was established with a slight difference in the arrangement of its members. The number of members increased from five to seven, which meant increasing the number of members from Kuwait University by two. Another change was the replacement of the KAAA member by one from the Kuwaiti Stock Exchange. The efforts of this PTCSAR resulted in the presentation of three recommendations for accounting guides. The Ministry of Commerce in its part enacted these guides, making them the basis for preparing financial statements in Kuwait. These guides consisted of the following: 1-Financial statements' guidelines; 2-The investment accounting guide; 3-The property accounting guide.

One of the main reasons cited for PTCSAR's inadequate role in the development of the accounting profession in Kuwait is the lack of a clear strategy for research and development which rendered PTCSAR's work to be limited and not up to-date. PTCSAR was accused of working in isolation of the interested parties or concerned parties. Even though the committee claimed its work is conducted on the basis of professional task forces which issues exposure drafts to be examined and commented on by interested parties. Some researchers questioned the committee claim's emphasising, that there had been neither draft stages nor trail periods (Al-Hajeri, 1992; Al-Rashed, 1994b). A handful of accounting firms

were consulted with relevance to the guides, but they and the other users and preparers of financial statements had only one month to express their opinions with relevance to the guides before they were enacted by the Ministry.

Even though the government offered its full financial support for the PTCSAR, its guides were not enforced by the Ministry - the level of compliance with these laws was very low with a large number of companies and their auditors not adopting them. The impartiality of the committee was questioned as approximately 50% or more of members were government officials. Likewise, PTCSAR's concern with the impartiality of its functions led to it surrounding itself with excessive secrecy. The minutes of the meetings and its final reports were confidential and only few people could access them (Al-Rashed, 1994b), again illustrating the political dimensions of accounting and auditing regulation in Kuwait (Fakhra, 1996a).

This period also witnessed one of the most important problems in the history of Kuwait's financial history, namely the collapse of Souk Al-Manakh (the unofficial Kuwaiti Stock Market), at a cost of \$92bn. The Al-Manakh problem started in early 1980s with the enormous growth in number of Gulf (offshore) companies and closed companies, whose shares were traded on the Al-Manakh. This saw rising demand for accounting services and growth in the number of accounting firms. These firms devoted much of their time to the registration of new stocks with the authorities. (Malallah, 1983). Some of these firms even went as far as entering as underwriters of the companies they audited, which resulted in some of the auditors losing their independence.

In the summer of 1982, the Al-Manakh market collapsed as result of the failure of some of the biggest investors to fulfil their obligations. The aftermath of the collapse revealed the negligence of the accounting profession, both through the work of big firms and small firms. Darwiche (1986) identified some of the abuses committed by audit firms in Kuwait before the collapse of Souk Al-Manakh.

“Accountancy firms colluded with the boards of Kuwaiti and Gulf companies to submit inaccurate reports on their standing. Some auditors presented false statements and balance sheets that showed profits where there weren’t any. The boards paid dividends of 15 or 20 per cent by drawing from capital.” (Darwiche, 1986, p.98).

Another criticism of the audit firms was that they kept quiet with regards to the private and public companies speculative use of resources in speculation in the Al-Manakh market, which often violated their corporate charter (Malallah, 1983, Abdul Raheem and Al-Jumah, 1989). Al-Hajeri (1992) examined the causes of the Al-Manakh crises through a questionnaire survey in Kuwait. The majority of the respondents, (who were accountants and people concerned with the profession) agreed that the lack of adequate accounting information had been one of the causes of the crises (Al-Hajeri, 1992). While it has been argued that the foreign audit firms were less culpable in the Al-Manakh crisis (see Al-Hajeri, 1992), others (e.g. Al-Mudhaf, 1990; Darwiche, 1986) have argued that they were clearly implicated in the crises.

Although the Kuwaiti commercial law did not discuss either implicitly or explicitly the right of shareholders to pursue audit firms in the courts for their negligence (Al-Bassam, 1983, p.28), these failures were pursued in Kuwait’s legal courts for the first time in the country’s history. As Shuaib noted:

“Until 1980, there had been no negative public concerns or lawsuits against practitioners. As a result of the stock market crash in 1982, some cases were brought against the auditors. This fact raises the question as to how to determine the liability of the auditor in the absence of generally accepted accounting and auditing standards” (Shuaib, 1987, p.383).

However, there are no available reports about the outcome of these claims or if they indeed were heard in court. On the other hand, a governmental committee from the *Fatwa and Legislation Department* was set up after the collapse of Al-Manakh to investigate the actions of the closed share-holding companies. The committee concluded that the founders of 39 companies had committed serious offences. The committee also recommended disciplinary actions for nine auditors for breaching the Audit Law No.5 of 1981 (Al-Qabas, 29/6/94). The committee’s recommendations, however, were not implemented. The head of the

committee was contacted to acquire a copy of the report. He indicated that a copy of the report can only be provided from the Council of Ministers, but the council subsequently refused to release the report claiming that the council does not have a direct contact with members of the public.

The collapse of the Al-Manakh market in 1982 prompted the Committee of the Stock Exchange to develop its own set of rules and regulations. It also issued Law 1/1985 stipulating the presentation of semi-annual reports of companies listed on the Kuwaiti stock exchange. The Kuwaiti stock exchange also issued an Auditing Guideline for attesting semi-annual information. This was designed to offer some guidance to auditors, requiring them to follow a specific prescribed procedure in examining the semi-annual financial statements

At that time, a Kuwaiti accounting firms associated with the Big Eight international firms controlled the audit market. For instance, Shuaib (1986) showed that 44 out of the 48 companies listed on the Kuwait Stock Exchange in 1982 were audited by firms associated with the Big Eight, that is 92% of listed companies were audited by these firms (see Table 5.2).

Table 5.2- Number of Listed Companies in the Kuwaiti Stock Market Audited by Selected Audit Firms in 1982.

Audit Firms	No. Of Companies audited by each firm	Association with the "Big Eight"
Al-Massed	8	Ernst & Whinny
Bader Bazie	17	Arthur Young & Co.
Saba & Co.	2	Touche Ross & Co.
Talal Abu-Ghazaleh	17	Price Waterhouse
Total	44	

Source: (Shuaib, 1986, p.161)

The Ministry of Commerce and Industry established (in early 1980s) a department to deal with the organisation of the accounting profession in Kuwait. Starting from 1986, Law No.5/1981 prohibited non-Kuwaitis from practising accounting and auditing. The foreign accounting firms had either to find a Kuwaiti partner or to leave the country. Some of the firms did leave the country while the others enforced their presence with Kuwaiti partners. For instance, Ernst & Whinney re-established their firm with Kuwaiti partners in 1982.

This 1980s witnessed fluctuations in the partnerships between Kuwaiti firms and the international firms. Price Waterhouse partnership with Talal Abu- Ghazaleh did not last for long and Price Waterhouse's became associated with the International Audit Bureau in 1984 (Deloitte, 1984). A manager with Talal Abu- Ghazaleh claimed that his firm dissociated with Price Waterhouse because they felt that they had no need for the international auditing firms as they were the one who getting clients and not Price Waterhouse. Deloitte, Haskins & Sells was associated with Saif Al-Saadoon in 1984 but it seems that it left Kuwait after the law forbid the practice of non-Kuwaitis. Peat Marwick Mitchell closed its office in Kuwait in 1981 only to re-establish a partnership with Masaud Serkhoh in 1986. Arthur Anderson entered into a partnership in Kuwait in 1986 with a Kuwait partner, Mr Ali Al-Hasawi, but again things did not work out and it terminated the partnership. In 1989 the merger of Ernst & Whinney with Arthur Young formed Ernst & Young in the UK and Kuwait. Mr Bader Bazie, a Senior Partner in AY, declined the offer of a merger. He asserted that E&W and Arthur Young were the biggest firms in Kuwait and if the merger went through they would control 60% of Kuwait's audit market. Controlling this huge share of the audit market was socially not acceptable. On the other hand, Mr Al-Osami, a Kuwaiti partner in EY, claimed that the merger issue was a confidential matter for the firm and he would only say that the merger didn't go through because the Ministry of Commerce and Industry was reluctant to approve the merger. He indicated that the Ministry made this decision to avoid a monopoly in the Kuwaiti audit market.

5.2.4 The Post Gulf War Period

The post gulf-war period has witnessed a greater role for accounting and auditing in Kuwait. In 1990 the Ministry of Commerce and Industry issued a resolution to make all share-holding companies and limited liability corporations in Kuwait adopt the International Accounting Standards (IAS) issued by the International Accounting Standards Board. Based on the recommendations of the permanent Technical Committee, the Ministry of Commerce can prevent these companies from adopting principles that are not relevant to Kuwait. Also PTCSAR can

suggest the accounting principles that are relevant to Kuwait and not covered by the international standards. This decision superseded another one imposed in 1987 to adopt a prescribed principle for preparing the financial statements. This decision was scheduled to be effective from January 1991 but it was postponed as a result of the Iraq invasion of Kuwait. Shuaib and Douglas (1996) concluded from their analysis of reporting practices in the banking industry in 1982 and 1995 that they had improved as a result of the adoption of IAS. For example he showed that the widespread practice where banks created secret inner reserves was abandoned after the adoption of IAS. In their study of accounting evaluation of fixed assets in shareholding companies, Abdul Rahim *et al* (1996) have shown that IAS are suitable for implementation in such companies. They also found widespread support for adoption of IAS by these companies.

The impact of Iraq's invasion of Kuwait not only saw the postponement of the adoption of International accounting standards, but also created other problems for accountants and auditors in Kuwait. Shortly after the liberation of Kuwait accountants and auditors were faced with the problem of missing or destroyed accounting data and records. A ministerial resolution No./110 was issued in 1991 as a basis for reporting losses and unusual transactions resulted from the Gulf War. As for the problem of preparing the financial statements for the financial year during the invasion, this was resolved before Kuwait was liberated when the exiled government issued law No. 4/A 1990 which propagated that the financial year of 1990 would be extended to include 1991. The UN resolution No.687 for 1991 propagated that those companies and individuals which had suffered emotional and material losses from the Iraqi invasion would be compensated through a special account set up from Iraq's sale of oil. The Big Six firms, including Price Waterhouse, took a major role in preparing applications for war compensation for companies, institutions and organisations in Kuwait. Price Waterhouse and the international law firm Bryan Cave were hired by the Kuwaiti government to prepare the compensation forms for institutions and organisations controlled by the government.

The destruction Kuwait suffered during the war put significant pressure on the government's budget deficit. Hence, the government thought seriously of privatising its highly subsidised utility services. The Big Six acted as consultants for the government's proposed privatisation plans in Kuwait. For instance, Coopers & Lybrand studied the plans for privatising the government owned telephone services. Another proposal for tackling the budget deficit was parliamentary proposal for the introduction of taxes in Kuwait as a source of revenue to finance the budget deficit in the short run and to constitute a long-term revenue for the government budget. If such a proposal came to fruition this would have translated into a larger role for the accounting firms in general and for the Big Six in particular, given their international taxation knowledge. The post-war reconstruction of Kuwait also aided the Big Six in Kuwait, in that they served as financial advisors for many international companies involved in building and construction projects.

The Big Six monopoly on the audit market in Kuwait was challenged in an interview by a partner at E&Y, claiming that Kuwait is adopting an open market policy and that there is no monopoly. He attributed their firms domination of the market as an outcome of their long history in Kuwait. For example, Ernst Young and its predecessor firms have audited the National Bank of Kuwait since 1952. However, his arguments does not explain how Coopers & Lybrand (who were only established in Kuwait in 1991) had increased their listed clients from 2 to 13 in two years. In addition, the E&Y partner indicated that currently competition is hard and requires enormous efforts on the part of the firms to maintain market share. Another partner at a small audit firm claimed that the monopoly is justified as the Big Six firms have the required means (large staff, extensive training, supervision through international partners) for auditing large companies. The small firms do not have the required means for auditing big companies in Kuwait.

Medium and small size audit firms also have a role in Kuwait's audit market. The medium size firms can be characterised by their association to smaller international⁷ auditing firms, and by being larger in size in comparison to the small firms, and by the full time participation of their partners. The majority of the medium size firms' clients include limited companies, individual companies and a small number of public and closed share-holding companies. The number of firms in this category is also small. The small audit firms, which represent the highest number of firms in Kuwait, are characterised by their small staff, and their part time partners' participation. The average number of auditors in these firms is less than five auditors, while the partners in these firms work in the government or companies in the morning and work in their firms in the afternoon

Recently the accounting program at Kuwait University had a face-lift. Changes being contemplated include an American based courses system, featuring an accounting curriculum partially taught in English. The changes are seeking to eradicate the problems of the previous accounting education system at Kuwait University. One of the major disadvantages of the current accounting education program is that little change in the program has taken place since 1967 and the recent developments in accounting have not been accommodated well. The program neglects auditing and fails to promote it as an important service (Malallah, 1983, p.116). In addition, the program lacks the practical orientation of accounting as it emphasises on the theory side of accounting. Furthermore, there is a lack of both the emphasis on the local environment and few textbooks with a local orientation. The shortage of accounting educators and the subsequent lack of research with relevance to accounting in Kuwait are a major problem for the profession (Al-Hajeri, 1992, p.203).

In 1990 Mr Bader Bazie and a fellow became the partners representing Arthur Andersen's worldwide partnership in Kuwait. Coopers & Lybrand entered Kuwait's audit market after the liberation of Kuwait. Mr Bader Al-Wazan, the

⁷ International Audit Bureau is a Member of Horwath International. Al-Fouz International Audit Bureau is a member of Urbach Hacker Young Worldwide. Bouresli Auditing Office is member

sole Kuwaiti partner, was in partnership with a firm called Spicer & Pegler since 1980. But he opted for a partnership with Coopers & Lybrand 1991. Since the Gulf War, Price Waterhouse tried and still trying to build up a new partnership in Kuwait. As it been discussed earlier Price Waterhouse through their office in Bahrain was hired by the Kuwaiti government to prepare the war compensation forms.

5.3 The Changing Nature of Social Attitudes to Accountants and Auditors

The problem for the accounting profession in Kuwait and KAAA is that their role and regulations will not be taken seriously unless backed up by government support, as an average citizen regards government support as constituting credibility. Although Shuaib (1995) supports standard setting by the profession he thinks that it is more appropriate for the government to undertake such a role given the limited resources of the profession. The accounting profession in Kuwait suffers from a shortage of Kuwaitis. This shortage can be attributed to factors such as the low wages of these firms, the long training period (5 to 7 years) and the prestige/benefits associated with working in the government or elsewhere in the private sector. A major factor for this shortage is that the accounting profession is not highly regarded in Kuwaiti society. This phenomena was asserted by Al-Hajeri

“Some of the problems of accounting in Kuwait can be put down to the fact that accountancy is not socially widely accepted as a profession nor regarded as important. It is regarded by a large sector of the society as a bookkeeping or money collecting (cashier) function. This view negatively affects the advancement of the accounting profession in Kuwait, and most Kuwaiti families prefer to educate their sons for more socially acceptable professions such as medicine and engineering. Even those who study accountancy prefer to join a government department in order to maximise their status.”(Al-Hajeri, 1992, Vol. II, p.175)

It has been argued by some researchers (see Malallah, 1983, Al-Hajeri, 1992,) that one of the major social influences on the development of the accounting

profession is the desire of the wealthy families of Kuwait for loose regulations to protect their interest. The situation was best explained by Malallah (1983, pp.169-170)

“The Kuwaiti business environment.....is characterised by the existence of large, privately held companies, which are controlled by a small number of big wealthy families. To protect the interest of their owners, these companies have resorted to secrecy and the protection of information from outsiders. Accordingly, accounting firms have been forced to submit to the pressure of these big clients, which led to financial reporting practices being characterised by undervaluation, hidden reserves and minimum disclosure.”

There is a tendency in Kuwait to believe that accounting information is just a formality. For example a manager of Coopers & Lybrand in Kuwait in response to an inquiry about the disinterest of clients in computerised audit claimed that the majority of clients do not care about the quality of the audit, they think its only a formality to be presented to the shareholders and the Ministry of Commerce. (Al-Hajji, 1993, p.121)

Family and social relations and friendship play a major role in the way auditors are hired by the management of companies. The importance of relations and connections has been confirmed by auditors from small and medium size firms, by KAAA and by members of parliament (Al-Qabas, 1994). These relations are what some auditors are claiming to be the motive behind some Big Six firms having more clients than others. KAAA claimed that it wouldn't be able to eradicate this practice yet it can contribute in cutting it down if better coordination could be set up between the Ministry of Commerce and KAAA to put a cap on audit fees and place a limit on the number of years over which an audit firm can act as an auditor of a specific client. KAAA believed that the requirement for two auditors would diminish the disadvantages of having audit firms with relationships or friendships with the members of the board of some share-holding companies. (Al-Anaba, 2/6/94, p.22)

Family relations and friendships are also claimed to be an important factor in getting in getting access to information about the financial status of companies and corporations. Al-Mosawi indicated that

“...the influence of family and friendship are considered very important among people in the country. This has led to users in general having access to companies' financial information. This together with the fast spread of news due to the small size of the country and widespread of Diwanias, gathering centres, lead the release of financial information in spite of the lack of financial information disclosure by companies”(1986, p.93)

The establishment of the international firms in Kuwait can be attributed to the perception that local firms are considered to be more efficient when associated with these firms. Al-Mudhaf highlighted this idea:

“...As a part of the process of gaining credibility, a number of auditing firms in Kuwait have affiliated themselves with international auditing firms in order to be perceived as competent and hence gain the credibility of their clients and the users of financial statements”(Al-Mudhaf, 1990, p.218)

The trend of association with international accounting firms seems to be on the increase in Kuwait. Several medium and small size audit firms in Kuwait have established some kind of relationship with international audit firms (See Table 5.3 for a list of the audit firms with their international associations). This trend might have resulted from the belief that international firms will be exerting pressure on their local partners to act more professionally to keep up the reputed image of the international firm. Another factor is that the desire of local accounting firms to provide better accounting services for private business might have led them to closer professional ties with international accounting firms. The international firm's knowledge and professional experience are claimed to be valuable tools for a better service and a way to improve the local profession (Al-Mudhaf, 1990, p.220). In today's global market various kinds of corporations are seeking business opportunities in any potential part of the world. To be able to grow in this era bank, investment organisations, insurance corporations, and industrial companies have sought to establish relations with overseas counterparts. To strengthen these relations, such organisations usually would like

to see the financial statements of their business partners audited by accounting firms familiar to them and in whom they trust. The association with reputed international firms means increasing the market share and revenue for both the local and international partners. As most of the large public share holding companies and the government owned organisations potentially could be expected to seek audits by these firms in order to build up business opportunities to these organisations in the world. Furthermore, the consulting services of these firms might be very rewarding as usually public companies and the government would require the advice and the consultation of professionals who are only available through the international practices of these firms.

Table 5.3 – Audit Firms in Kuwait and their International Association

Name of Firm	No. of Partners	No. of Employees	International Association
Abdulwahad Aman Public Accountants Office	1	7	
Al-Murtaja for Auditing and Accounting	1	9	
Al-Ahli Bureau Certified Accountants	2	11	
Al-Aiban, Osaimi & Partners	2	95	Member of Ernst & Young
Al-Asry Office For Auditing	1	8	
Al-Ateeqi Certified Accountants	1	18	Member of PKR International
Al-Baian For Accounting & Auditing	3	15	
Al-Bassam & Company	1		
Al-Dallal Audit Office	1	10	
Al-Dar Audit Bureau	3	17	Member of Abu-Ghazaleh Group
Al-Fahad Al-Marzook Deloitte & Touche	2		Member of Deloitte & Touche
Al-Faraj Auditing Office	1	10	
Al-Fouz Audit Bureau	1	8	Member of Urbak Hacker Young Worldwide
Ali Salem Taqi Auditors And Accountants	1	11	
Al-Koot Audit Centre	1	10	
Allied Accountants	3	13	Member of RSM International
Al-Waha Auditing Office	2	7	Member of International Accounting Group
Al-Wehda Auditing Office	2	13	
Bader & Company Coopers & Lybrand	4	35	Full Member Firm of Coopers & Lybrand International
Bader Al-Bazie & Co / Arthur Andersen	3	80	Member of Anderson International
Burqan Auditing Office	3	20	Member in BDO International
Experience Auditing House	2	10	Member of Kingston International
Fakhra Auditing Office	1		
Grant Thornton / Anwar Yousef Al-Qatami & Co	1	65	Grant Thornton International
International Auditing Bureau	1	35	Member of Horwath International
International Auditing Centre	1	15	
Jazira Auditing Office	1	17	
Legal Auditing Centre	3	10	
Masoud & Partners	4	35	Member Firm of KPMG
Middle East Auditing Bureau	1	7	Member of International Association of Practising Accountants (IAPA)
Nazar & Partners	2	15	Member of Nexia International
Tareq Boursli & Co.	1	12	Member of Pannell Keff Forster International
Technical Auditing Office	1	16	

Source: KAAA, 1998

The practical impact and the role of the international firms on the accounting profession in Kuwait, however, are not known. Al-Mudhaf (1990) conducted a very limited study aimed at finding out whether investors and lenders differentiate between financial reports verified by international firms or local firms. The result of the al-Mudhaf study suggested that there is a perception of the international auditing firms as being more credible to investors and lenders than the small local firms.

According to Mr Bazie it was the Kuwaiti accountants in most cases who sought partnerships with the Big Six in Kuwait. The advantage of association with international firms is that the firm is acknowledged to be familiar with the latest developments in accounting though the training conducted by the international firms, the methods and software used by these firms. They also offer more opportunities for the audit firms' staff – giving them the opportunity to work in many countries around the world.

In his study of the factors that mostly affect auditor independence in Kuwait, Al-Rashed (1994a) found that auditors in Kuwait believed that small firms are more likely not to be independent while association with international firms will usually strengthen the independence of the auditor. Consulting services offered by audit firms and competition between these firms were also seen to some degree to compromise auditor independence.

5.4 Conclusion

The development of accounting and auditing in Kuwait has shown that the government has been the major force behind the regulation of the profession. It set the law of accounting practice in 1962 and then amended it in 1981 without much input from the accounting firms or the profession's representative, the KAAA. Another influential role for the government was in trying to set accounting standards. Throughout the history of accounting in Kuwait there have not been any Generally Accepted Accounting Principles (GAAP) adopted. The management and auditors have had the freedom to adopt any accounting principles they see fit (El-Azma, 1987, p.353). The international accounting

firms usually adopted their home country standards. The same can be assumed of both the multinational corporations working in Kuwait and the foreign accountants practising in Kuwait. Even though companies were required to prepare their financial reports based on the guides of PTCSAR since their enactment in 1987, there was compelling evidence that these guides were not adhered to (Al-Rashed, 1994b, p.54). The PTCSAR guides were abandoned in 1991, as companies were required to adopt the International Accounting Standards. The Accounting profession in Kuwait still lacks Generally Accepted Auditing Standards (GAAS). No professional requirements have been adopted by the local profession, as there are only statutory laws in Kuwait. The international firms are adopting their home countries' auditing standards. The absence of such standards could be problematic for the accounting profession in Kuwait. Shuaib argued that:

“The absence of defined audit standards has made it more difficult for the auditor to prove that he has done what a prudent and diligent auditor would do under the given circumstances in accordance with recognised auditing standards” (Shuaib, 1987, p.383)

However, practitioners and academics in Kuwait perceive the problem in accounting and auditing to be related to inadequate efforts in education and other measures to transcribe the Anglo-American accounting model. For example they pin the problems of the accounting profession in Kuwait on the lack of qualified accountants, lack of continuing accounting education and training and they expect that the profession will improve greatly if these measures are undertaken. This limited focus fails to recognise the limitations of the audit function and the myth surrounding it. Another aspect of which that a strong emphasis has been placed in Kuwait is the requirement for conceptual framework of accounting. Researchers are still promoting such a concept for advancing the audit function in Kuwait. However, these arguments fail to recognise the belief that the profession in Anglo-American contexts have engaged in such framework to maintain the status quo and fend off governmental regulation (Hines, 1991).

Another conclusion that can be drawn from this analysis of the history of the accounting profession in Kuwait's that concern and efforts are primarily geared towards entrance into the audit market rather than the quality of the audit function. Debates are focusing on the examination requirement, continuing education and required experience but not on the more practice related issues like the role of friendships and family in securing audit engagements, and the lack of disciplinary measures against disgruntled auditors.

Chapter 6

The Development of Accounting and Auditing in Spain

6.1 Introduction

The aim of this chapter is to highlight the development of accounting and auditing in Spain. In order to understand the role of accounting and auditing, it is crucial to examine the political, business and social environment in Spain. This development is also beneficial to understand the environment in which KIO started to invest its money from the mid-1980's. Accordingly this chapter will start with a brief history of Spain's political, economical and social dimensions. Then the chapter will discuss the development of accounting and auditing both before and after Spain became a member of the European Union. This division of the chapter is useful as most of the development in Spain's accounting profession emerged after joining the European Union.

6.2 The Spanish Environment

6.2.1 Political Background

Spain was under the rule of the Spanish dictator General Francisco Franco since the end of civil war in 1939 until his death in 1975. Franco ran the country under an authoritarian and centralised dictatorship (Bruton, 1995). There was only one political party and it is argued that Franco maintained power by balancing the opposition of elite groups against other groups and tolerating widespread corruption. Franco's regime sympathised with the fascist powers in Germany and Italy despite Spain's apparent neutrality in the Second World War. His regime was also engaged in violent oppression of the Spanish people even after the civil war. These factors led to Spain's isolation from the rest of Western Europe in most of the 1950s and 1960s. Franco chose Juan Carlos, the grandson of King Alfonso IV (Spain's previous monarch) as the heir apparent to succeed him after his death feeling that he would maintain his legacy. However, Juan Carlos' accession to the Spanish throne as King of Spain after the death of Franco in 1975 led to Spain's return to democracy. The new king was totally committed to democracy in Spain and started a transitional period from dictatorship to democracy in 1977 with the draft of the constitution in 1978. During that period, political parties were legalised and the constitution was drafted. The constitution

established Spain as a monarchy with parliamentary democracy. The pursuit of democracy also led to the devolution of political powers to other regions such as Catalonia and the Basque county having their own independent government. The Spanish parliament (*Cortes Generales*) is divided into two bodies the Congress (*Congreso de los Diputados*), the Lower house, and the Senate (*Senado*), the Upper house. There is no clear separation of powers in Spain. Instead, there exists a deliberate integration of executive and legislature via the government (Heywood, p. 89). The leftist - Socialist Party (*Partido Socialista Obrero Español* - PSOE) governed Spain under the leadership of the Prime Minister, Felipe González from 1982 to 1996. Under a socialist government, Spain joined the EEC, joined Nato and prospered economically. However, scandals came to dog the socialist party in the early 1990s and nearly caused them to lose the election in 1993 to the centre right - Popular Party (*Partido Popular* - PP). However, PP was duly successful in the 1996 general election and took over the government of Spain under the leadership of, José María Aznar. They continued to govern since recently winning the year 2000 general election. Spain has emerged from fragile democracy in 1970's to a strong democracy. The new Spanish prime minister saw the process of democracy as 'absolutely consolidated' through the achievement of three elements - a peaceful transition to democracy, the devolution of government and the pursuit of an open economy (Time, 17/11/97, p. 40).

6.2.2 Economic Background

The closeness of Franco's regime to the fascism during the Second World War and the regime's oppression of the Spanish people saw Spain being isolated from the rest of the world for many years after the war. The exclusion of Spain from the Marshal Aid Plan for Europe and the trade sanctions imposed by the United Nations on Spain (1946-1950) were clear examples of its isolation. This situation forced the Spanish regime to adopt policies of economic self-sufficiency and protectionism. Hooper (1995) even argued that this policy also coincided with the fascist doctrine of "emphasis on national economic independence and on agriculture rather than industrial development" (p.14). Accordingly, Franco's

regime imposed heavy restrictions on the movement of goods and people from and into Spain. This policy made agriculture the dominant sector in the Spanish economy and had a detrimental effect on the Spanish economy, almost leading to the bankruptcy of the Spanish state in the mid 1950s (Ross, 1997). Consequently, Franco drafted technocrats to address this problem – their work and recommendations of IMF culminated in the stabilisation plan of 1959 (*Plan de Estabilización*) that was based on the French model of inductive planning. It was responsible for creating the boom that was identified in Spain as the ‘economic miracle’ of the 1960s (Heywood, 1995). The plan proposed a package of actions that were implemented in the late 1950s to achieve short and long-term goals. The plan embarked on reducing public spending and credit. These actions instituted some form of liberalisation of the Spanish economy, allowing the import and export of goods, foreign trade, foreign investment in Spain and the migration of Spanish workforce. The Spanish laws were amended to enable foreign investors wholly to own Spanish corporations. Encouraging tourism was also part of the stabilisation plan.

These developments overall enabled Spain to move from an agrarian economy to an industrial one. Since the adoption of this plan, the map of occupational labour in Spain has changed dramatically from one where workforce was heavily dominated by agriculture to one with a much higher industrial base. The government established several industrial corporations and by the 1970s, the government was dominating the economy through the *Instituto Nacional de Industria* (INI) (National Institute for Industry) with INI holding a large portfolio of industrial companies in Spain. Spanish banks also control many of the companies in the economy, taking a more prominent role in providing capital than the stock market. The Spanish stock market was not as active and as important as those in other parts of Europe and the USA. This was attributed to the backward structure that followed the ‘economic miracle’ of the 1960s. However, the introduction of several reforms to the stock market and the establishment of the CNMV in 1989 have led to a growth in its activities. By the early 1980’s, the

World Bank, United Nations and the International Monetary Fund (IMF) considered Spain to be a developing country.

Around the time of death of General Franco, Spain was starting to experience the effect of the oil crisis of the 1970's. Inflation shot up to 20% and unemployment reached 7.1%, starting a trend of high unemployment that still present today. This period also saw more focus starting to be placed on establishing democracy – a concern with political process rather than on the economy. The real political developments started in 1982, with the socialist government coming to power. In 1984, it embarked on an industrial retransformation policy that involved cutting redundant labour, undertaking financial restructuring and adopting technical modernisation. The government secured Spain's admission to the European Commission (EC) in 1986. While the economy started to achieve real GDP growth, above the EC average (Bruton, 1995). Inflation substantially fell from 24.5% in 1977 to 4.9 (5.3% in 1987) in 1993 (Bruton, 1995, p. 39), although unemployment in Spain became the largest among the OECD countries, moving from 5.2% in 1977 to 22.7% in 1993 (Bruton, 1995, p.64). Foreign investments in Spain were boosted after Spain joined the EC, growing almost ten fold between 1982 in 1990 (Bruton, 1995). This growth was attributed to lower labour costs, growing domestic markets, political stability and financial incentives. However in the early 1990's, there was a concern that aggressive foreign investments were becoming detrimental to Spain's interest. Although, the government was keen to sell some of its public companies to foreigners, the law restricted acquisitions in the Spanish banking sector (reflecting the importance of the banking sector to the local economy). Spanish banks still hold significant holding in a large number of strategically important industries such as petrochemical, construction etc.

Spain was required as a member of the EC to modify its laws and regulations to those of the EC. Accordingly, several laws in Spain were introduced in the late 1980's to achieve this goal. These included the Audit Law of 19/1988, the *Law 19/1989 – Partial Reform and Adaptation of Commercial Legislation to EC Company Directives* and the stock market law (*the Ley de Reforma del Mercado de Valores*).

6.2.3 The Spanish Society

Tax evasion has traditionally been significant on both personal and business levels – interestingly it was only since 1977 that tax evasion was deemed as an offence in Spain. The history of the Spanish tax systems has been one of general inadequacy. There has been more reliance on indirect taxes which were easier to collect than direct taxes. Also, the tax administration has been cumbersome and there has been widespread evasion. One by-product of this unsatisfactory state of affairs has been the keeping of more than one set of accounting books which hindered progress towards providing reliable financial information (Donaghy and Laidler, 1982).

“Tax evasion, by those who have the opportunity to practice it, is still rife. According to a study carried out for the Instituto de Estudios Fiscales, half the income earned in Spain is undeclared. It is still common for companies to keep several sets of accounts, and in 1990 the president of Spanish employer’s federation described evasion as an ‘entrepreneurial necessity’. As for taxes on the buying and selling of property, it is reckoned that on average the parties to a transaction declare about one-third of the real price when the house or flat is new, and only a fifth or so if it is not.” (Hooper, 1995, p. 241).

Tax evasion was so prevalent in Spain that the government sought to attach what is commonly known and called in Spain as *Dinero Negro* (Black Money - or the undeclared assets held by individuals). The Spanish government’s actions led to the divulgence of Pts 3.4bn in 1989 and Pts 1.7bn in 1990 of *Dinero Negro* (for more details, see Hooper, 1995).

The nature and the importance of family and friends in Spanish society has a significant influence on the business environment. Family relations and friendships seem to have a great impact on employment in Spain – generally referred to as the phenomenon of *amiguismo* in Spain (jobs for the boys). Corruption in Spain is seen as one of the country’s ‘perverse norms’, considered acceptable at all levels of society (The Independent, 28/10/94, p. 12). Spanish entrepreneurs have also traditionally lived in hope of the *Pelotazo* (the ‘long ball’ or ‘big kick’) - that single stroke of luck or genius which will bring them a fortune overnight (Hooper, p. 188). This ‘get rich quick’ mentality overtook

Spain in the eighties, and not surprisingly had considerable impact in a society where operating at the margins were very much accepted. In Spain, the development of a good business relationship is very much tied up with the development of a good personal relationship. Mutual trust and understanding are regarded as very important and social situations facilitate their development (Bruton, 1994, p.107).

Since the late eighties Spain has witnessed some quite major political and financial scandals, starting with the Filesa scandal, where big companies were paying huge sums of money for consulting studies by Filesa - a company acting as a front for fund raising by POSE, the socialist party. Scandals have often involved high figures in the government, including government ministers, the governor of the Bank of Spain and, even to some degree, the Prime Minister. The range of scandals include using secret funds to finance the dirty war against ETA, the Basque terrorist group, tax evasion and share price manipulation, fraud and bribery, phone tapping and party financing (for more details see FT, 7-2-96, p.3). The increase in recent scandals is seen as making Spain a contender for supplanting Italy's reputation as the European corruption capital:.

“It has been [corruption] fruit of a stage that's now past. There is a graphic journalistic view that two or three years ago Spaniards awoke each morning, we put on the radio and we asked ourselves: What's the scandal of the day? That's finished. I believe today Spain is morally solid country. The recipe is simple: those governing have to be honest, and appear to be honest. Transparency is fundamental, and public spending has to be increasingly scrutinised. Law can help, but the critical factor is personal honesty.” (José María Aznar, Time, 17/11/1997, p. 41).

6.3 Development of Accounting and Auditing in Spain

6.3.1 Accounting and Auditing Pre-EC

The history of accounting in Spain can be traced back to the 14th century where research has shown that double entry bookkeeping was used in Mallorca (Gonzalo and Gallizo, 1992). Spain has enacted several commercial codes (in 1829, 1885, 1973 and 1989). The code of 1829 was concerned with providing merchants and traders with instructions on bookkeeping (Gonzalo and Gallizo, 1992). Historically accounting in Spain was identified with taxation rather than with financial accounting. In 1973, the *Plan General de Contabilidad* (PGC) (General Accounting Plan) prescribed the statutory accounting requirements for Spanish companies. Further legislation in 1970's and 1980's has amended this plan for some sectors.

The *Law of 1848 on Share-Issuing Companies* required the first form of auditing in Spain. The law required the civil governors of the provinces to check that the annual balance sheet was matching the company accounts. However, this requirement was short lived when that law was abolished by the 1868 decree of abolition of the 1848 law and regulations (Giner Inchausti, 1993a). Still in the early twentieth century, there was no statutory requirement for audited financial statements in Spain and consequently there were no professional accountants in Spain. Even in the limited situations where audited financial statements were required, the board of directors appointed a person they trusted (who did not necessarily have a professional qualification) to audit the accounts (Brown, 1905). The first attempt to form the auditing profession in Spain was represented with the establishment of the Institute of Public Accountants of Spain in 1912 only to disappear shortly after (Giner Inchausti, 1998).

Accounting associations in Bilbao, Madrid, Barcelona and Vigo were bundled into the body *Instituto de Censores Jurados de Cuentas de España* (ICJCE) (the

Spanish Institute of Chartered Accountants) between 1942-1945¹, with a membership of 44 individuals (Donaghy and Laidler, 1982). Despite the emergence of ICJCE, the auditing profession failed to establish itself, given the lack of statutory requirement for auditing. Donaghy and Laidler (1982) also attributed the lack of growth in auditing to the limited number of individual shareholders, the existence of two forms of accounting books (official and other) and the widespread nature/scale of tax evasion. They believed that these factors did not create a suitable environment for auditing to thrive. However, the government's introduction of legislation in 1959, which made it possible for foreign investors to own unlimited amounts of a company's capital, is seen as a most important factor for the development of auditing. Donaghy and Laidler (1982) claimed that the flow of foreign investors into Spain was accompanied by an increase in the number of international audit firms to satisfy the lack of expertise in auditing in Spain. They saw these firms as having been a major force behind exposing Spain to modern auditing.

A new regulation was enacted in 1967 where companies listed on the stock exchange were required to appoint an independent auditor who was a member of ICJCE. However, this type of audit was later restricted to certifying that the financial statements were in agreement with the accounting records (AICPA, 1973). Companies not listed on the stock exchange were not required to appoint an external auditor but were required to prepare financial statements and present them to two shareholder-auditors. Another development in Spain's audit history started to emerge when voluntary audits was pursued as result of major financial scandals in the banking sector and the subsequent recommendations of the Bank of Spain for undertaking audit in that sector. Public companies' desire to improve their tarnished image due to mismanagement and lack of control led to the adoption of voluntary audits (García Benau and Ruiz Barbadillo, 1996). The monopoly of ICJCE on the audit profession was challenged when the *Consejo*

¹ There seems to be inconsistency over the exact date for the establishment of ICJCE, spanning from 1942-1945. Donaghy and Laidler (1982) reported the date of the establishment as 1942

General de Colegios de Economistas de España (the General Council of Spanish Economists' Associations) established in 1977 in their statute that auditing as one of the functions of economists, given their educational background (Cea Garcia, 1992). Accordingly, the General Council established, in 1982, a *Registro de Economistas Auditores* (REA) (Register of Economist Auditors) to register economists who were providing auditing services. The international accounting firms supported the creation of REA given the disagreement among ICJCE members as to whether it was appropriate to accept these firms as members. The incompatibility of the views between these firms and ICJCE on how to tackle the problems of the profession was seen as another reason for the international firms' support for REA (Cea García, 1992).

In similar circumstances/process to those surrounding the establishment of REA, a third professional body was set up. It started with the 1977 professional statute of *Consejo Superior de Colegios Oficiales de Titulados Mercantiles y Empresariales de España* (the Supreme Council of Spanish Commercial Graduates' Associations) granting the commercial graduates the right to perform auditing. Shortly after the establishment of REA in the early 1980's, the council of commercial graduates set up the *Registro de Titulares Mercantiles* (RTM) (Register of Commercial Graduate Auditors) to register its members wanting to practice auditing. Cea Garcia (1992) attributed the establishment of RTM to ICJCE's suspension of its links with the council of commercial graduates in attempt to restrict the practice of auditing to ICJCE's members. He also claimed that the establishment of REA also encouraged the establishment of RTM. However, the establishment of the three accounting professional bodies did not change the status of limited company auditing and voluntary audits until the enactment of the Audit Law of 1988. However, the three bodies did draft their own auditing standards and obliged their members to adopt them in conducting their work (Lopez Combarros, 1992).

while Cea Garcia (1992) thought it was in 1943 and others reported it to be in 1945 (Gonzalo and Gallizo 1992; Giner Inchausti, 1998).

Despite the limited statutory requirement for auditing in Spain, all of the Big Six audit firms established themselves during period. The international audit firms first surfaced in Spain in the early 1960's (Arthur Andersen) while the other firms established in the 1960's and 1970's (Gonzalo and Gallizo, 1992). However, the growth of the number of auditing firms did not significantly enhance the image of the profession.

“It seems likely that there will continue to be a growth in auditing work. However, it is not always easy for a Spanish businessman to accept the concept of auditing as it is practised in the UK. Until very recently it has not rated very highly either as an academic discipline nor as a task to be undertaken by professionals. Attempts are being made by the international accounting firms and by the Spanish institute to redress the balance.” (Donaghy and Laidler, 1982, p.57).

6.3.2 Accounting and Auditing Post EC

Spain's admission to the EC in 1986 led to the enactment and modification of key laws to mould Spanish laws along the lines of the European Community's Directives. Two major laws had a major impact on auditing and accounting in Spain, namely the *Law 19/1988 – Audit Law* and *Law 19/1989 – Partial Reform and Adaptation of Commercial Legislation to EC Company Directives*². The Audit Law was moulded on the European's Community Eighth Directive, while Law 19/1989 was concerned with implementing the Fourth and Seventh directives. The Audit Law made it a statutory requirement for companies (excluding small companies) to have an audit - the intention serving to bring auditing to the same level as that in other member countries. The law required the setting up a special register, the *Registro Oficial de Auditores de Cuentas* (ROAC), for auditors seeking to practice in Spain. The law also established the *Instituto de Contabilidad y Auditoría de Cuentas* (ICAC) (The Accounting and Audit Institute) as an independent agency under the control of the Ministry of Economy and Finance to maintain that register and to regulate the profession.

² The law amends the Commercial Code, the Companies Act and other laws that regulate the work of companies.

ICAC was also given the right to investigate auditor's work, including examinations of working papers and issuing disciplinary and sanctioning measures. The law also recognised the three professional bodies (ICJCE, REA, RTM), providing them with several powers that are subject to the final approval of ICAC. These powers include drafting auditing standards, maintaining quality control procedures and mechanisms to control the entrance to the audit market (continuing professional training, administering the entrance examination and control of practical experience). While the law entrusted these bodies with the drafting of auditing standards, it ultimately placed the ratification and publication of these standards in the hands of ICAC. The Audit Law also instituted the concept of auditor rotation in Spain, propagating that auditors must be appointed for a minimum of three years and maximum of nine years with reappointment only possible after the completion of three further years. This rotation concept was clearly incompatible with the stances of the Big Six, especially in Anglo-American countries.

García Benau and Barbadillo (1996) saw the development of the Audit Law, 19/1988 as an outcome of the inability of the profession to secure recognition and to close the market for non-competent professionals. The division and competition among the three Spanish professional bodies was a major motive behind the government's regulation of the profession via ICAC (Cea Garcia, 1992). The ruling socialist party preference for state intervention and its domination of parliament resulted in governmental regulation of the profession. The socialist government made it clear that it would reduce its level of intervention depending on the future behaviour of the profession (Bougen (1997). The audit profession saw this type of regulation as interventionist and thought that ICAC gave the government too much power over accountants. On the other hand, Cea Garcia (1992) argued that the model of the regulation of the profession is a mixed one as the law granted the three professional bodies important functions for organising the profession. ICAC's Consultative Committee has six representatives from the three professional bodies serving on

it, ensuring the involvement of the profession in tackling the main issues that face the profession in Spain.

The *Law 19/1989 – Partial Reform and Adaptation of Commercial Legislation to EC Company Directives* also had a major impact on the auditing profession in Spain. It required all companies that comply with specific criteria to perform an independent audit. The law also required all capital companies to publish their financial statements and submit them to the Mercantile Registry. Corporations were also required to present consolidated financial statements and the law spelled out the methods to be followed for conducting the consolidation. The law also highlighted the accounting principles that should be complied with to provide a *True and Fair View (Imagen Fiel)*. The General Accounting Plan was also revised in 1990 and came into force in 1991. This new plan made a clear distinction between accounting rules and taxation rules – with the former is more concerned with providing a *True and Fair View* while the latter is geared towards the calculation of taxes due to the government (Giner Inchausti, 1993b).

6.4 Optimism and Growth of Auditing

“A revolution is taking place in the hitherto arcane world of Spanish financial reporting. For many Iberian finance directors, the effect will be akin to marching out under arc-lamps after a very long spell in a very dark dungeon.” (David Owen, FT, 23/5/1991).

“...it is thought that the quality of accounts is greatly enhanced if independent auditors verify the annual accounts...” (Giner Inchausti, 1993b, p. 385)

The enactment of the Audit Law 19/1988 and other laws brought with it growth and optimism in a function that was previously better known for its awkwardness and for its lack of transparency. The number of statutory audits increased from 2,212 in 1991 to 20,324 in 1993 (Corona Romero *et al*, 1995). The international audit firms dominated the audit market in 1990 receiving fees of Pts17bn in comparison with the other local firms receiving a total of Pts4bn (Gabas Trigo, 1992). García Benau and Humphrey (1992) highlighted the positive status of

auditing in the late 1980s/early 1990s. This increased transparency in financial reporting and improved processes of corporate governance. Such beliefs seemed naive and little informed by international debates. That said, Bougen and Vazquez (1997) have claimed that their analysis of the debates in Spain's Congress of Deputies has shown politicians to be aware of the questionable potentialities of the audit function. Nevertheless, the survey is not that strong in terms of revealing the significant of the Audit Expectations Gap, and certainly not one as widespread as in the USA and Britain (García Benau *et al*, 1993).

Having reviewed recent developments in Spain it is apparent that expectations of auditors were set at a high level, with the legislative moves to bring Spain into line with EU regulations being seen as laying the foundation for a more transparent and reliable accounting or reporting function. Such expectations of an accounting and auditing system, however, have been based on a limited analysis or appreciation of the practical impact and effectiveness of such a system. Further, such changes have not seen a significant improvement in the public image of the auditing profession, to the extent that the Spanish government have been reluctant to grant the profession a considerable amount of autonomy. A good way of judging the significance and force of recent changes in the Spanish Legislation, is to explore the impact that major corporate scandal has had on the perception of auditing and image of audit firms. The following chapters (7 and 8) analyse the impact of the GT/KIO case, particularly exploring the capacity of auditors to deal with complex practical scenarios, the ability of auditors to deal with situations where management dominates, the ability of auditors to report in a manner which is both timely and clear.

6.5 Conclusion

The chapter has briefly discussed the political development of Spain from dictatorship under Franco to a total democracy. It also described the economic development under the two different systems. Spain, under the socialist government, joined the EC in 1986, a step that had a great influence on the development of auditing in Spain. Prior to joining the EC, accounting was used

for taxation purposes rather than for financial accounting purposes. That period was also marked by the failure of auditing to take a prominent position in Spain, as auditing was either mostly voluntary or statutory required for a limited number of companies. However, this period has marked the establishment of Spain's main accounting bodies (ICJCE, REA, RTM). Generally in this period the accounting profession was not perceived as a prestigious profession. Spain's joining the EC has led it to adapt its laws to those of the European Directives. The audit law made auditing statutory requirement for a larger number of companies. It also appointed ICAC as the regulator of the profession something that the profession in Spain was not pleased about. The new General Accounting Plan made a distinction between the taxation rules from those of financial accounting.

Chapter 7

The Kuwait Investment Office Case

7.1 Introduction

Kuwait Investment Office's investments in Spain were met with euphoria and enthusiasm. It almost seemed that everything that KIO touched turned into gold. The mammoth investments massed by KIO between 1986-1992 culminated in Grupo Torras (GT), KIO's Spanish holding company, becoming the largest (non-governmental nor bank owned) industrial group in Spain. The group created Spain's biggest chemical company (Ercros), its biggest food company (Ebro), largest paper company (Torraspapel), and Spain's second largest property developer (Prima Inmobiliaria). However, in May 1992, there were concerns behind the scene about the group that led to a change of management in KIO and GT. The new managers were overwhelmed with financial problems and fraud at the group which subsequently led to some of the group subsidiaries being placed under 'suspension of payments' (*suspensión de pagos* - receivership) and ultimately saw GT, the parent company, filing for receivership at the end of 1992. This was seen as the bursting of what many regarded as "Spain's biggest bubble", leaving KIO with its first experience of a collapse in any of its investments, following its establishment in London in the early 1950's. The huge scandal involving KIO's investments in Spain made headlines for months in Kuwait, Spain and around the world. Initial estimates placed financial losses at \$5bn and job losses at 100,000 in Spain. The collapse represented Spain's biggest corporate failure since the re-establishment of democracy in 1975.

The collapse of GT is one of a series of major corporate collapses to hit Spain in recent years (others including PSV and Banesto Bank). It has often contained all the colourful elements of a suspense thriller film, with claims of fraud and misappropriations of funds (\$500m apparently disappearing into thin air), allegations of political payments from GT's funds, wire-tapping of GT's offices and GT's data diskettes being stolen from the Ministry of Economy. Allegations were also made of a conspiracy to blackmail the Spanish king in order to get the charges dropped against De la Rosa and Mario Conde (the disgraced former chairman of Banesto Bank). The case allows for a detailed reflection on the state

of auditing in Spain, a country in which a number of positive declarations were made in the late 1980's and early 1990's with regard to auditing expectations. It is also useful in enabling an examination of the case's implications for auditing in Kuwait and can inform current debates about the international auditing environment and the global role and practice of the Big Six accounting firms.

This chapter focuses on the history of KIO and the context that prevailed during KIO's investments in Spain to prepare the ground for analysing the accounting and auditing implications of the KIO case in chapter 8. The chapter is organised into three main parts. It starts with a brief historical account of the establishment of KIO and its younger parent KIA. It seeks to understand the environment that shaped the development of these organisations and their dual role in influencing Kuwait's investment strategy. The historical review is also helpful in understanding the nature of the relationship between KIO and KIA, as (in theory) KIA was supposed to act as the parent of KIO, while in practice the opposite often seemed to be true.

The second part of the chapter begins with a brief description of the rise and fall of Grupo Torras. It then documents the subsequent events and court cases that have arisen since the collapse of the group. The political fallout from the scandal in Spain and Kuwait is also discussed. The third section focuses on the main issues evident in the KIO case. These include a discussion of the secrecy doctrine adopted by both organisations, KIO's chosen investment strategy and the lack of control and accountability processes revealed by the case. Other issues that are discussed in this section include a brief overview of the failure of the Spanish and Kuwaiti governments in terms of supervising KIO's investments in Spain. Comprehending these issues is essential to the understanding of the elements that led to the collapse of KIO's investments in Spain and is also helpful in understanding the role played by accounting and auditing in the KIO case.

7.2 The Emergence of KIO and KIA

“Attracting these revenues represents a high priority for us and for the Sterling area. As these revenues will lead directly to a high demand on imported goods, which leads to the disruption of the Sterling area as result of the high demand on it. Our interest compels us to get these revenues invested, with the stipulation of endowing these investments in good hands - as misappropriations and mishandling of these funds will lead to the disruption of the London Financial Market. In addition, leaving this huge capital in the hands of the Sheikh will make him exposed to individuals and organisations who are seeking to take advantage of this capital and certainly not all of them deserve these advantages.”(A letter sent by the Foreign Office to the British Political Representative in Kuwait, Quoted in Al-Watan, 29/6/1985, p.22).

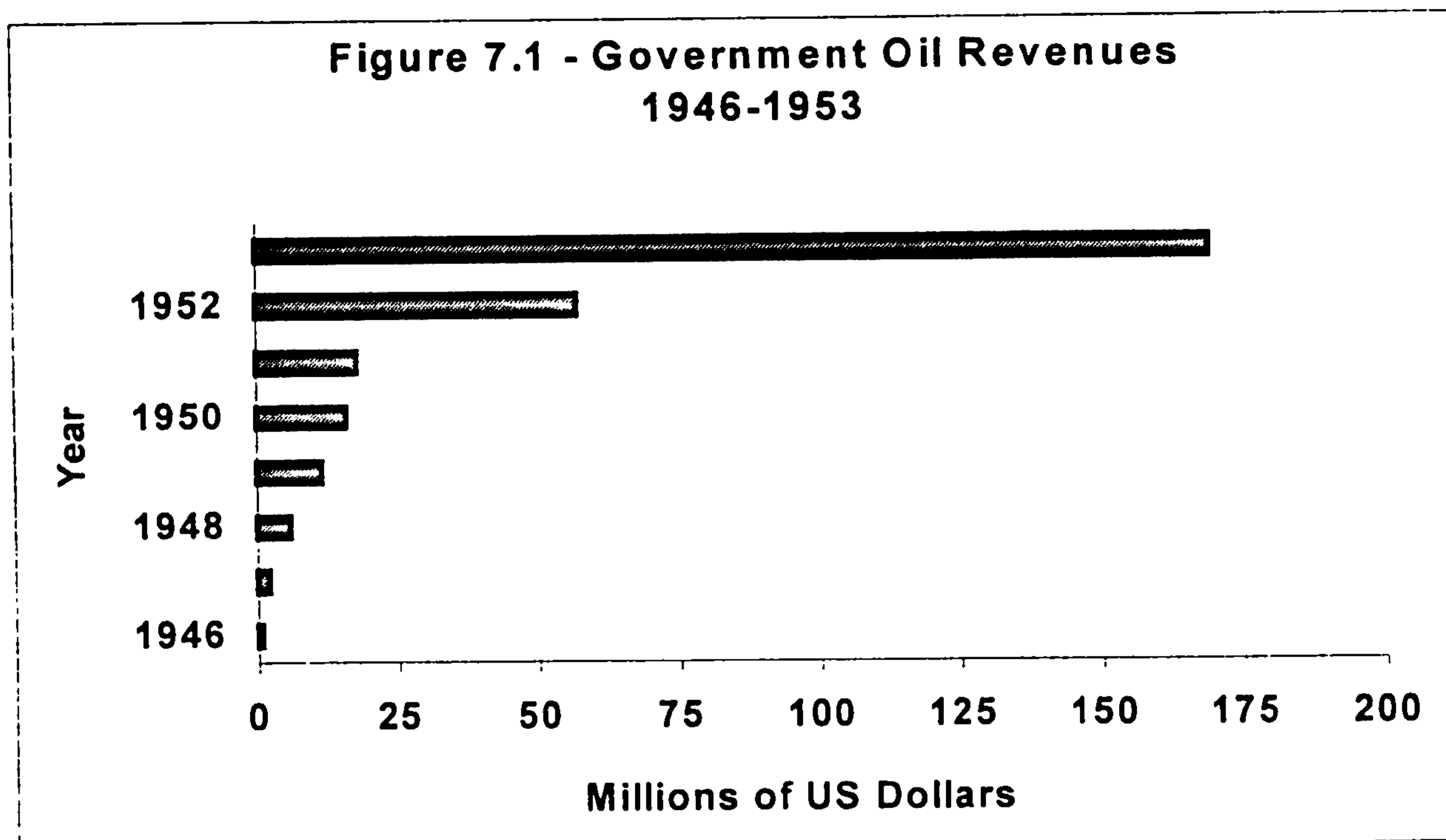
“It is now not only a question of Kuwait but of Qatar; and if something is not done on the lines of our investment proposals in both cases very soon, the consequences for sterling can be most serious.” (A letter dated 14/10/1952 and sent by David Serpell from the British Treasury to Clive Rose of the Foreign Office, FO 371/98399, pp.118-120)

“It is highly important to try to get the proposals accepted well before the next large payment of oil revenues (nearly £50 million) in March 1953.” (A telegram dated 17/10/1952 sent from the Foreign Office to the Political Resident in Bahrain, FO 371/98399, p.125).

The beginning of production of oil in 1946 in Kuwait saw the country's oil revenues boosted from \$760,000 in 1946 to \$57m in 1952, providing Kuwait with enormous surplus funds (see Figure 1). This surplus attracted the interest of its protector, Britain, who saw Kuwait and Qatar as very promising and helpful to the British economy. Official British documents revealed that the British government started to persuade the Amir of Kuwait, Sheikh Abdullah Al-Salem, to invest Kuwait's oil revenues in Britain - a process which began when Sir Roger Makins, head of the economic division at the Foreign Office, visited the Gulf States on a mission in February 1952. The Foreign Office saw the objective of Makins' mission as being to examine the economic and political problems facing the Gulf States as a result of the increasing importance of their oil production and to consider Britain's special responsibilities in the area (FO371/98340). The British Foreign Office's objectives in Kuwait were to maintain its influence in Kuwait, introduce financial control to avoid upsetting the sterling area and guarantee that Kuwait's wealth would be fairly shared among the public (FO 370/104272). The

Amir was reluctant in the beginning to accept the British proposal as he did not understand it and suspected that Britain wanted to direct Kuwait's revenue to channels that would place as little strain as possible on sterling (FO 371/98399). However, by October 1952, the British were more eager to get the approval of the Amir, with the British Treasury claiming that if the investment proposal was not approved then it would have serious consequences on sterling¹. On 21 October, 1952, the Amir expressed to Britain his willingness to accept the investment proposals and ultimately signed an agreement in February, 1953, which established an investment board in London to invest Kuwait's sterling surpluses (Smith, 1999). British officials saw the Amir's decision as an act of faith in their government - noting that he "did not really understand what was involved and his decision represented a considerable act of faith in Her Majesty's Government." (FO 371/104272). The agreement initially provided the Kuwait Investment Board (KIB) with £27m to invest and saw the appointment of four British nationals to its board (the representative of the Amir in London, a member of the Bank of England, director from the British Bank for the Middle East, and a partner from the law firm in London representing the Amir) (see Smith, 1999). The agreement also stipulated that the funds would be exempted from all taxes levied in Britain, especially income tax and death duty tax (FO371/98399, p.17). KIB was also forbidden from pursuing any investment strategy that would upset the London stock market. The agreement mandated hiring professional accountants to attest the reliability of KIB's accounts and to present an audit report each year to the Amir. H. Kemp, the political representative of the ruler of Kuwait in London recommended that Peat Marwick Mitchell & Co. act as the auditor of KIB (Al-Najar, Al-Watan, 22/7/1985, p. 24).

¹ According to a document of the British Foreign Office, Kuwait started to emerge in the early 1953 "as the Principle creditor country of the Sterling area" (for details see FO 371/104272).

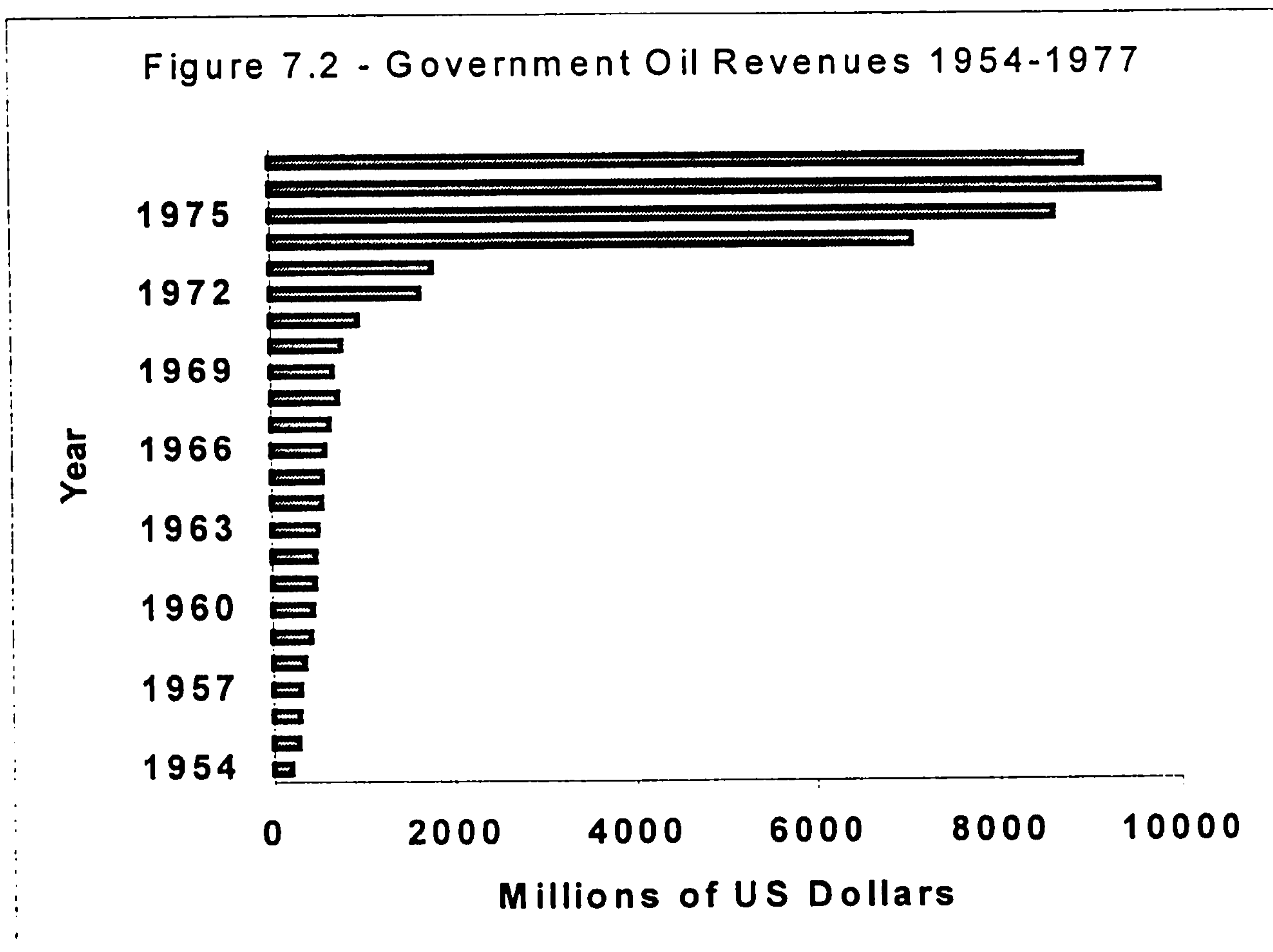


Source: Khouja and Sadler (1979, p.26).

In 1960, the British Foreign Office proposed the appointment of a Kuwait member as a way of making the KIB more accountable, given the exclusivity of British managers at the board. The chairman of KIB opposed such a proposal claiming that the Amir and the Kuwait finance department had control over the policy of the board. Ultimately, the ambassador of Kuwait was appointed as a Kuwaiti member of KIB's board in May 1962 (for more details see Simon, 1999). A year later the Kuwaiti ambassador in London, Khalid Jaffar, changed KIB's name to the Kuwait Investment Office² (KIO) (Whittington, 1993). In 1963, an international advisory committee was entrusted with the job of advising Kuwait on its investment strategy (Smith, 1999). The International Advisory Committee started to change Kuwait's investment strategy and broadened its investment area from merely depositing funds with the Bank of England to setting up two investment portfolios (equities and other property) in the USA and purchasing properties overseas (for further details, see Field, 1975). In 1967, two years after joining KIO, Sheikh Fahad Al-Sabah, a cousin of the present Amir of Kuwait, was appointed as the general manager of KIO. In that same year, Fouad Jaffar

² There was a lack of consensus with relevance to the date of the establishment of KIO. These dates spanned from 1963 to 1966.

(Jaffar's father was KIO's first chairman) was appointed at KIO to become the deputy general manager of KIO in 1969.



Source: Khouja and Sadler (1979, p.26).

In the early 1970s the increase in oil prices boosted Kuwait's revenues substantially – these rising over four fold to \$7095m between 1973-74 (see figure 2). This led the Kuwaiti government in 1976 to set up the Reserve Fund for Future Generations (RFFG), a pension fund designed to establish an alternative source of income for Kuwait's future generations once oil revenues started to decline. The growth in revenues made more money available for KIO to invest beyond the UK-USA market to include Asia, Australia and Germany. Acquisitions in real estate were also targeted - KIO, for example, acquired St. Martins Property Corporation (a large real estate company that holds properties in the UK and Australia) in 1974 and established Foster Lane in the USA as a real estate holding company. KIO's investment portfolio included many blue chips companies around the world (e.g., a 14% share in Daimler Benz). In the early 1980's it was reported that KIO had minority (less than 5%) shareholdings in many Fortune 500 companies in America. KIO's power in the international

markets was such that, in 1976, investigators from the American Federal Bank expressed concern about KIO's holdings at Citibank where it had become the biggest depositor. The investigators feared that KIO's \$1.7bn deposits would create a liquidation problem if the funds were withdrawn at short notice (Al-Qabas, 17/1/1976, p.5).

In 1982 the Kuwait Investment Authority (KIA) was established. It took over the duties of the Finance Ministry's Investment Department, a move which also meant that KIA assumed control of KIO³. KIA, which officially started its operations in July 1984 and had its own management structures and operational powers, had a constrained degree of independence from the Finance Ministry. The head of KIA was also the head of the Finance Ministry and KIA was still required to report to the Finance Ministry on a regular basis. The establishment of KIA came as a result of calls for such an organisation from the Kuwait parliament. Abdel-Latif Al-Hamad, the then finance minister and a major advocate behind the creation of KIA, indicated that the Kuwaiti government's motives for establishing KIA rested in their belief that traditional bureaucratic governmental administration was not "the best institution for managing a portfolio" (Euromoney, June 1982, p.85). There were also arguments suggesting that KIA was set up with the purpose of controlling KIO and making it more accountable (Institutional Investor, August 1988). KIA's establishment, however, did not change the way KIO was operating. It maintained most of its power and was seen as more experienced and successful than its parent. Both organisations held international investment portfolios estimated at approximately \$94-100bn⁴ before the Iraqi invasion of Kuwait in 1990 and were generating income greater than Kuwait's annual oil revenues. It is estimated that between 1986-1989 Kuwait's investment revenues exceeded those of oil. The importance of KIO/KIA's investment portfolio was clearly evident during the Iraqi invasion of Kuwait. The exiled Kuwaiti

³ KIO fell under the responsibility of the investment department at the finance ministry before the establishment of KIA

government used the portfolio to support exiled citizens, to contribute to the war effort, to support the liquidity problem of the Kuwaiti banks abroad, and subsequently to finance the reconstruction projects following the liberation of Kuwait. These activities cost Kuwait approximately \$50bn until the end of 1992, decreasing KIO/KIA's portfolio to about \$44bn. KIO, however, still maintained a powerful role in the international markets. In 1996, KIO was ranked as the sixth largest UK fund management institution (Quant ir, 1996). KIO still had the ability to influence the financial markets as evidenced by its sale of a 3% stake at BP for \$2bn in 1997, representing the biggest ever block trade of shares (Institutional Investor, January 1998). The secrecy that surrounded the real scale of KIO/KIA's investment portfolio was broken for the first time in 1998 when the Al-Watan, the Kuwaiti newspaper owned by Sheikh Ali Al-Khalifa of the Al-Sabah family (and the former Oil and Finance minister) disclosed that the funds invested by KIO/KIA were about KD 12bn (\$40bn), with revenues of \$4bn in 1997. These figures were discussed in the closed session of the Kuwaiti parliament in May 1998 and were not meant to be made public (see Al-Watan, 3/5/1998, p.1).

7.3 The Rise and Fall and Re-emergence of Grupo Torras

7.3.1 The Rise: From Torras Hostench to Grupo Torras

The planned entry of Spain into the European community in 1986 made the prospects for growth in the Spanish economy very promising in the early 1980s. Arab investors saw their investments grow from Pts1,101m in 1979 to Pts14,567m by 1984, with Kuwait being the most prominent Arab investor in Spain (Arab Banking Corporation, 1985). KIO was at the forefront of Kuwait's investment. Its initial Spanish investments were no different from any other investment made by the Kuwaiti institution, including the acquisition of farmland and a 30% stake in a hotels group called Hoteles Agrupados, S.A. (Hotsa) in 1984

⁴ For a list of some of KIO/KIA's previous investments see for example Dixon, 1989; The

for Pts8m (later sold by KIO for Pts70m). KIO's general manager, Fouad Jaffar, however, concluded that KIO's normal strategy of making portfolio investments, but staying off the boards of the companies, wouldn't work in Spain. He said "the stock market in Spain is minute. We could have invested at most \$200m or \$300m and that would be it. I thought we should make a big commitment" (Forbes, 5/3/90, p102). KIO's 'big' stake in Spain started in 1984 with the acquisition of a bankrupt packaging company called Industrias del Papel y de la Celulosa S.A. (Inpacs) for \$30m. While undertaking this acquisition, the head of Inpacs's creditor bank, Javier de la Rosa, was introduced to one of KIO's senior managers who convinced KIO to keep de la Rosa on the board of Inpacs (FT, 30/11/92, p. 19). Moreover, de la Rosa (JR) was introduced by the bank of America to KIA's Managing Director, Dr Fahad Al-Rashad, and in 1986 Al-Rashad signed a contract with JR to act as a stockbroker on behalf of KIA in Spain. In interview with a member of KIA's staff at the time, it was claimed that KIA's operations with JR were successful and profitable. It was also indicated that KIA's operations with JR were straightforward transactions which involved the direct purchase and sale of shares and, in consequence, all transactions were profitable and legal. However, KIA cancelled its contract with JR eight months after signing it. It justified the cancellation on the basis of information it had received regarding the integrity of JR. Whittington, (1993), however, provides a different account for KIA's break up with JR. He claims that when JR offered KIO the chance to buy Banco Central, KIA was slow to respond and became upset with de la Rosa as they considered him to be in KIO's camp which had a rivalry with KIA and accordingly suspended its contract with JR (p.81). Regardless of which of these stories represents the true account, what is clear is that while KIA did not want to do business with JR it was not able to stop KIO from dealing with him. This might be explained by the fact that KIA since its establishment was never able to exert control over KIO due to several factors that will be explained later in the chapter.

Guardian, 10/9/1988, p. 13; FT 10/8/1990, p. 4.

KIO's Spanish investments continued to evolve in 1986 when it acquired Torras Hostench (TH), a Catalonian paper company which had just emerged from three years under receivership. The acquisition of 40% of the paper company, with cash reserves of \$204m, was made on the recommendations of JR⁵. In early 1987, KIO took over the board of TH with KIO's chairman (Sheikh Fahad Al-Sabah) becoming TH's chairman and Fouad Jaffar, Bruce Dawson (a senior manager of KIO) and JR all acting as deputy managers. KIA did not have any role in the composition of that board. A few months later Spain witnessed the biggest rights issue in its history, when TH made a fully subscribed rights issue to the tune of \$513m.

The Torras Hostench group was used as KIO's holding company for launching other acquisitions in Spain. This was clearly evident when KIO (through TH) tried to takeover Explosivos Rio Tinto (ERT), the Spanish chemical group, in 1987 – a bid which triggered a fierce challenge from Escondrillas, the chairman of ERT, who hired external advisors, Lazard Freres, to defend against the bid. Escondrillas tried to persuade the Industry Ministry to approve his plans to unify the private Fertiliser sector and to recommend Torras' plans for take-over. The Industry Ministry informed Escondrillas that he supported KIO's plans, claiming that KIO's plans was backed up by capital (Chemical Week, 4/11/1987, p.60). Ultimately, KIO was successful in launching and winning Spain's first hostile take-over as it acquired ERT. However, KIO's acquisitions of ERT raised concerns for the USA, (a member of NATO) as ERT was the largest private supplier for explosives in Spain and was heavily involved in defence contracting. Accordingly, the USA felt that if KIO took a position on the board of ERT it would be privy to NATO secrets – thus, it lobbied the Spanish government to block such a move (Business Week, 7/3/88, p. 20). KIO's investments in Spain also raised concerns in the Spanish press, with some hostile coverage depicting

⁵ Javier De la Rosa left Banco Carriga Nogues in 1985, which collapsed a year later with bad debts of \$800m, to form his own investment company, Quail Espana.

KIO as “behaving as a shark in Spain”, something denied by Fouad Jaffar (FT, 10/5/1988, p.2). The Spanish government was initially also concerned about KIO’s motives in Spain as there was a feeling that KIO might be just a short term investor aiming at stripping the country’s assets and then fleeing the country. Such concerns were alleviated to a degree when Jaffar met several Spanish officials and explained to them that KIO intended to be a long-term investor in Spain (Whittington, 1993). Other acquisitions duly followed in the remainder of 1987, with KIO/TH securing stakes in Spain’s then largest bank, Banco Central, another chemical group (CROS), Banco de Vizcaya and Ence. In 1988, KIO merged ERT with CROS to form Ercros (Spain’s largest chemical group) and acquired stakes in other companies such as Coma Cros (Bures), Beta and Amaya.

Controversy surfaced again in 1988 when TH took over Ebro, Spain’s largest food group. Ebro's management tried to resist Torras’s take-over bid, hiring the firm Lazard Freres. In a desperate attempt, Ebro management also wrote to the Amir of Kuwait to advise him that KIO was embarking on acquiring a company that was involved in the distillation business – something outlawed by Islam (Whittington, 1993). KIO’s stakes in Spain’s banking sector also raised great concern amongst the Spanish government and the Spanish banking community. Protests by the chairman of Banco de Vizcaya and Mariano Rubio, the governor of the Bank of Spain, forced KIO to sell its stake in Banco de Vizcaya but it held on to its stake in Banco Central, which led Rubio to question the Chairman of Banco Central about KIO’s stake in the bank. Rubio suggested that KIO should find a Spanish partner for its stake in Banco Central. Accordingly, KIO formed a partnership with “Los Albertos” (two Spanish businessmen and cousins) called Cartera Central to manage the 12.5% stake at Banco Central - Los Albertos held the majority stake of 51.2%. KIO’s interest in the banking sector lay in the banks’ industrial investments portfolio. The chairman of Banco Central wanted to fight Los Albertos so he accepted a merger proposal offered by Mario Conde (the Chairman of Banesto - another top five bank) which forced Cartera Central to acquire stakes in Banesto. The Los Albertos’ subsequent criticism of the management of Banesto eventually led to the collapse of the merger. Breakdowns

in communications with Los Albertos and a sexual scandal involving one of the cousins, eventually led KIO to sell its stake in Cartera Central to Los Albertos.

In 1988, KIO was also planning to use TH to launch investments in Europe in anticipation of the forthcoming European single market in 1992. It acquired 50.1% in the Belgium paper company, Cellulose des Ardennes. KIO's injection of a significant amount of capital into JM Sassoon, the Singapore broker 49% owned by KIO, was seen as a possible indication that KIO might use Sassoon's European office to launch its European acquisitions - especially given that a prominent Economist had been recently appointed at European Sassoon (Euromoney, August, 1988, p.7). Jaffar also indicated that KIO could use TH to break into Europe and markets such as France and Italy, where Arab investment might not be as warmly welcomed as in Spain and UK (Forbes, 5/3/1990, p.104)

In that same year Salomon Brothers, the American Bank, underwrote a £100m convertible Eurobond issue for Phoenix International Finance, a holding company owned by KIO, which offered Eurobond investors the opportunity to buy convertibles in TH. The Eurobond attracted influential investors such as Bank of America, Chase Manhattan, Credit Suisse, Banco Santander, Banco Central Hispano Americano, Banco Bilbao Vizcaya, Barclays Bank (Al-Qabas, 11/7/92). Two months later Salomon Brothers helped TH to go public by underwriting one third of a \$450m stock offering by the group. The flotation of TH resulted in a change in the name of the group (from Torras Hostench to Grupo Torras) and the paper business was placed under the new name of Torraspapel. Torras Hostench, the previous name of KIO's holding company, was given to a new financial company in London called Torras Hostench London.

7.3.2 The Fall: From Public to Private Status, to War and Collapse

In late 1989, it had become increasingly evident to KIO's executive committee that, contrary to positive reports presented by KIO's operational managers, Grupo Torras (GT) was facing serious problems. Just a few months after presenting a favourable report, Torras' creditor banks suspended their lines of credit to the group and KIO had to inject \$450m - a loan which KIO's Chairman did not have

the authority to grant (FEAC, 1993b, p 29). On discovering the granting of this loan, KIO's executive committee made the decision, in late 1989, to gradually liquidate GT - the first step being to take GT private in 1990⁶, with KIO purchasing all the shares held by the public. KIO's bid for the remaining stake of 37.5% cost \$630m, representing the most expensive bid in Spain's history (FT, 5/1/90, p.20). Two months after de-listing GT from Madrid's stock market, Fouad Jaffar (the general manager of KIO for the last 20 years) and two of KIO's junior staff were recalled to Kuwait. Jaffar's recall to Kuwait would see him assume an undisclosed position at KIA, an action designed to nullify any influential role for Jaffar in the operations of KIO and KIA (The Independent on Sunday, 25/2/1990, p.3). The recall of Jaffar seems to be consistent with the Kuwaiti tradition of moving unwanted people to different positions rather than dismissing them (e.g., see Tetreault, 1995). Jaffar elected to resign from his post at KIO. Although it was not made public why he was recalled or resigned, it was seen as the consequence of him increasingly making sensitive decisions without reference to his parent organisation (i.e., KIA) in Kuwait and the desire of the Finance minister to reassert control over KIO (see Wall Street Journal, 21/2/1990; FT, 21/2/1990). During the same time, KIA appointed three executives at KIO (Salah Al-Moushargi, Abdul Aziz Al-Tayar and Abdul Wahab Al-Haroun) – the appointments, however, were resented by Sheikh Fahad Al-Sabah, who duly restricted their involvement in the operations of KIO.

⁶ The committee decision shows that De la Rosa justification for the actions of taking Torras privately was a smokescreen. JR explained the KIO's move saying "what we need to now is the ability to proceed calmly with our industrial strategy in Europe. Small investors cannot keep up in the long-term. We want to re-invest all our profits" (Financial Times, 5/1/1990, P.20). He also listed two reasons for removing GT from the stock market:

- 1- The belief that shares in holding companies that own controlling stakes in subsidiaries tended to trade at discount.
- 2- The stock market were probably going to be flat for most of the year as result of the slow recovery of the 1987 crash.

He claimed that KIO's decision to take full control would guarantee the holding company a powerful and interested in long term partner without having to change industrial strategy (Financial Times, 18/6/90, p.25).

On the 2 August, 1990, Iraq invaded Kuwait and the Kuwaiti government fled the country to Saudi Arabia. One day later, the Finance Minister and the chairman of KIA, Sheikh Ali Al-Khalifa, sent a fax to KIO giving plenipotentiary powers over Kuwait's assets to just three people - himself, the chairman and the deputy chairman of KIO. This action by-passed the Managing Director of KIA, who arrived in London shortly after the Iraqi invasion. He was very concerned with the state of KIO and wrote a protest letter to the State Minister for Cabinet Affairs in September 1990. This letter and a resignation notice by a member of KIO's Executive Committee (subsequently retracted) resulted in no action by the exiled Kuwaiti government towards KIO. During the same month GT was badly in need of cash to pay its creditors and employees. KIO transferred \$1.44bn between 10 and 15 September, 1990 to enable GT to satisfy its financial obligations in Spain. Subsequently, in December 1990, three members of KIA's board, including the Managing Director, who were also members of the Executive Committee of KIO/KIA, resigned. They cited, as reasons, a whole list of irregularities and non-compliance with the rules and regulations of KIO and KIA (for details see Appendix 1). Their resignation letter was sent to the Crown Prince/Prime Minister of Kuwait, clearly illustrating that the exiled government were fully aware of the problems of KIO.

In December 1991, the newly appointed Executive committee of KIO instructed KIO's auditor (KPMG) to examine Kuwait's Spanish investments. KPMG's report placed the value of GT at between \$2.9bn and \$4.4bn. It also indicated that the management was weak and recommended changing the board of GT. In April 1992, Ali Al-Bader succeeded Sheikh Fahad Al-Sabah as the chairman of KIO. Fahad Al-Sabah had been forced to resign as a result of seven months of lobbying by the newly appointed Kuwaiti Finance minister – he had replaced Al-Khalifa, who had been a strong supporter of KIO's independence from KIA (FT, 30/11/92, p.19). The GT board was changed in May (with the appointment of several Kuwaiti officials) and immediately had to respond to warnings from the Spanish government regarding the group's debts of \$1.2bn. KIO's new managers asked Aresbank (Banco Arabe Español) to investigate GT's financial position - they

duly concluded in June 1992 that bad management and financial irregularities were clearly evident. The resignation of Javier De la Rosa followed in July, with him claiming that he wanted to concentrate on the business group he had created while working for GT.

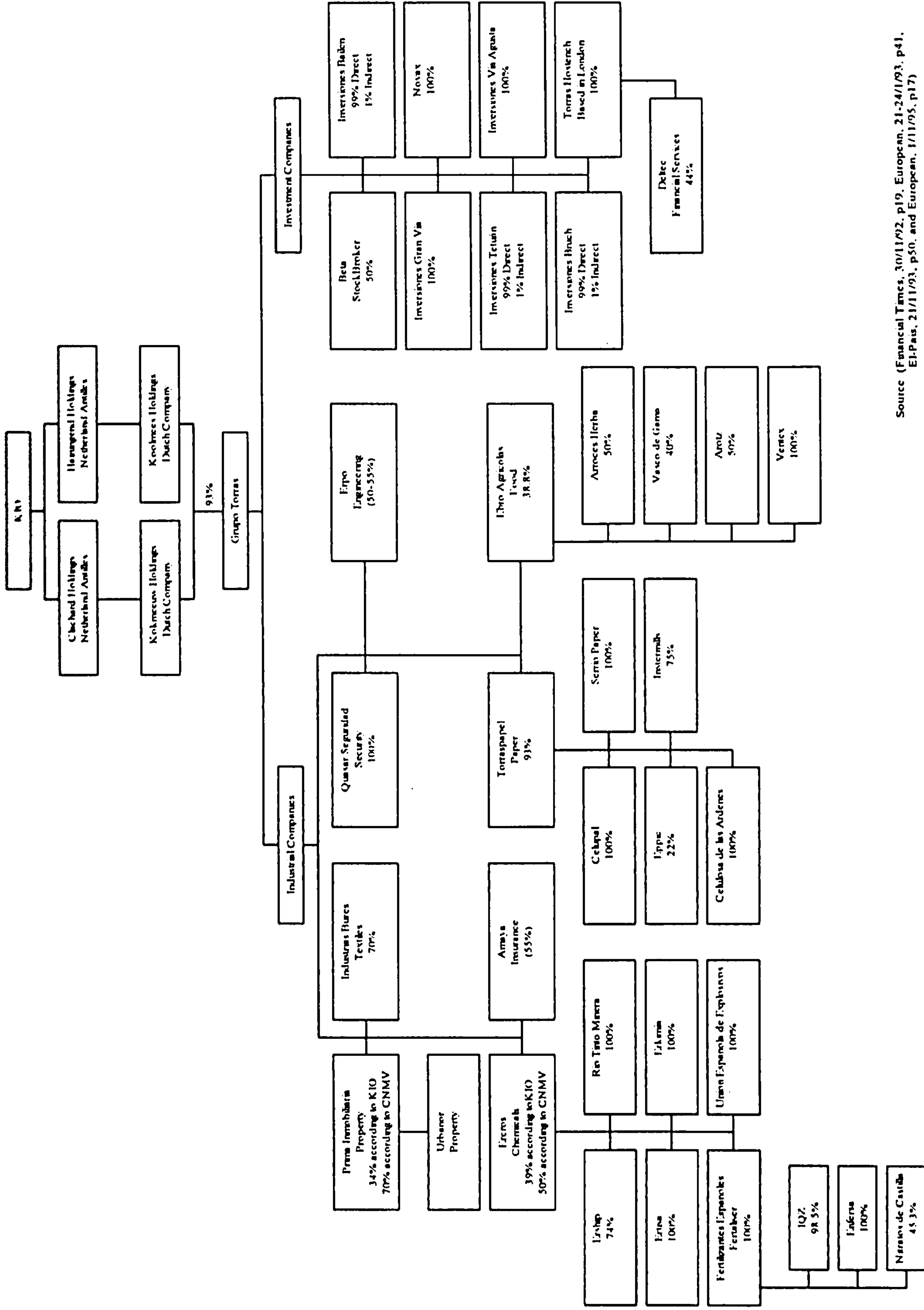
The new managers of KIO presented a report to the board of KIA in June 1992, stating that KIA's guidelines had possibly been breached over the Spanish investments. Consequently, the board advised KIO to investigate the matter thoroughly, employing any organisation it needed to facilitate the investigation. The concerns of KIO's managers became a reality when it was revealed that Ercros was unable to repay \$990m worth of debts to its creditor banks. KIO refused to make more funds available to Ercros unless the Spanish government offered some financial aid to the chemical group. Negotiations with Ercros' creditors to reschedule the debts failed and this ultimately led to Ercros filing for suspension of payments in Spain. The collapse of Ercros marked Spain's biggest corporate collapse since the re-birth of democracy in 1975. It was also KIO's first association with a bankrupt investment.

GT's problems with Ercros caused a 'domino effect' on its other group companies. Share prices of GT's listed companies considerably declined⁷ in value, leading to both Prima (a property developer) and Industries Bures (a textile company) filing for receivership. KIO's new managers ordered GT's auditor (Coopers & Lybrand) to prepare the group's accounts for 1991, removing all extraordinary profits and re-valuing its investment portfolio at current stock market prices rather than at book value. They also commissioned KPMG to examine the group accounts and also asked Soloman Brothers to investigate the group's financial position. The results of these investigations were devastating. Coopers & Lybrand reworking of GT's accounts changed its \$3m profit into a loss of £300m (a change rejected by GT's board of directors - basically KIO's

⁷ Ebro share prices fell from Pts3200 to Pts1000 while Prima share price fell from Pts7600 to Pts600 (FT, 7/11/1992, p.14).

managers - who subsequently also refused to sign the company's accounts). The investigations of both KPMG and Soloman Brothers were also unfavourable to the group. Their investigations revealed that KIO had injected a total of \$4.88bn - spending \$2.8bn on acquisitions of shares, \$700m on loan interest, \$700m on share price support operations, \$510m on unidentified transfers and \$170m on GT expenses (FEAC, 1993b, p.26). This ultimately led to GT being placed in receivership with debts of \$2bn to KIO and \$145m to other creditors in December 1992 (see Figure 7.3).

Figure 7.3 - KIO's Holdings in Spain Before the Collapse in June 1992



Source (Financial Times, 30/11/92, p19, European, 21-24/1/93, p41, El-Pais, 21/1/93, p50, and European, 1/11/95, p17)

7.3.3 The Aftermath of Collapse: Re-emergence of GT and the Search for Explanations/Compensation/Punishments

The collapse of GT resulted in heated public debate in Kuwait and led to several official investigations of KIO's investments in Spain. In Kuwait, both the parliament and the Audit Bureau carried out investigations of the collapse of KIO's Spanish investments. The reaction in Spain was similar with additional investigations taking place. The securities commission (CNMV) carried out an investigation of the ownership of shares in GT, while the regulator of the accounting profession (ICAC) examined the role of Coopers & Lybrand in auditing GT. The Spanish authorities were concerned that further collapses in the group would severely harm Spain's economy. Consequently, Pedro Perez, Spain's Economic minister, flew to Kuwait and signed a memorandum of understanding with KIA. The aim of this memorandum *inter alia* was to establish a liaison committee to make sure that the disposal of the different companies in the group were carried out in an "orderly manner", avoiding a "fire-sale" (for the full text of the memorandum see Al-Qabas, 5/12/98, p. 32). GT subsequently sold most of its smaller companies - with its chemical group, Ercros, emerging from receivership in November 1993 after disposing of its oil refining, pharmaceutical, defence industry, mining and fertiliser units. Kuwait and Spain signed an agreement in 1995 aimed at guaranteeing Kuwait's presence in Spain and creating the conditions to carry out new investments. Kuwait agreed to invest \$148m in Torraspapel, Ebro and Ercros, while the Spanish government provided an official credit of \$123m to Torraspapel. At the end of March 1997, GT ended the longest suspension of payments in Spain's history after agreeing with its creditors to pay Pts25.1bn of its Pts217bn debts (Pts184bn owed to KIO was written off together with Pts7.5bn owed to other creditors). Prima, which was on the brink of bankruptcy, also emerged from receivership in 1997. KIO sold off large stake at Ebro in 1998 and also sold 95% of Torraspapel in 1999 for Pts52bn, in addition to transferring debts of Pts44bn to the buyer (El-Pais, 9/11/1999). The sale of Torraspapel represented the biggest divestment by KIO in Spain since the collapse of the group in 1992. It reflected KIO's desire to return to a position in Spain of

Spain of being a passive investor (holder of small stakes with no responsibility for the management position). This is evident from the size of the stakes it currently holds in Spain - 12.1% at Ebro, 9.1% at Ercros, 4.5% at Prima and in a small group of plastic manufacturers - with a total capitalisation value of Pts27bn (El-Pais, 9/11/1999).

KIO attempted to file a criminal suit in Spain against seven former managers of GT (alleging misappropriation of \$1bn), but this was rejected four times by Madrid's senior financial judge. Judge Miguel Moreiras claimed that there was no single indication that fiscal crimes had been committed. However, an appeal to Madrid's high court approved KIO's request for a criminal investigation in early 1994. Little progress was made since the filing was approved and KIO complained to the Spanish General Council of Judicial Power about Moreiras attitudes and called for his removal from overseeing the motion. KIO claimed that Moreiras had breached official regulations by revealing secrets to the media about the instruction under his consideration (El-Pais, 27/10/1995, p.57). Ultimately, Moreiras was replaced by Judge Teresa Palacios, who is currently overseeing the criminal case that was originally scheduled to start in October 1999 (but has been postponed to March 2000 because of de la Rosa's mental health). GT's Spanish case is demanding a sum of approximately \$1bn from the defendants, while the public prosecutor in the case has requested a 38 year jail sentence for de la Rosa for his role in the collapse (El-Mundo, 19/11/99).

In 1993, KIO also filed a civil case in London against several defendants (ultimately totalling 56 defendants) including former managers of KIO and GT, accountants and offshore companies - seeking around \$500m in damages. Some of the defendants tried to stop the case from being heard in London, claiming that the English courts did not have jurisdiction to hear the case. Their attempts were dismissed by the High Court in *Grupo Torras S.A. v. Al-Sabah* [1994]. Similarly, their appeal to the House of Lords in *Grupo Torras S.A. v. Al-Sabah* [1995] was also dismissed and the trial for the civil case started in October 1998. The civil case focused on five transactions (Croesus, Oakthorn 1, Oakthorn 2, Pincinco, and

Wardbase) that took place between 1988 and 1992, through which approximately \$500m was embezzled from GT via its subsidiary, THL. In the first four transactions, the embezzled funds were either transferred directly from KIO to GT/THL or through the transfer of some of KIO's financial instruments (such as promissory notes or treasury bills) to GT (who, in turn, used them as collateral for acquiring bank loans). These funds were then diverted, via a web of offshore shell companies, to unidentified Swiss accounts. For most of the transactions, documentation was prepared at a very late stage to cover up the reality of the transactions. In the fifth transaction, known as Wardbase, the money was transferred directly from GT via THL to an offshore company (Wardbase) as a payment for a fictitious job. This transaction was the least ingenious, probably because of the lack of time available - given that it was carried out on the same day that de la Rosa resigned from GT. During the course of the trial, the findings of the investigations by a Swiss judge revealed the identity of the people who had received the embezzled funds. They included, among others, the former managers of KIO and GT (Sheikh Fahad Al-Sabah, Fouad Jaffar and Sheikh Khalid Al-Sabah), the former managers of GT (Javier de la Rosa and Juan José Folchi) and two prominent Spanish individuals (Manuel de Prado y Colón de Carvajal and Enrique Sarasola Lerchundi). Manuel de Prado, a close financial advisor to the Spanish king¹, was not named in the civil action but has now been added to the list of defendants in the Spanish criminal action. He claimed that the money he received was payment for business transactions between JR and himself and that he wasn't aware that the funds came from GT. Sarasola, a close friend of the former Prime Minister Felipe Gonzalez, was also not named in the civil case in London. Both of the Spaniards did not have any business dealings with GT, so

¹ It was alleged in 1996 that De la Rosa (in alliance with Mario Conde the former chairman of Banesto who was ousted from the bank in 1994 and found guilty of misappropriating funds and was handed a jail sentence of 50 months) tried to blackmail the Spanish king, using Prado's closeness to the king, in order to pressurise the Spanish courts to drop the investigations against them. This tactic did not work as it was leaked to the press and there was no credible evidence of any wrong doing on the part of the king.

the reasons behind their receipt of the funds remain a mystery according to Judge Mance.

In June 1999, a judgement was announced on what is seen as having been the biggest fraud and corruption trial in English legal history (The Observer, 27/6/99, p. 3). The judge ruled in *re Grupo Torras S.A. v. Al-Sabah* [1999] that Sheikh Fahad Al-Sabah, Fouad Jaffar (in the first four transactions) and Javier de la Rosa conspired to defraud GT, while Sheikh Khalid al-Sabah was only found to be a co-conspirator in the Pincinco transaction. Similarly the judge found the four managers (on the same transactions) liable for breach of duties as directors of GT and guilty of dishonest assistance. Juan Folchi was also judged to be liable for breach of duties as a director of GT (in one transaction) and dishonest assistance (in four transactions). However despite the involvement of the other defendants in schemes and documentation to conceal THL's and GT's operations, the judge did not find them party to any conspiracies or liable for dishonesty. The judge felt that their involvement stemmed from their belief that what they did was for the interests of GT/THL/KIO and was not a part of any conspiracy. The judge ordered the five defendants to repay the siphoned funds of \$500m, plus seven years interest of \$240m and \$70m of legal fees. The judge refused Sheikh Fahad's and Sheikh Khalid's appeal against the decision but Sheikh Fahad is still planning to launch an appeal. The judgement also revealed other relevant findings and facts in the case that will be discussed further in subsequent parts of this thesis.

The KIO scandal led to several changes in the organisation of KIO and its relations with KIA. The parliamentary committee which investigated KIO's Spanish investments proposed establishing a separate entity from KIO to oversee KIO's Spanish investments - so as not to inflict further reputational damage (FEAC, 1993b). Indeed, a unit was set up in Kuwait (called 'Spain's Desk') to deal with the Spanish investments and to report directly to the managing director of KIA. The control of Fosterlane, KIO's holding company for its real-estate portfolio in the USA, was transferred from KIO to KIA in Kuwait (Al-Hajiri,

1993b). In March 1994, KIO came under the total control of its parent KIA. The power of KIO's manager was transferred to the managing director of KIA in Kuwait. The two executive committees of KIA/KIO were combined into one committee. KIA now determines all strategic decisions while KIO, as a department of KIA, implements its approved investments strategies and plans in Europe (KIA, 1996a). The internal audit procedures of KIA and KIO have also been unified/combined (KIA, 1996b). Recently, the chairman of KIO (the Kuwaiti Finance minister) made a decision to restrict the years of employment at KIO to 6 years (although this can be extended to 10 years with the minister's approval) – see Al-Qabas, 15/7/99. The parliamentary committee suggested that the composition of KIA's board was susceptible to political pressures. The positions of the central bank governor and the under-secretary of Finance were not seen to be independent from the Finance minister and might be politically affected (FEAC, 1993b). However, no change was made to the composition of KIA's board.

7.3.4 Political Fallout from the Scandal

The very close relation between politics and business in Spain can be easily demonstrated in the KIO case. The Spanish government had taken an initially sceptical attitude towards KIO's intentions of pursuing investments in Spain especially when they were carried out by de la Rosa - the government had particular concerns about him following his role in the collapse of Banco Carriga Nogues. The government's negative attitude towards KIO suddenly changed when Fouad Jaffar met and explained KIO's position to the prime minister Felipe Gonzalez, Carlos Solchaga, and Mariano Rubio. Jaffar also met Gonzalez, after being summoned by Rubio over the actions of the 'Los Albertos' towards the proposed merger between Banco Central and Banesto. Jaffar requested that Rubio should not interfere in KIO's operations and the Prime Minister apparently told Jaffar "anything you need I will make sure it gets done" (Whittington, 1993, p.88).

Eventually, the friendly relationship between KIO and the Spanish government changed once the newly appointed management team at GT decided to stop injecting more funds into the Torras group. In response to KIO's actions, the government started publicly criticising KIO and threatened to pursue KIO all over the world with legal actions. The Spanish authorities feared that a swift withdrawal by KIO from Spain would destroy a number of Torras' companies and would increase the already high unemployment rate in Spain. Tens of employees of Fesa Enfresa went on hunger strike for 12 days in a protest over Ercros' plans to shut down 5 plants and make 1900 employees redundant (Al-Qabas, 27/1/1993). There were also regular negative comments about KIO and Kuwait in the Spanish press when GT was taken into receivership.

“The Spanish government has been snubbed and made a laughing stock of and now the question remains: why not expropriate now, as was the case with Rumasa?” (Tribuna, 22/3/1993).

“The Kuwaiti's cannot just walk away leaving these floundering companies to go under. Nor can they turn their backs on a country which had a direct hand in restoring its independence, spending some \$500 million on dispatching a fleet to the Gulf, risking the lives of young recruits and allowing squadrons of B-52's to take off from Spanish airfields on their way to bomb Iraq. At the same time, however, our foreign policy should be used to take whatever diplomatic measures or trade sanctions are deemed necessary to make Kuwait's feudal lords realise that they won't get off lightly for abusing the friendship of one of their allies.” (El-Mundo, 5/12/1992).

The daunting economic prospects of the collapse of GT and the huge public outcry made the Spanish government intervene. Accordingly, Pedro Perez, the Economic secretary, visited Kuwait and signed a memorandum of understanding between the two countries to ensure that GT's problems could be resolved in an orderly manner (for details see Al-Qabas, 5/12/98, p.32). This agreement changed the GT affair from a business issue to a political one. For instance, the Spanish ambassador in Kuwait saw the collapse of Kuwait's investments in Spain as “the black point” in the relations between the two countries (Al-Qabas, 18/2/1995). However, securing agreement from Kuwait to support GT meant that the Spanish government was no longer attacking KIO in Spain but was supporting its actions

and later made funds available to some of the companies in the group. Strikingly, it seems that political negotiations were needed to facilitate KIO's entrance into Spain and were also needed to persuade KIO to stay in Spain. Moreover, the relationship in the former was between the Spanish government and KIO while, in the latter, the relationship was between the Spanish government and the Kuwaiti government.

The problems with KIO's Spanish investments were a major issue in the Kuwaiti parliamentary elections in Kuwait in October 1992. The affair provided a legitimate reason for the opposition members to demand more control and accountability over the country's public funds. The return of democracy in Kuwait represented a major force behind the publicity attached to the KIO scandal. The parliament, who called the scandal "the theft of the century", played a significant role in demanding investigations of the GT affair. The KAB was asked by parliament to investigate GT's accounts in 1993. In addition, the financial committee of the parliament investigated the scandal in the same year. The government endorsed the parliamentary investigation and claimed that it wouldn't intervene for the sake of former managers. Similarly, the KIO scandal was emphasised by the right wing opposition party in Spain, the "Partido Popular (PP)" (Popular Party), during the general elections in June 1993. PP highlighted the government's failure to scrutinise KIO's investments in Spain, even though Spanish regulations required cabinet approval for foreign investments made using public money. At one stage, PP were contemplating suing the prime minister over the collapse of KIO's investments. However, the socialist party won the general elections and PP appeared to drop its interest in investigating the GT affair.

7.4 Key Elements of the Collapse of GT: Analysing the Business/Regulatory Environment/Culture in the KIO Case

In order to consider the role of auditing in the KIO case and the case's implications for auditing (and its future promotion) in Kuwait, it is vital to understand the investment, business culture and regulatory environment in which

KIO (and its auditors) was operating. This section identifies a number of key elements in business practices that have a direct bearing/influence on the work of auditors. The subsequent chapter then considers the detailed role of auditing in the case. Many of the issues raise questions for the efficacy of audit practice that go well beyond the confines of the KIO case. These issues are crucial to understanding the way in which auditing operated in KIO and the problems it encountered.

7.4.1 A Culture of Secrecy

Information about the Kuwaiti investments managed by KIO/KIA has long been regarded as Kuwait's most protected secret. The tradition of secrecy was mainly adopted in the 1970s as a way of overcoming anti-Arab feelings that were present at the West as a result of the Arab-Israeli war and oil-sanctions imposed by the Arabic, oil producing nations. Being secretive also meant escaping the media publicity in the countries in which KIO was investing, enabling it to buy and sell without causing market prices to move against its interests. Another force behind the secrecy might be attributed to the Kuwaiti government's attempt to reduce the demand for loans and aid from other countries. One Kuwaiti official explained to a newspaper that "if we disclose, you have no idea of the planeloads who come to us" (International Herald Tribune, 25/4/1983, p.11S). Moreover, the magnitude of Kuwait's revenues and its small size made it vulnerable to aggression by some of its neighbours. Therefore, Kuwait thought secrecy about its investments might save it from such potential aggression.

Regardless of the motivations and merits of KIO's secrecy, it was successfully achieved through several means. The main strategy for KIO and KIA to achieve this secrecy rested in the fact that information about their total investments and revenues had never been disclosed nor been incorporated in the government's budget. Severe punishment was propagated to maintain this secrecy. Even though the secrecy of KIO's investments was secured long before the establishment of KIA, Law 47/1982 (which established KIA) further emphasised secrecy by stating that any one disclosing secrets relating to the operations of KIA

or information about it would be punished by a maximum jail sentence of 3 years. Institutions and organisations working with KIO/KIA have also been required to honour their client's secrecy doctrine. This attitude was clearly captured in the comments of some of the brokers dealing with KIO, with one reported as saying "I don't want to go to prison" and another noting that "No one talks about them, they don't like it and they are too important to lose" (Euromoney, 1988, p.52). Consultants and the advisory committee working for KIO were also not fully informed of all KIO's operations. This claim is evident in the case of KIO's acquisitions of stake at British Petroleum (BP) in 1987. The Advisory Committee for KIO, which included members of the House of Lords², was not aware of KIO's acquisition of BP until it became a controversial issue in the British press (FEAC, 1993b). KIO's use of offshore and external accounts played an instrumental role in maintaining the secrecy of its operations.

The veil of secrecy that surrounded KIO's operations was also maintained through the limited number of people undertaking KIO's strategic decisions and privy to all of its secrets. These people mainly consisted of Sheikh Fahad Al-Sabah, Fouad Jaffar, Sheikh Khalid Al-Sabah and a handful of British managers. This small group did not even provide complete information to KIA. Dr Fahad Al-Rashed, told the judge in the civil case filed by GT in London that KIO responded to KIA's inquiries with general, inaccurate statements about its investments portfolios and its assets (Al-Qabas, 5/12/98, p.33). The secrecy of KIO's Spanish investments was greater than normal in the sense that so few people at KIO were aware of the financial operations of the group. Executives outside the above circle in both KIO and GT had no knowledge of the group's operations, including the general manager of direct investments at KIO who was supposedly responsible for GT operations (GT represented 72% of all direct operations held by KIO)

² For instance Lord Thomson of Monifieth is currently a member of the advisory committee of KIO (House of Lords-Register of Lords' interests, <http://www.parliament.the-stationery-office.co.uk/pa/ld/ldreg/reg16.htm>, 2/11/1999).

(FEAC, 1993b). KIA was also in the dark when it came to KIO's operations in Spain, receiving only limited information from KIO executives. As one source close to KIA indicated to me in interview, during routine meetings at KIA about the status of KIO's investments a question mark was often placed in front of KIO's Spanish investment revealing KIA's lack of knowledge about the status of such investments. Even when KIO presented information about its Spanish investments it sometimes gave untruthful information, as in the case of the report presented to the executive committee in 1989 (FEAC, 1993b).

The secrecy doctrine seems have made it difficult for regulators, supervisory bodies and, to some degree, the government to know what was going on with KIO's investments. The parliamentary committee concluded that "senior officials responsible for the investment of the RFFG funds did not have a full and broad picture about these investments" and attributed this to the doctrine of secrecy (FEAC, 1993b, p. 9). Ironically, the secrecy that surrounded KIO/KIA's investments, meant that people in Kuwait only obtained information about these investments from what was published in the newspapers – which usually amounted to translations of articles already published in the international press.

The obsessive secrecy, unfortunately, offered the platform for mismanagement, illegal acts and fraud. In addition, it led to an exaggeration of Kuwait's assets and revenues, enticing other countries to ask for loans and aid which rather nullified the argument of being secretive to stem the tide of requests for financial aid. Moreover, the argument that secrecy might save Kuwait from a greedy neighbour proved false as it failed to prevent Iraq from invading Kuwait in August 1990. The issue of secrecy in the light of the GT scandal has been criticised in Kuwait as being both unreasonable and unnecessary. For instance, even simple information debating whether KIO had bought certain property or not was considered to be secret and not to be disclosed to the public.

"The government is obsessed with secrecy. One member of the parliament who asked the Finance minister for simple questions such as 'what is the magnitude of the funds invested in Spain?' and 'what are the companies in

which these funds are invested?’ and ‘are these companies listed in the stock exchange?’...The Finance minister prepared written answers for the parliament requesting that these answers be kept a secret. The public has the right to know the answers to these simple questions. As with reference to the inquiry about whether it was true that KIO purchased a Golf Club in the UK that is believed to have cost KIO more than \$100m, the required answer is a simple “yes or no” and if it was yes, how much did it cost KIO” (Editorial, Al-Qabas, 7/12/92).

Such secrecy was eased to some degree after the return of democracy in 1992 and the huge publicity that emerged following the collapse of GT. For instance, the parliament published the report of its investigation of KIO’s Spanish operations and the Audit Bureau published two reports about KIO/KIA’s investments. However, many aspects still remain secret, including the extent of KIA/KIO’s holdings around the world and estimates of KIO’s international portfolio. The belief in secrecy can also be seen in the form of information provided on KIA’s internet site - where there is scarcely any information about KIO/KIA’s foreign investments and details are mainly geared towards KIA’s stakes in shareholding companies in Kuwait.

7.4.2 Investment Strategy

“An examination of Kuwait’s current domestic and international investments and discussions with those involved in investment decision making in Kuwait indicate an absence of clearly defined objectives and/or an overall strategy for the utilisation of Kuwait’s surplus funds. Ad hoc investment decisions, bilateral transfers and investment management are indications of the lack of well defined investment objectives, strategies and policies. ...” (Al-Rashed, 1976, p. 3)

There was no clear strategy for KIO’s investments, especially before the 1980’s, as investments were made on an ad hoc basis or by accident. The above findings by Al-Rashed (1976) were shared by other researchers (see Al-Awadi, 1975, Al-Temeemy, 1993). KIO’s investment in Japan was a clear example of this claim. KIO’s entrance into the Japanese market was initiated accidentally by Fouad Jaffar in late 1971. He saw a surplus \$200m worth of yen in an unused KIO account and suggested that KIO invested in Japan. This investment grew subsequently to a value of \$12bn in 1990 (Whittington, 1993, p.50).

There was also a lack of co-ordination between the investments of KIO and KIA, with the two bodies unknowingly investing in the same companies (and, in the process, often breaking an investment rule that they hold in total no more than 10% of the equity capital of specific companies). Consequently, KIA drew up investment plans in the late 1980s, aiming to co-ordinate the investment efforts of both organisations. For instance, it required that neither KIO's nor KIA's stake in a specific company would exceed 5% of the equity capital at any time. Despite KIA's effort to map out a specific investment strategy for both organisations, there remained a clear conflict in opinion between the two bodies. This was most vividly evident in the issue of investments in oil companies or those related to the oil business. KIO's acquisition of 22% of British Petroleum (BP) in the period between 1987-1988 was a move that did not go down well with Jasem Al-Kharafi, the then Finance minister and chairman of KIA. Al-Kharafi believed that the BP investment ran counter to Kuwait's desire to use its investment as an alternative to dependence on oil. However, Ali Al-Khalifa, the Oil minister and a strong supporter of KIO's independence, argued that it was inevitable that investments will be affected by the oil market (Institutional Investor, August 1988).

Although KIO/KIA do not publish any figures or data about their investments, the parliamentary committee was able to show the distribution of RFFG funds between the two organisations as they stood in June 1992 (see Table 7.1). This distribution revealed that the investments of the two organisations were almost equally divided into two categories. The first category represented investments in cash, bonds and stocks. KIO was believed to have more than three-quarter of its staff assigned to these transactions in the dealing room. KIO's investments in this category can be characterised as that of a "passive investor", with small stakes in blue chip companies - neither assuming any board representation nor sometimes being identified as an investor in these companies. For example, KIO usually held stakes of less than 5% in the USA and UK - with companies required to declare any holdings of over 5%.

Table 7.1 – Allocation of RFFG funds to KIA and KIO as of June 1992

<i>Assets Category</i>	<i>KIA</i>	<i>KIO</i>	<i>Both</i>
Cash	19.86%	9.68%	15.42%
Bonds	3.87%	15.65%	9%
Stocks	30.53%	23.03%	27.26%
Direct Investments and Real Estate	45.75%	51.64%	48.32%
Total	100%	100%	100%

Source: (FEAC, 1993b, p.94)

The second category represented direct investments and real estate, with the investments not usually being listed on the stock market and KIO usually assuming a direct management role. Less than a quarter of KIO's employees were believed to be responsible for this type of investment. Some of KIO's investments in this category include St. Martins Property and St. Martins Hospitals in the UK, Foster Lane in the USA and Grupo Torras in Spain. Accordingly, KIO's Spanish investments fell into the second category and therefore it shows that KIO taking over the role of management of Torras was not something unique. However, what made KIO's investments Spain clearly different from other investments was that KIO constructed a large conglomerate with a highly diversified number of operations (the main companies being in the areas of chemical, food, paper, real estate, textiles, engineering, security, insurance and investment). This huge conglomerate, with its major industrial companies, was something that KIO did not have the expertise nor the skill to manage. The former president of KIO, Ali Al-Bader, implied that this new role for KIO might have been one of the reasons for the losses. He explained:

“...In Spain we took big positions in companies but we don't have the capabilities to do these things; we are financial investors not managers of industrial corporations. We have limited resources and our strategy is to take small stakes in well-defined companies; it is not our objective to act as a manager.” (The Banker, February 1993, p.32)

7.4.2.1 *A Complicated and Vague Investment Style*

“Acquiring and purchasing companies was conducted through a number of brokers, individuals and companies, who traded in big volumes with inflated prices which made it difficult to identify the real owner of these shares” (FEAC, 1993b, p. 46)

“.... Torras wasn’t so much a stock market problem. For me, the key was what happened in the relations between the management and shareholders of the company and its subsidiaries. On that issue I feel we have pretty much drawn a blank.” (Pedro Cases, CNMV’s spokesman - quoted in *Corporate Finance*, 1/94, p.15)

“The ingredients are all there: an in-house bank; a string of obscure firms (including the appropriately named Croesus International) based in loosely-regulated offshore financial centres; and blocks of money winging electronically around the world.” (The Economist’s description of the GT scandal, *Economist*, 15/5/93, p.96)

The construction of GT was so complex that, seven years after the collapse of the group, investigators are still unable to solve some of the mysteries surrounding the group structure. KIO invested in Spain using a combination of offshore/shell companies and the so-called ‘External Accounts’. KIO used the former to enter Spain, following a practice it had previously used to acquire investments in other parts of the world (see *Euromoney*, March 1988, pp.52-60). KIO’s acquisition of Torras Hostench was made through a route from KIO to Clachard Holdings N.V. (a Netherlands Antilles’ company), then through Kokmeeuw Holdings B.V. (a Dutch subsidiary), who duly acquired Torras Hostench. Other Spanish investments of KIO took place through Hainingend Holdings N.V. (a Netherlands Antilles’ company) and then through Koolmees Holdings B.V. (a Dutch subsidiary) (see Figure 7.4). The indirect acquisition of the companies can be attributed to the fact that KIO liked to keep its identity unknown. Furthermore, investing from the Dutch Antilles cut KIO’s tax rate from 30% to 15.5% as the Dutch Antilles was a tax haven (*Expansión*, 15/2/1993).

A major part of KIO’s Spanish investments also took place via the External Accounts, known as ‘under management accounts’. These were opened in the 1970s with Swiss banks, such as Lombard Odier and Volksbank, to manage funds on KIO’s behalf, although the banks were required to consult with KIO before embarking on any investments (Whittington, 1993). Very limited information is available about the functioning and purpose of these accounts. On the one hand, Whittington (1993) claimed that these accounts were created to

bypass restrictions imposed by the Bank of England in the 1970s. He highlighted the legal and operational reasons for the creation of such accounts as:

- a) The agreements between KIO and the UK government in order to compensate for the devaluation of the sterling.
- b) The secrecy of some investment transactions, in particular those regarding a large holding in equities, gilts, and gold, due to restrictions by the UK government.” (Whittington, 1993, p. 215).

On the other hand, the former managing director of KIA, Dr Fahad Al-Rashed, (whose organisation was also not aware of these accounts for many years) was informed by KIO that the establishment of these accounts was used to disguise the identity of KIO when making investments. The aim here was to protect KIO from potential detrimental effects on the prices of investments it acquired or sold (Al-Qabas, 21/11/1998, p. 24). These accounts were shrouded with secrecy to the extent that a former manager of KIO described KIO’s attitude towards them as “paranoid” (Grupo Torras S.A. v. Al-Sabah, 1999, p.7). Only the president, vice president and the chief investment officer at KIO were privy to the details of these accounts. The executive Committee of KIO expressed concerns about the external accounts, indicating that most of the reasons necessitating them had disappeared by 1989 (a decision was subsequently taken in May 1989 to gradually close these accounts - Whittington, 1993). These accounts were also highlighted as a cause of concern for KIA’s managing director and two members of the executive committee in their resignation letter (for more details, see Appendix 1).

The external accounts played a prominent role in acquiring the Spanish shares, albeit in a complicated manner. Rather than acquiring shares directly from the stock market, KIO acquired these shares initially through external accounts held in offshore companies in Switzerland and other parts of the world such as the Antilles and Jersey (Financial Times, 30/11/92, p.19). Then, based on rumours that KIO was interested in acquiring stakes in the companies (which it already owned through external accounts), the price of these shares would be boosted. The increase in prices would make KIO sell the stakes held in the external

accounts at a profit to TH, who financed the purchases through public offerings and loans (Figure 7.4). In its investigation of GT, KPMG revealed that, in late-1987, an external account of a Swiss company acquired a stake in Ebro, the food group, for \$9.8m and sold it a few weeks later to Torras for \$19m. Moreover, the Financial Times reported that a KIO internal memo revealed that the external accounts used by KIO made \$231m in profits, while the RFFG (KIO's main source of funding) made only \$23m profits for the same period. The London newspaper also believed that these accounts belonged to government officials or influential figures in the country (Financial Times 30/11/92, p. 19) rather than to KIO (as has been claimed by the former managers of KIO). The confusion and the near impossibility in asserting the true benefactor of these accounts is no doubt a clear consequence of the secrecy and lack of transparency surrounding KIO's operations.

However, regardless of the true identity of the benefactor of these accounts, the fact remains that the acquisition of shares through these accounts had a detrimental effect on Grupo Torras. Acquisitions through the external accounts were designed to shift the profit from selling shares to Torras abroad, tax free (either for KIO or other parties) while increasing Torras' debts and, hence, decreasing the group tax liability. However, such a scheme contributed to the collapse of the group, as the group ended up holding numerous shares at inflated prices paid for by bank loans. The huge debts owed by the group made it particularly vulnerable when the economic recession hit Spain in the early 1990s – but the use of the external accounts shows that the collapse of the group was not purely a direct result of the economic downturn (as has been claimed by the former managers of the group). It also undermines the accounting profession's usual claim that corporate collapses are the inevitable consequence of the economic cycle and have no bearing on the standard of audit services being provided. On the contrary, the case shows that the collapse was clearly related to indulgence in a complicated investment scheme – and the inability of the auditing function to cope with such complexity.

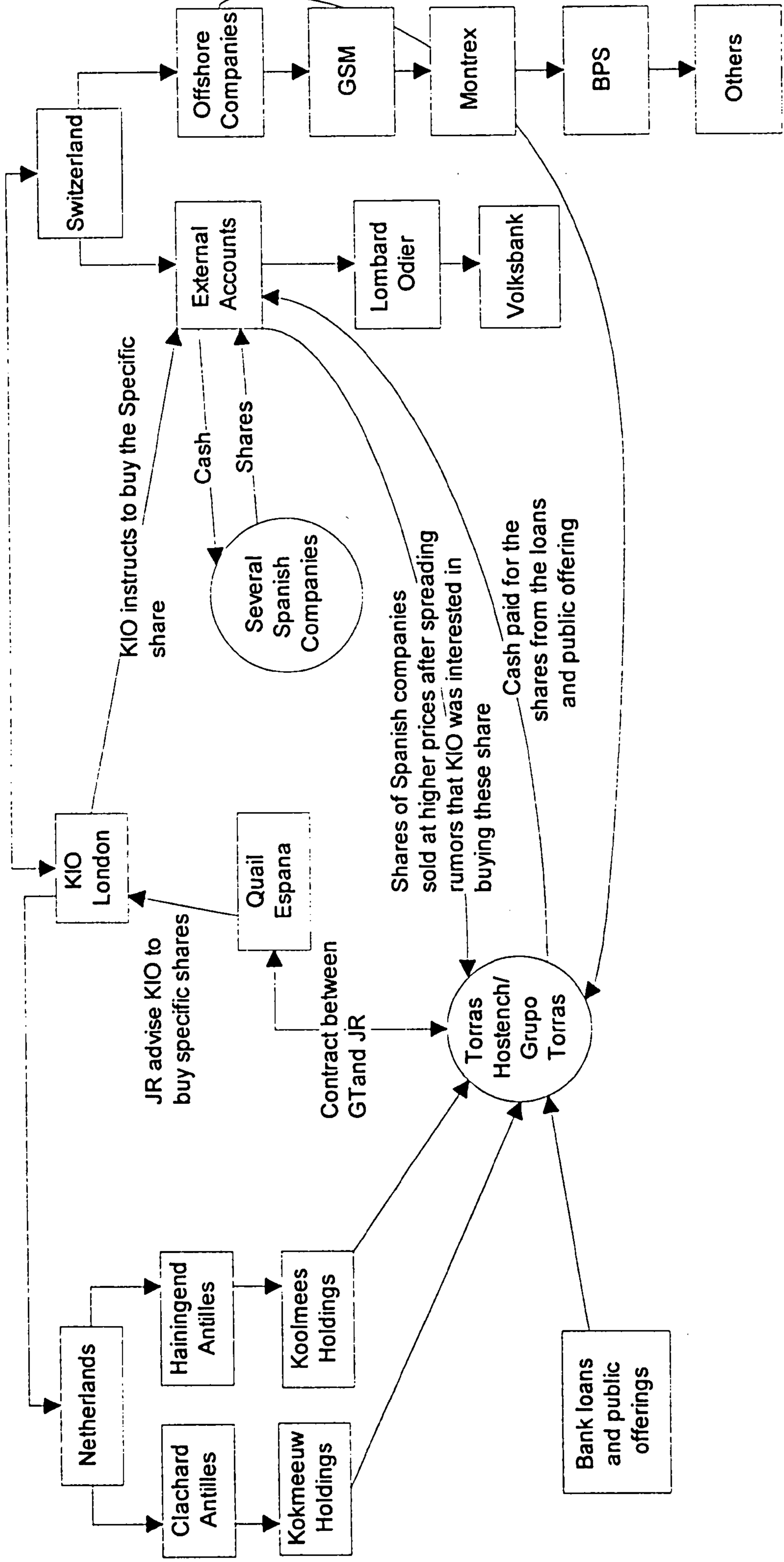
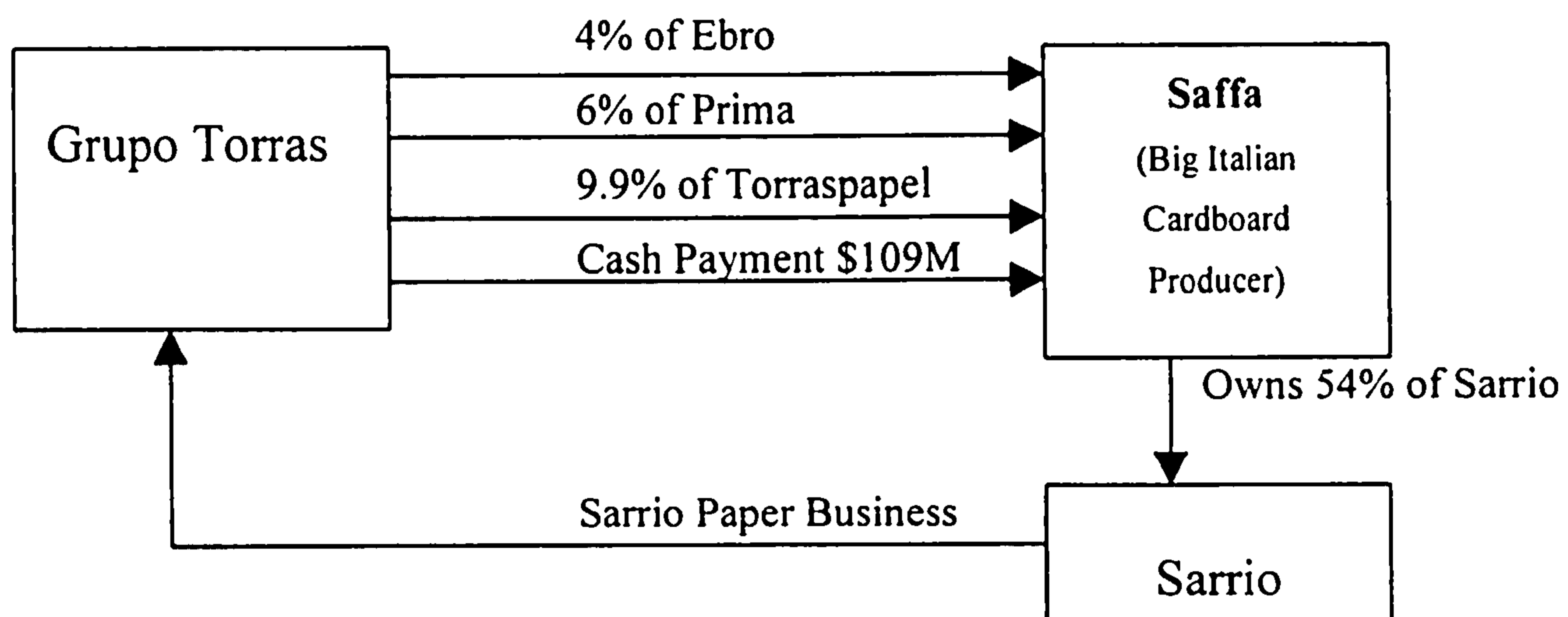


Figure 7.4 - KIO's alternatives mode of entry in Spain

An additional factor that increased the complexity of GT's structure were the way KIO acquired stocks or assets by combining share transactions and cash. The delisting of GT from the Madrid stock market in early 1990 was done by offering cash of \$76 and one share in Prima, the property developer, for nine shares in GT. Another example was the complicated transaction that took place in February 1991, when GT swapped a combination of shares in Ebro, Prima, Torraspapel and a cash payment of \$109m for the paper business of the Spanish company Sarrío (Figure 7.5).

Figure 7.5 – GT acquisition of Sarrío's paper business



The strategy of combining shares with cash made KIO embark on share price support operations to maintain share values before making offers (such as the above, which cost KIO \$700m). This support operation created a problem of control and provided a platform for irregularities at GT. The former managers of KIO claimed that they had participated in concealing some of KIO's stakes. They indicated that KIO parked these shares with them to support the share price and to avoid making bids for GT affiliates¹. KIO's new managers claimed that stakes held by de la Rosa and Jaffar, estimated at 32.5% of Prima, were personal stakes held by the former managers. Hammarstone, a company established in the

¹ Spain's law propagated that companies holding more than 25% of a subsidiary must make a bid for that subsidiary if it acquires stakes bigger than 6% in one year

Antilles (and headed by Jaffar) acquired 12.5% of Prima shares in February 1990. Although, Jaffar claimed that he was only acting as a proxy for the company, the new managers of KIO dismissed his claim that this company was owned by him. De la Rosa claimed in court that Mesa Redonda (a company 60% owned by him) had acquired 18.8% of Ercros on behalf of GT, who denied the claim. One of the new managers indicated in interview that the former managers were accustomed to making investments on the Spanish stock market and if their investments were successful they kept them for themselves while transferring such investments to GT if they failed. The complexity associated with Torras also included undisclosed acquisitions of stakes in the group. A one-year investigation by Spain's stock market commission, the Commission Nacional del Mercado de Valores (CNMV), revealed that KIO disguised some stakes in the group through a network of offshore companies. Accordingly, the CNMV fined GT and Kokmeeuw Holding, a Dutch subsidiary of KIO, \$13m for concealing from the stock market regulator the acquisition and disposition of shares in listed companies. The stock market regulator also imposed a maximum fine of \$36,000 on Javier de la Rosa for concealing stock market transactions relating to GT.

The use of offshore/shell companies and external accounts might be legitimate in reference to KIO's objectives of reducing its tax liabilities and protecting itself against speculation against its interests. However, regardless of these merits, the fact remained that the widespread adoption of such mechanisms enabled the former managers of KIO and GT to embezzle approximately \$500m from the group over a considerable period of time (1988-1992). The findings of the London court in *re Grupo Torras S.A. v. Al-Sabah* [1999] showed the reliance of the former managers on a network of offshore/shell companies and external accounts in different financial centres (e.g. Switzerland, Jersey, Bahamas) around the world to channel the embezzled funds. It can also be argued that KIO's and GT's frequent reliance on these mechanisms might have made auditors less inclined to suspect (have doubts) about the real purpose and destination of these funds. Auditors in other organisations and other countries (where such mechanisms were less frequently used and accepted) might have been more

inquisitive and sceptical about the transactions and funds exercised through such mechanisms. It is ironic that the auditors' job was clearly made more difficult by the prominent role played by accountants and lawyers in designing these mechanisms. The mechanisms made it undoubtedly difficult for auditors and other parties to understand the complex networks that were used to embezzle funds and hide their stakes in some of the Spanish companies. The role of accountants in designing these mechanisms and the related impact of the offshore/shell companies and external accounts on the auditing process will be further discussed in the next chapter.

7.4.2.2 Questionable Partners

The former managers of KIO made some of their investments with questionable partners. One of their partnerships was with Lincoln Savings & Loans, with Charles Keating (the mastermind behind the Savings & Loans scandal in California) selling to KIO a resort in Phoenix-Arizona at a highly inflated price. Keating told American investigators into the debacle of the S&L scandal that he paid \$17m in commissions and brokerage fees to unidentified Swiss accounts related to this sale (Audit Bureau, 1993). Partnerships with questionable individuals was also evident in Spain. The controversial partnership established with Los Albertos in 1988 to manage the acquisition of Banco Central initially ended in a sexual scandal. However, the Albertos are also now facing criminal charges over the allegations that they committed fraud and falsified documents in the sale of a plot of land in Madrid to Prima (this being where the famous towers known as "Torres de KIO" were built).

Nothing was more costly than KIO's partnership with de la Rosa who had a questionable past given that Banco Garriga Nogues collapsed after he left it and that his father had fled Spain after embezzling money from the Spanish government. The Spanish authorities claim that they warned KIO about JR's history and that KIO did not take their advice, taking the view that the Spanish government was targeting him because of his Catalanian descent. KIO appointed

him as deputy president of GT, while allowing his own company, Quail España, to commission all of GT's transactions through a contract that was clearly unfavourable to GT. The contract forbade GT from using the services of any company other than Quail for a five year period. It also stated that if GT cancelled the contract, or made specific changes², a \$50m compensation fee would be paid to Quail. De la Rosa's company was in no way legally obliged for any bad investment decisions it made on behalf of GT. The contract also stipulated an annual fee of Pts30m regardless of other fees that would be payable on transactions. This contract virtually gave JR the full control of KIO's investments and made him known as KIO's man in Spain. Accordingly, Spanish officials seemed to overcome their reservations of de la Rosa when they realised the huge investments made by KIO. This fact was echoed by Jordi Pujol, the head of Catalan government, in noting "I said something that I will say again. At a specific moment in time, it was Javier de la Rosa who helped the Spanish and Catalan economies out of every difficult patch" (El-Pais, 26/1/1993).

Quail's contract and JR's prominent position at GT allegedly enabled him to undertake a catalogue of actions that were detrimental to GT. JR used the contract to buy and sell shares for GT at inflated prices among related parties. KIO estimate the fees earned by Quail were around \$110m³. KPMG concluded in its 1992 investigation of GT that many of these acquisitions resulted from closed negotiations, without any justification for the prices paid. Many of the operations de la Rosa was involved in revealed a pattern of irregularities, including the acquisition of the paper business of Sarrio and the acquisition and merger of Coma Cros and Bures (which represents part of the legal action in Spain). It

² The contract stipulated that Quail has the right to terminate the contract and be paid \$50m if any of the following cases (Audit Bureau, 1993):

1. Change in the ownership of GT's capital that leads to change in management.
2. Change in the board of GT or change in the majority power of the board.
3. Injection of funds into the group stops as a result of factors related to the Spanish laws.

seems that de la Rosa was carrying out some of the acquisitions on behalf of GT just to acquire the commission. GT's acquisition of Sarrio's paper business is a good example of this tactic - it is alleged by Stampa Braun, GT's lawyer in Spain, that GT's purchase of Sarrio "lacked economic or industrial justification and it was set up by JR in order to obtain hefty commission" (Cambio 16, 22/3/1993). Misappropriations of funds occurred in many transactions usually involving companies owned by de la Rosa or his friends. For example, in 1988, de la Rosa recommended that GT buy an aeroplane at the price of \$3.56m from the son of Bruce Dawson, one of KIO's senior managers (the cost of the aeroplane was \$0.5m). Then the aeroplane was refurbished for an extra \$2.5m and sold for \$1.5m to one of the companies headed up by de la Rosa (FEAC, 1993b).

The widespread corruption phenomena identified by the Spanish social psychologist, José Miguel Fernandez-Dols, as '*amiguismo*' ('jobs for the boys') (The Independent, 28/10/1994, p.12) was clearly evident in this case. De la Rosa appointed many of his friends to senior posts in GT with lucrative contracts. He also acquired from his friends, companies and shares for GT at unfavourable conditions and prices (e.g. Cros and Bures). De la Rosa played a major role in the five transactions discussed earlier in the chapter and has been in prison more than once as a measure of preventive custody. He is currently under house arrest waiting for the start of the Spanish criminal case⁴.

³ In interview with El-Mundo, JR admitted receiving the \$110m but said he had to pay out \$60m of it as fees (El-Mundo, 22/1/1993).

⁴ On 18 October 1994, Javier De la Rosa was sent to prison pending charges of falsifying public documents and misappropriation of funds brought against him by the minority shareholders of the bankrupt Grand Tibidabo, a holding company acquired by De la Rosa in 1991. De la Rosa is accused of re-routing at least £15m from Grand Tibidabo towards his own private business. On 13 February 1995, De la Rosa left prison on bail of \$7.6m after one hundred and seventeen days in prison. However, he was sent again to prison as a measure of preventive custody for 15 months for his in the KIO case. He was released from jail in January 2000 under house arrest until the start of criminal case in Madrid (El-Mundo, 14/1/2000).

7.4.3 Lack of Control & Accountability

“In the first four years, I was the entire Japanese Department of KIO and made all the decisions myself” (Fouad Jaffar, quoted in Whittington, 1993)

“The first rule is that there are no rules” (Fouad Jaffar quoted in Euromoney, 1988)

The KIO case can serve as a classic example for Lord Acton’s famous motto that “Power tends to corrupt and absolute power corrupts absolutely”. KIO’s formula of few people managing huge funds in secrecy, independently with little, if any, accountability, was a recipe for disaster. KIO was also not under the direct supervision and audit of the Kuwait Audit Bureau. Furthermore, the external auditor of KIO, KPMG Peat Marwick, was relieved of its position in 1979 as the auditor of KIO and the office remained without an external auditor⁵. One well-known economist in Kuwait, Jasem Al-Souddan, was at the forefront of the people who were concerned and sought to investigate the operations of KIO in the 1970’s. However, his attempts were blocked by claims of secrecy. His concerns appeared to gain some validity in 1981 when KIO acquired Santa Fe, an American oil company, on behalf of Kuwait Oil Corporation (KPC). The acquisition of Santa Fe was surrounded with claims of insider trading before the acquisition took place at inflated prices⁶. American authorities subsequently investigated the matter and found no evidence of insider trading emerging from Kuwaiti sources. The opportunity to control the activities of KIO started to evaporate when the Finance minister, Abdel-Latif AlHamad (who advocated the establishment of KIA) resigned and his post was filled by Sheikh Ali Al-Khalifa - who supported the independence of KIO. Sheikh Ali made these belief clear in an interview to the Institutional Investor in 1988

⁵ There is no documented reason for the removal of auditor except one former official close to KIA indicated to me that KPMG was removed to maintain the secrecy of KIO’s operations.

⁶ KPC decided to sell Santa Fe after years of attempts to support the company has failed and proved costly to the KPC.

“Yes, the KIO does have a lot of autonomy. But it is absolutely essential for them to operate the way they do and as well that they do. We do not want to be making all their decisions for them.”

Consequently, KIO operated with little consideration to the wishes of KIA. Everything appeared to be going KIO's way until the issue arose of the investment in the liquor company, Arthur Bell. This investment generated huge criticism in Kuwait because Islam outlaws the consumption of, and trade in, liquor. KIO was ordered by the Finance minister to sell the investment and was warned to refrain from such investments in the future. Kuwait sold its stake in Arthur Bell at a huge loss to Guinness, who was bidding to take-over Arthur Bell (Kochan and Pym, 1987). The Kuwaiti parliament was irritated with KIO's investments and tried to assert some control over KIO, but the parliament was dissolved a year later. In 1986, KIO's executive committee visited KIO in London to try to enforce some kind of control. The reaction of KIO's managers was to prevent access to their offices and computers. One of KIO's employees described the attitude of KIO's managers to the executive committee as “how dare they come in and look at our books” (Asian Wall Street Journal, 25/11/92, p. 8).

After the 1987 stock market crash KIO started to acquire big chunks of the British government's floated shares in British Petroleum (BP). BP and the British government were concerned about KIO's acquisitions and made this known to KIO. Ignoring such concerns, KIO continued its aggressive acquisitions until its stake reached 21.6%, making it the largest investor in BP. These acquisitions were examined by the Monopolies and Mergers Commission (1988) who concluded that a merger situation existed and stated that KIO should reduce its stake to 9.9% within one year (later amended to three years). Eventually, BP bought back the shares from KIO at a favourable price (giving KIO a profit of \$750m).

Even though the Oil minister and the most senior managers at KIO were strongly opposed to the new regulations which KIA was trying to implement, the new board of KIA reinstated the post of external auditor for KIO in 1987 and

introduced a set of internal control guidelines in 1988 to govern the type, value and the region of investments. Subsequently, in the late 1980's, three members of KIO's executive committee met with the Amir to ask him to intervene to ensure that the internal guidelines were implemented (KIO had ignored them). The new guidelines advocated the establishment of two executive committees, one for KIA and one for KIO. These committees were set up to deal with urgent issues that did not need the approval of KIA's board. The Amir agreed to this but before they were implemented, Iraq invaded Kuwait (FEAC, 1993a). This ended up leaving KIO's operations and fund management basically in the hands of three people (the chairman, deputy-chairman and the Finance minister) – while the managing director of KIA had his powers largely taken away by the Finance Minister. The executive committee made a decision in March 1990 to appoint Abdul Whab Al-haroon, the new head of the direct investment department, as a member of the board of GT and a replacement for Fouad Jaffar. KIO's chairman chose to ignore the appointment of Al-haroon, although Jaffar was still appointed to the board.

The above indicates that there was a problem of control over the activities of KIO, which have contributed to the problems in Spain that culminated in the scandal of Grupo Torras. This catalogue of controversies should have, at least, served to change the way KIO was controlled and brought to account. However, this was not the case, with KIO embarking on riskier and unaccountable actions in Spain - making investments without reference to KIA and without informing KIA about the full status of KIO's investments in Spain. Lack of control is evident in the way KIO relied on one man in Spain to manage its huge industrial investments. Moreover, the creation of a web of offshore and shell companies made it very difficult to control the funds invested in Spain. Furthermore, the management of KIO committed the organisation to a different investment style, assuming management control of industrial groups without having the required skills and expertise. The large loans granted by the chairman of KIO without the approval of the Kuwaiti authorities was another vivid example of the overall lack of control. In 1989, the chairman made a loan for \$450m to GT for which he did not have the authority (loans in excess of \$30m required what is called a 'loan by law'). KIO's

executive committee's protests about this loan did not deter the chairman from granting further loans to GT – totalling \$1044m during the first three months of the Iraqi invasion of Kuwait (Audit Bureau, 1993). What is more striking is the passive attitude of the government over such loans - it was aware of their existence in 1989 but did not swiftly intervene to put an end to such violations. The government was seen as taking the side of the managers of KIO (FEAC, 1993, p 32). This can be vividly demonstrated by the way the government failed to react to several warnings and protests from the members of the board of KIA – leading them to resign in December 1990. The KIO management team, in contrast, stayed in position until they were forced to resign in May 1992.

The lack of control and accountability can also be attributed to the unstable history of the Kuwaiti parliament. The absence of the parliament from 1976 to 1981 and then from 1986 to 1992 enabled Kuwaiti organisations such as KIO to make controversial investment decisions without any reference to matters of parliamentary accountability. In addition, the absence of the parliament made the role of supervisory bodies such as KAB more limited as the Bureau was reporting directly to the government rather than to the parliament. Lack of accountability was also documented by the way one of KIO's British managers was involved in insider dealing activities regarding KIO's share purchases. KIO allowed the manager, who made £1m from his illegal dealings, to resign when it discovered the matter but did not report him to the authorities. The lack of action by KIO can be attributed to the fact that it wanted to maintain its low profile and avoid publicity.

7.4.4 Failure of the Supervisory Bodies

“Neither has the Spanish government shown any desire to block foreign take-overs, even when it comes to companies like Explosivos Rio Tinto, which is a major supplier of explosives to the armed forces, and which has been trying to fend off the attentions of the Kuwait Investment Office. Since the 1986 Foreign Investments Law specifically empowers the government to intervene in cases involving any aspect of national defence (along with gambling, television, radio, and air transport), it would have been easy to do so, but Kuwaiti capital has been of considerable value in revitalising some once sickly companies - like quality paper manufacturers

Torras Hostench - and risk alienating them might have been thought unwise. Besides, the government has good reasons for keeping Spanish companies worried about the possibility of being taken over: it is common knowledge that most of them have been concealing profits and undervaluing assets at the expense not only of the long-suffering investor, but of the Spanish treasury as well.” (Euromoney, June 1988, p.27)

“Eventually, politics helped carry the day for KIO. While Defence minister Narcis Serra sided with Escondrillas, KIO's Jaffar was able to convince Economics minister Carlos Solchaga that KIO would make ERT the centrepiece of what could be Europe's biggest chemical company. Proposals to shore up Spanish industry go down well with Solchaga, with whom Jaffar is careful to maintain good relations.” (Patterson, 1988, p.60).

“The Government had been helpful to the KIO but had not compromised Spanish interests.” (Fouad Jaffar speaking about the Spanish government at FT organised conference on Business with Spain, FT, 10/5/1988, p.2).

The failure of the supervisory bodies in Spain is clearly evident in the case of KIO's investment. Spanish rules on direct investment by foreign institutional investors state that approval of the Spanish cabinet is required for investments of more than 50% of the company's share capital. However, this law was ignored in the case of KIO. Carlos Solchaga, the former Finance minister, defended the government, claiming that it was not aware that the investments made in Torras represented KIO as they were carried out by companies from the Netherlands (Expansión, 23/2/1993). Nevertheless, this claim does not seem to hold water when considering an internal memo dated June 27, 1988 written by Manuel Conthe, Director of General Foreign Transactions at that time, pointing out that KIO's investments in Spain should have been presented to the Spanish cabinet for approval. Conthe suggested two alternatives to comply with the Spanish regulation – either to authorise the investments after they had already taken place or to change the existing regulations. None of Conthe's proposals were acted upon (Parry, 1994). Solchaga's claim also seems inconceivable when one looks at commentaries in the business and financial press in the late 1980s such as those sighted above. Moreover, it was reported that Banco Central had written to the government in 1988 asking for Cartera Central's constitution to be annulled, claiming that KIO as a foreign government agency had not acquired the necessary

approval required under the Spanish law. However, Solchaga intervened and resolved the matter, demanding an agreement between Cartera Central and Banco Central in order to maintain KIO's holdings at the bank (El-Mundo, 22/2/1993). These facts show that the Spanish government was not only adopting a *laissez faire* attitude towards KIO's investments but also was giving its support to KIO. The government's attempts to legitimise its claims by reports from the legal services department (El-Mundo, 11/3/1993) were not taken seriously by some of the Spanish daily newspapers, such as El-Mundo, whose editorial noted:

“And the government continues to confuse the issue by making incoherent statements... Only this very week, in response to questions raised by the opposition, the government claimed to have no records of KIO's investments in Spain. The ruling party still maintains that it was the Dutch companies, Koolmes and Kokmeeuw that invested in Grupo Torras on behalf of KIO. What an insult to intelligence! Not only is there no doubt in anyone's mind that KIO had been investing in this country without the authorisation of the government (as denounced by Banco Central in 1988), but why did the government go to the extremes of discussing the matter at the highest level, with its Kuwaiti counterparts? If it is true that these investments did not require the authorisation of the Council of Ministers due to their condition of being Community-based, then why on earth did Pedro Perez go all the way to the Emirate to sign an agreement with the Kuwaiti finance minister, ensuring KIO's continued presence in Spain. Why didn't he scuttle off to Amsterdam - far more in keeping with the government's logic.” (Casimiro Garcia-Abadillo, El-Mundo, 14/3/93).

Similarly, the Kuwaiti government's supervisory position was ineffective. It did not take firm action regarding the concerns of KIA's managing director and two executive committee members who had resigned in December 1990. Similarly, twelve Kuwaiti executives at KIO resigned in the same month, citing the failure of KIO's management to comply with office regulations and the executive committee's decisions (see Al-Qabas, 3/12/98, p. 9). The twelve executives retracted their resignations after the intervention of the governor of the Kuwaiti Central Bank and assurances from the Finance minister that these complaints will be resolved. However, nothing seems to have happened which ultimately led them write to the Prime Minister and Finance minister in June 1991, raising similar concerns (for more details see Al-Hajiri, 1993b). Despite all of these

complaints and the fact that he overstepped his authority more than once to grant loans to GT for huge amounts⁷, the chairman of KIO was only forced to resign in April 1992. Had the government acted earlier and forced him to resign when the complaints first surfaced, most certainly the magnitude of KIO's losses and the fraud committed against it would have been much less. The actions of the Kuwaiti government came at a very late stage of KIO's investments in Spain. Overall, the position of the two governments shows that they failed to act before the breakout of the scandal – although this is something they have not readily accepted. The Spanish government denies that it did not enforce the law and argued that it thought the law was not valid concerning KIO's investments. The Kuwaiti government's response has been more muted – placing blame ultimately on the former managers of KIO.

7.5 Conclusion

The aim of this chapter is to document the collapse of the KIO's investments in Spain and the context in which it operated. It began with a brief history of KIO, highlighting the role of the British government in persuading Kuwait to establish the office in London as a base to invest its oil surplus funds. The office's investments have grown throughout the years, especially during the growth in oil prices in the 1970's, making KIO an influential institutional investor in many parts of the world. In the mid-1980s, KIA was created as a parent for KIO with the aim of making Kuwait's investment strategy less bureaucratic and to gain more control over KIO's operations. However, the long history of KIO and the success it had achieved gave it unequivocal support from the Kuwaiti

⁷ In 1989, he granted a loan of \$450m to GT (he only had authority to grant loans with value of less than \$30m). The executive committee of KIO objected to this action and wanted the issue addressed. The finance minister, Ali Al-Khalifa promised to look into the issue after the summer vacation. However, the Iraqi invasion of Kuwait came before that end of summer. He again overstepped his authority and made several loans (approx. worth \$1072m to GT during the period from 1990-1991)

government, but turned it into a weakly controlled organisation – with a handful of people managing billions of dollars in utmost secrecy with very limited, if any, accountability for their actions. The prestige and the large autonomy enjoyed by KIO made it difficult for its new parent KIA to control KIO. Given this context, a crisis of some sort was almost bound to happen and, indeed, it did happen with KIO's Spanish investments.

KIO embarked on investments in Spain from the mid-1980s, making it Spain's largest foreign investor. The group was faced with huge losses and debts in 1992 and eventually put some of its subsidiaries into receivership. The aftermath of the collapse revealed fraud, misappropriation of funds and mismanagement. These led the group to file legal proceedings against the former managers of KIO and GT in Madrid and London. The judge in the civil case in London found some of the former managers guilty, among other things, of fraud and ordered them to pay \$700m of damages to GT.

The chapter has discussed the context in which KIO and GT operated, as this is vital to understand the factors that most probably had some bearing on the functioning of auditing in the KIO case. Several major issues stand out from the examination of the KIO case. The issue of excessive secrecy surrounding KIO's operations in general (and to a greater extent in its Spanish investments) made it extremely difficult not only for outsiders, but also for KIA, to access reliable and transparent information about KIO's Spanish investments. It was difficult to identify the beneficiaries (i.e. KIO/KIA or personal stakes of the former managers or other parties) of some of the transactions carried out in Spain, as a result of the secrecy and lack of transparency. The way KIO invested in Spain and constructed its group using offshore and external accounts played a crucial role in complicating the group's structure and transaction flows. It was a feature that was successfully tailored to embezzle millions of dollars from the group – and something that, after almost seven years of investigations, means that it is still difficult to trace particular business activities. The case showed that the fraudulent transactions were conducted with the knowledge and benefit of senior

managers at KIO and GT. The chapter also shows how in several cases KIO chose to do business with questionable partners rather than with respectable institutions. De la Rosa's partnership with KIO also shed light on the widespread practice of '*amiguismo*', with de la Rosa appointing many of his friends at GT and its subsidiaries. Lack of control was vividly evident in the way KIO operated, working largely with no reference to its parent KIA and paying little, if any, attention to investment regulations set by KIA. The fact that the chairman of KIO was a member of the ruling family (and also one of the Amir's cousins) and was supported by Sheikh Ali Al-Khalifa (the one-time Finance minister, who wanted KIO to remain independent) played a major role in enabling KIO to by-pass KIA and indulge in unauthorised actions (such as granting loans with the value of more than \$30m). Concerns about KIO's actions were communicated on more than one occasion to the Kuwaiti government but the government did not act at the right time – even though the managing director of KIA and other executives resigned in protest over KIO's actions and the lack of government action. The Spanish government was also accused of turning a blind eye to the legal requirement of approving foreign institutional investors, presumably not wanting to discourage investors like Kuwait. The facts and the major factors highlighted from the KIO case in this chapter will be used in the next chapter to assess their impact on the role and functioning of audit work in the case and for auditing in general.

Chapter 8

The Role of Accounting and Auditing in the KIO Case

8.1 Introduction

The KIO case, with its polemical elements, its international scope and the involvement of a number of different sets of auditors is a valuable vehicle for studying the contemporary role and nature of international audit practice. Auditors involved in the case included KPMG Peat Marwick (auditors of KIO in London and KIA in Kuwait), Coopers & Lybrand and Price Waterhouse (auditors of Grupo Torras and its subsidiaries/affiliates). In addition, Kuwait's Audit Bureau, the parliamentary-backed auditing organisation, audited both KIA and KIO. In this chapter, the role of these auditors is examined, along with that of other professional service providers used by GT.

The involvement of more than one auditor in auditing KIO and GT did not reveal any clear benefits over other forms of arrangement. The high reputation of KIO and its international wealth shows how auditors and consultants were proud to be associated with KIO but then ended up distancing themselves to some degree from KIO after the outbreak of the controversy over KIO's investments. The case also highlights the issue of creative accounting, where group accounts prepared using alternative accounting methods translated small profits into huge losses. The case also questions the independence of KIO's auditors, namely KPMG and the Audit Bureau, with KPMG being depicted more as an internal auditor than an external auditor. The politics of auditing is clearly highlighted in the case through the way auditors were hired and fired and the way they were hired to re-examine what they (or other auditors) had failed to uncover. The opaque way auditors collected their evidence is also discussed, emphasising the extensive degree of reliance that auditors place on management assurances or management created evidence.

KIO stands in some contrast to major financial collapses in Anglo-American countries in that such scandals usually generate several books and academic papers. For instance, the recent collapse of Barings Bank was the subject of at least five books, while the Savings & Loans crises in the USA produced various Books and academic papers (for example see Adams, 1992; Gapper and Nicholas

Denton, 1997; Hunt and Heninrich, 1996; Jonathan Beaty and Gwynne, 1993; Pizzo *et al*, 1989; Rawnsley, 1996; Truell and Gurwin, 1992; White, 1992; Hogan, 1997). Despite the fact that the KIO scandal was a bigger collapse than for instance that of Barings in terms of losses and its effects on the Spanish economy, it has not produced much in the way of academic research. One reason for this might lie in the historical tendency of auditing research in both Spain and Kuwait to concentrate on normative research. Lee (1993) criticised the use of scandals in auditing research believing that it was wrong and potentially misleading to rely on corporate failures to examine standards of auditing, especially given the limited number of completed cases in the courts. Other researchers (Stamp, 1980, Kaplan, 1987, Clarke *et al*, 1997) have a different view, seeing corporate failures as a valuable source of information to study the audit function. Indeed, audit scandals are used by some academics (Frecknall Hughes *et al*, 1998) in their teaching of auditing and they consider them to be useful tools for developing auditing knowledge.

This chapter starts by highlighting the role of different auditors and other professional service providers. Then it explores a number of key implications for the auditing function, include the subjectivity of accounting valuations, auditor independence, fraud detection, evidence collection, disciplinary proceedings and auditors' apparent immunity to scandals. The chapter then moves to consider the impact and the response of the accounting profession to the scandal in Kuwait and Spain, closing with a number of final reflections on the significance of the KIO case.

8.2 Assessing the Role of Auditors and Other Professionals in the KIO Case

This section discusses the role performed by KIO's different sets of auditors in Kuwait, UK and Spain, examining each one in turn before seeking to identify a number of key analytical themes in the case. This part also considers the involvement of other professional service providers in the case.

8.2.1 The Role of the Audit Bureau

Although the Audit Bureau was established eleven years after the establishment of KIB/KIO, it was indirectly auditing the information that the London office was presenting to the Investment Department at the Ministry of Finance. The Bureau started to audit KIA as soon as it commenced its operations in 1984 and duly assumed responsibility for the audit of KIO once it was came under the control of KIA. However, Law 47/1982 governing the establishment of KIA exempted it from the Bureau's ex-ante examination and stipulated that the Bureau's examination should not interfere in KIA's management and operational policies. The Bureau's statutory role also seemed to be restricted, with a Kuwaiti Member of Parliament claiming that KIA's accounts were not under the supervision of the Audit Bureau (Al-Qabas, 21/6/86, p.3) – apparently, the Audit Bureau's report on KIA's accounts for the year 1983/1984 did not contain any comments about KIA's investments activities relating to the General Reserve Fund (GRF) and Reserve Fund for Future Generations (RFFG). The Bureau's report only showed figures for KIA's total investments and revenues. Accordingly, the above mentioned MP proposed that the Audit Bureau carry out an investigation and audit of the accounts of KIA from 1983 to 1986, especially examining whether the GRF and the RFFG were in compliance with KIA's regulations and guidelines. The proposal, however, did not come to fruition as the Kuwaiti parliament was dissolved 12 days after the proposal's formal submission (the parliament not being re-formulated until late-1992).

The Audit Bureau lost much of its independence during the period when the Kuwaiti parliament was dissolved (1986 to 1992). This represented the period when KIO constructed the Torras group and during it the Bureau was reporting directly to the Kuwaiti government rather than to the (dissolved) parliament. Accordingly, the role of the Audit Bureau in auditing KIO and GT before the outbreak of the scandal continued to be rather insignificant. The Bureau's examination was restricted to the accounts prepared by KIO and sent to KIA. As KIO did not report all the required details to KIA, it is likely that most of the important transactions relating to the Spanish investments were never audited by

the Bureau. Despite the inability of the Audit Bureau to directly examine KIO's accounts and its Spanish investments, it seems that it was informed of KIO's mismanagement and illegal acts in Spain and elsewhere. A senior official (formerly close to KIA) indicated in interview that he informed the president of the Audit Bureau about irregularities and mismanagement at KIO in late 1990 but the president was reluctant to intervene (and apologised that he did not have the necessary manpower to investigate KIO). It was only after the collapse of GT and the return of the parliament that the Bureau's auditors visited KIO to conduct their audit of the London based office. Therefore, it would appear that the Audit Bureau had a very limited role in investigating KIO's operations and accessing its accounts but, even when it was informed about the possibility of misappropriations of funds and illegal transactions, chose not to intervene. The Bureau's failure to take action might be attributed to the fact that members of the ruling family controlled KIO and it was difficult for the Bureau (being under the control of the government rather than the (dissolved) Kuwaiti Parliament) to investigate their actions.

8.2.2 The Role of KPMG

'We audit their two big funds, but we are not actually auditors to the organisation and we never have been', insists a spokesman. A letter to KIO from now-retired partner John White, in 1990, says: 'My firm, in its capacity as auditor of Kuwait Investment Office and Kuwait Investment Authority . . .' White was the most senior partner working on the Kuwaiti business - so how could he be wrong? 'Oh, it's an understandable mistake because we audit the two big funds', blusters a spokesman. 'They have their own auditors in Kuwait - I forget the name - and we have no links with them.' (The Daily Telegraph questioning the role of KPMG Peat Marwick with relevance to KIO - Daily Telegraph, 6/12/93)

Information about the auditors of KIO is confusing. The previous chapter has documented that KPMG Peat Marwick was chosen by the British political representative of Kuwait in London as the auditor of Kuwait's first investment body in 1953. A prominent person (formerly close to KIA) revealed in interview that in 1979 KIO decided that it no longer needed an external audit of its accounts and Peat Marwick was discharged. He believed that the reason behind the dismissal of the audit firm was to maintain a veil of secrecy over KIO's

investments and operations. Accordingly, it is suspected that Peat Marwick was indeed the auditor of KIO, during the period 1953-1979, although no public audit reports or documents are available to support that belief. Law 47/1982 covering the establishment of KIA led to the re-introduction of external auditors at KIO, as the law required that one (or more) auditor be appointed by the board of KIA, based on the recommendation of the Finance Minister (the chairman of KIA). An auditor was only appointed one year after KIA started its operations, with KPMG Peat Marwick-London being selected as the auditor of both KIA and KIO - a point disputed by KPMG. KPMG have claimed to be the auditor of KIO before the breakout of the scandal of GT but subsequently have maintained that they were only auditing two of KIO's accounts (the GRF and the RFFG). The significance of KPMG differentiating between being the full auditor and the auditor of two accounts might be explained by the fact that in the former role KPMG would be auditing all of KIO's funds (and all other funds KIO's invests on the behalf of other organisations, such as KPC), while, in the latter, KPMG would only be responsible for KIO's funds. KPMG's claim that they only audited the two accounts enabled it to claim that it was unaware of the allegations that KIO (a tax exempt body) made the controversial investments in BP on behalf of KPC (a tax paying corporation) avoiding payment of £600m in taxes to the Inland Revenue in Britain.

In seeking to clarify issues relating to KPMG's audit of KIA/KIO, I contacted KPMG in London. On 12 April 1996 a letter was mailed to its head of audit making inquiries about the possibility of arranging an appointment to discuss the firm's involvement in the audit of KIO. KPMG's head of audit responded that "...it is extremely unlikely that we would be prepared to comment on matters concerning a specific client..." and he passed my request to the partner responsible for KIA's audit. A follow up letter was sent to the concerned partner explaining that I was seeking clarification of certain factual matters which could be answered without any breach of client confidentiality - e.g. "From what date and until when were KPMG the external auditors of KIO?" (For a complete list of the presented questions, see Appendix 2). The audit partner concerned

responded that “as a matter of principle we do not disclose the affairs of our clients in any form”. He communicated my requests to KIA and suggested that I should contact KIA directly to obtain such information. Consequently a letter was mailed to Mr Ali Al-Bader (the Managing Director of KIA) requesting an interview to discuss the questions put to KPMG. The director of his office, Mr Ahmed Bastaki, responded to my letter suggesting that an interview could be arranged in Kuwait. I met Mr Al-Bader on 29/1/1997 and after explaining my research project he told me that KIA’s rules and regulations forbid him from talking about KPMG’s work at KIA and KIO - and that the only organisations who could get access to information about KIO/KIA’s auditors were the Audit Bureau and the National Assembly (the Kuwaiti Parliament).

However, he did state that according to his knowledge, KPMG only started to carry out audits in real terms in 1992 and that its first audit report was in 1992 – prior to this it was merely checking investment procedures. He added that there was “no beef in it”, meaning that there was no story in the claims that KPMG-London had been negligent or did not act professionally. He carried on saying that, “in fairness to KPMG, I will tell you that in December 1991 KPMG staff had come to KIA in Kuwait warning them to save their money, recommending that KIA changed the management team at GT”. According to Mr Al-Bader, KIA had originally appointed KPMG (London) in 1987 and that KIA had no relations with KPMG (Kuwait). In the interview, it was very apparent that Mr Al-Bader was reluctant to provide information on the role of KPMG. The difficulty in obtaining basic factual evidence from either KPMG or Mr Al-Bader emphasises the sensitivity of the KIO/GT case and the degree to which it has been clouded in secrecy.

Regardless of whether KPMG was a full auditor of KIO or not does not change the fact that it was restricted in its investigations of some of KIO’s investments, such as those in Grupo Torras. That KPMG did not appear to have had access to all of KIO’s documents and papers is backed up by the resignation letter of three

KIO's executive committee, dated 30 December 1990. These three members of the executive committee wrote to Kuwait's Prime Minister in exile¹, sighting a list of irregularities at KIO. They indicated that one of KIO's accounts, estimated at \$1.9bn (and managed by KIO's chairman, vice chairman and overseen by one person) was not audited by the external auditor (KPMG) or the internal auditor of KIA. In addition, KIO did not present its monthly and quarterly reports to the executive committee, while the latter's call for the external auditor (KPMG) to carry out a full inquiry into GT operations was ignored. All of this suggests that KPMG's access to information was severely restricted by KIO's management team. KPMG was assigned to assess the value of KIO's Spanish investments, which they estimated to be between \$2.7bn and \$4.4bn in late 1991. A year later KPMG was asked to undertake another examination of GT, duly giving it a negative value of \$4.4bn.

The parliamentary committee investigating the collapse of GT claimed that many of the people it met during its investigation did not think that hiring KPMG in 1993 (after GT's collapse) was a good decision, given KIO's previous experiences with KPMG and its expensive fees². The committee felt that KPMG had been aware of KIO's difficulties in Spain, claiming that when a draft financial report of Torraspapel (prepared by Coopers & Lybrand in Spain) was presented to KPMG, it failed to pass its concerns to KIA. Accordingly, members of the committee thought that KPMG had not properly performed its job:

“It became clear to the committee that KPMG was the external auditor of KIO during the time when the Spanish investment was carried out. One of KPMG's tasks was to attest to the financial position of these investments and to express an opinion on them. But it did not present any reports, or notes, or reservations concerning the financial reports prepared by the auditors of GT companies in Spain...” (Kuwaiti Parliamentary Financial Committee Report, 1993, p.62).

¹ During the period of Iraqi occupation of Kuwait between 2/8/90 and 26/2/91, the Kuwaiti government assumed its responsibilities from Saudi Arabia.

² It was estimated that the fees of KPMG for the period from early 1992 to early 1993 were £18m for the audit of KIO and investigations of GT (Al-Sharq Al-Awsat, 20/3/93, p.13).

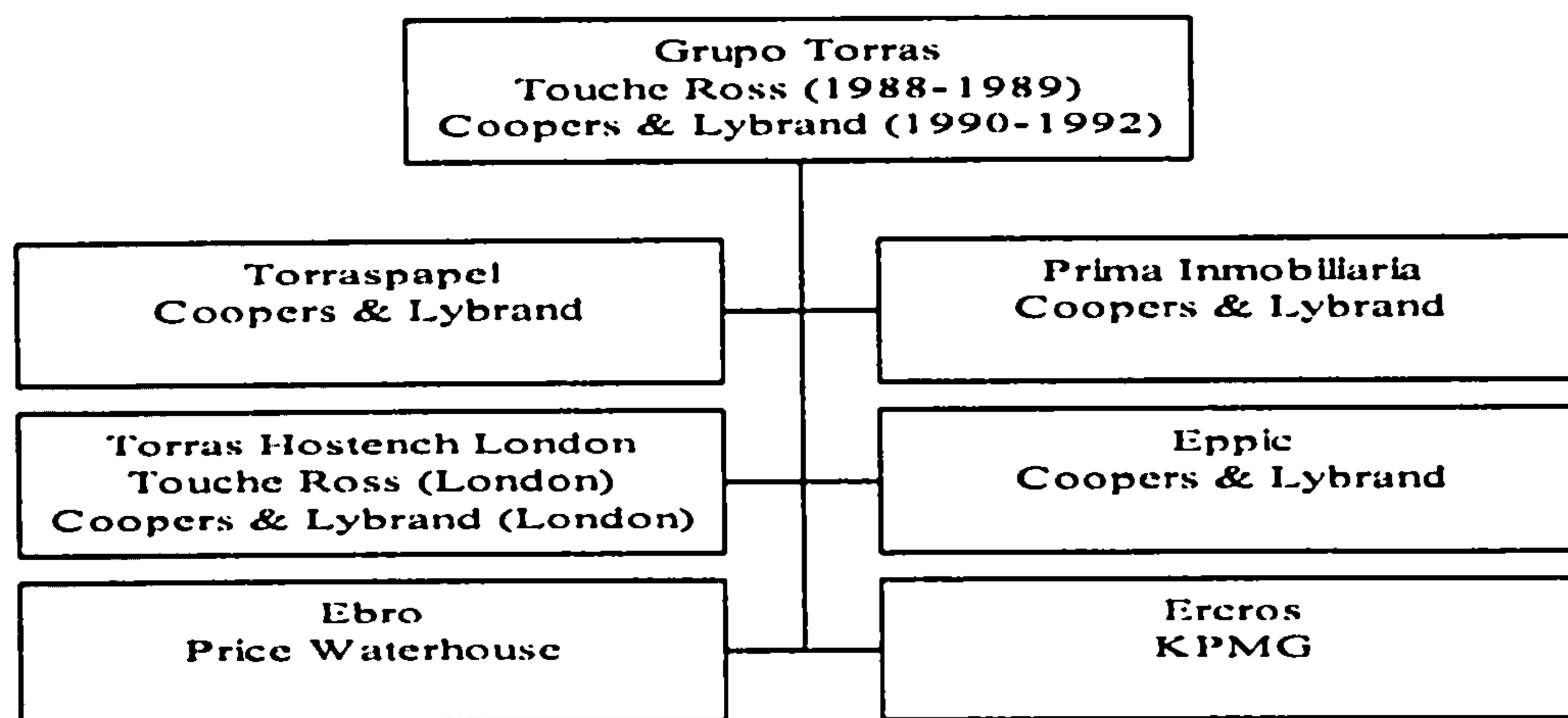
However, it can be argued that even if KIA had found KPMG negligent to some degree (as the committee thought) it wasn't prepared to change auditors because of its historical desire to maintain the secrecy that surrounds its operations. Indeed, the Kuwaiti Finance minister's justification for hiring KPMG to investigate GT was that KPMG was already familiar with KIO and, more importantly, it would preserve the secrecy around KIO (Al-Watan, 4/7/1993, p.10).

In summary, it would appear that the involvement of KPMG and the Audit Bureau played a major role in creating a façade that KIO was being properly audited and controlled - while in reality both were restricted in terms of their access and scope of work. Further, both became aware of GT's difficulties but did little, if anything - raising questions regarding their independence. However, in failing to prevent mismanagement they stand in company with the managing director of KIA, two members of the executive committee of KIO and the Prime Minister of Kuwait. The involvement of members of the Kuwaiti ruling family in the management of KIO made any such corrective/preventive actions difficult for all concerned.

8.2.3 The Role of Grupo Torras Auditors

Grupo Torras, its subsidiaries and affiliates were audited by a number of the Big Six audit firms in Spain (see Figure 8.1). Surveying the audit reports of Torras and selected subsidiaries between the period of 1988-1993 reveals an extensive pattern of qualified audit reports (see Tables 8.1 - 8.3). KPMG (Spain), the auditor of ERT before the merger with CROS in 1989 and later the auditor of the merged group Ercros, issued qualified audit reports from as early as 1988. KPMG's qualification of ERT in 1988 and Ercros' accounts in subsequent years led Touche Ross and Coopers & Lybrand to qualify GT's accounts over the uncertainty of Ercros' future.

Figure 8.1 - Some of the Auditors of GT, its subsidiaries and affiliates



The financial statements for 1988, when Torras Hostench was floated at the stock market and its name changed to Grupo Torras (GT), represented the group's only unqualified report. In March 1990, the board of Torras made a decision to replace Touche Ross with Coopers & Lybrand (Barcelona) as the auditors for GT starting from the financial year of 1990. In June 1990, Ricardo Gomez the Touche Ross partner responsible for GT's audit also moved to Coopers & Lybrand and became the partner responsible for the GT audit. In August 1990, GT's 1989 accounts were filed with the CNMV, with a qualified audit report by Touche Ross sighting the uncertainty over the future of Ercros (as highlighted in KPMG's audit report of Ercros). However, these accounts did not show or highlight the concerns expressed by Touche Ross (London), the auditor of THL, regarding two of the fraudulent transactions (Croesus and Oakthorn 1).

According to the KIO legal judgement in London, the concern about these two transactions was raised in June 1990, at the time that THL's auditor was preparing to complete their work on THL's 1989 accounts. Shortly before that time, de la Rosa had given GT's guarantee for the Croesus (\$25m) and Oakthorn 1 (\$55m) loans made by THL. De la Rosa's action led Touche Ross (London) to inquire about the rationale of these two transactions. Touche Ross' inquiry resulted in the production of a letter from Miguel Soler, the general manager of administration and finance of GT and a director of THL, justifying the two transactions as a part of a strategy for reorganisation of the group. The inquiry also secured letters from Croesus and Oakthorn confirming their liability towards THL and Nunez from GT also guaranteed GT's responsibility for these loans

towards THL. Touche Ross (London) also communicated their concern about the status and rationale of the transactions in a letter to Coopers & Lybrand, as the new GT group auditor for year 1990, and to Nigel Black at KIO, whom they met along with his superior manager shortly after. The KIO officials weren't able to provide answers to their inquiries. Touche Ross wrote again to Coopers & Lybrand wondering if they had received similar information. Eventually these inquiries and the guarantee letter received from GT were sufficient for Touche Ross to sign the 1989 accounts of THL (for more details see the official judgement in *Grupo Torras S.A. v. Al-Sabah*, 1999).

Neither of Torras' auditors in Spain, Touche Ross (Barcelona) and Coopers & Lybrand (Barcelona), seemed to share the concerns of Touche Ross (London) as they both did not make reference to the issues in their audit reports of 1989 and 1990, nor raised concerns about the two transactions with KIO or GT. Interestingly, it appears that the 1989 group accounts for GT were not signed off by Gomez (Touche Ross) until late June/early July (although the published date that the audit report was signed was given as April 1990 - and May 1990 for the second paragraph in the opinion). The KIO legal judgement stated that officially the audit report was signed off before the THL audit had been completed, giving the impression that the real desire of Touche Ross was for supporting evidence to justify the existing opinion rather than to resolve the questions coming from Touche Ross (London).

Coopers & Lybrand audited GT's accounts for 1990 and issued a qualified audit report. Coopers & Lybrand attributed their qualification to two transactions. The first concerned Ebro's merger (creating a bigger food group) which saw Grupo Torras' overall stake at Ebro change from 51% to 40%, but its investment value increase to Pts33.73bn according to an independent expert. C&L disagreed with such a valuation and indicated that the book value should not have been changed. The second transaction related to concerns about Ercros, which was in the process of restructuring. Coopers & Lybrand was concerned with the audit report of Ercros which stated that it was not possible to determine if the provisions registered in Ercros' accounts were sufficient to cover the relative costs of

restructuring. However, uncertainties also existed with respect to subsidies received in relation to this process, while C&L were also subsequently criticised for their failure to qualify GT's accounts for the capitalisation of the two fraudulent loans (Croesus and Oakthorn 1) which were subsequently transferred to the reserves of THL. This, and other transactions, was investigated by ICAC who fined C&L (see below for further discussion). This transaction was also the focus of the civil case filed in London, where the judge concluded that Grupo Torras has suffered losses.

KPMG gave a qualified audit report in 1992 for Ercros' 1991 accounts, just a month before the chemical group filed for receivership, citing uncertainties about the future as motivations behind their opinion. Interestingly a year later, KPMG, in its audit report on Ercros' 1992 accounts, not only refused to give opinion but also retracted its qualified opinion for the 1991 accounts - replacing it with a disclaimer of opinion. This change of opinion (from qualified to disclaimer) is unusual, as it implies that there was something wrong with the previous audit opinion. The draft financial statements of GT for the financial year 1991 showed a profit of Pts3.9bn but the new management in KIO and GT ordered C&L to rework the accounts using market prices and removing extraordinary gains. The new accounts saw GT's results change from Pts3.9bn profit to a Pts44.4bn loss, leading GT's managers to refuse to sign the audit report. Accordingly, the formal accounts of GT were only presented to the CNMV in 1993 (a year overdue), with C&L disclaiming their opinion (citing uncertainties with GT's suspension of payments). A disclaimer of opinion was also common to the financial statements of companies in the GT group, due to the uncertainties about the future of the holding company and other uncertainties, such as the CNMV investigation discussed in the previous chapter. The accounts of THL in 1991 also raised concerns for its auditor Coopers & Lybrand (London). Their concern was related to a sum of \$300m used in the Pincinco transaction as a Fiduciary Deposit from October 1990 to October 1991 at Bankers Trust (Switzerland). In July 1991, the auditor of THL sent an audit confirmation form to the bank to complete, not knowing that the deposit was no longer held at that bank. A Co-operative Bank

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employee implemented the request of GT's managers to provide confirmation that the \$300m deposit was at the bank when no such deposit was in existence. Accordingly, an auditor told the civil court in London that his firm had signed the accounts on the belief that the confirmation was genuine.

Unlike other cases, where corporate collapses shortly follow a clean audit report and raise the infamous question as to "Where were the auditors?", the GT case, as illustrated above, had a significant number of audit qualifications some years prior to the collapse. However, C&L's qualification of the 1990 accounts and refusal to give opinion on the 1991 accounts were not seen as sufficient by ICAC, the Spanish audit regulatory body. ICAC investigated the audit reports for these two years and fined C&L for the 1990 audit after completing a ten month investigation (see Appendix 3). This was the first instance of a Big Six accounting firm being fined in Spain. ICAC initial investigations identified six charges. It claimed that the facts relating to charges 1 to 5 could be constitutive of a serious breach of article 16,2.c of the Audit Law 19/1988, for supposing non-compliance with audit procedures that can cause economic prejudice to third parties or to the company or entity audited. The facts reported in the sixth charge could be constitutive of a serious breach of article 16,2 relating to differences between what is reported and what was obtained by the auditor during his work. ICAC also showed that C&L did not comply with ICAC's *Technical Procedures* and the *Reformulated Text on Company Law* (see Table 8.4 for a summary and Appendix 4 for further details). ICAC prepared a proposed resolution for all but the fifth charge and communicated its findings to C&L, giving it the opportunity to defend itself against the charges. C&L's response to ICAC's findings and its proposed resolution was twofold. On the one hand, C&L made a series of general statements questioning the legality of the principles specified by ICAC and ICAC's interpretations of what constituted a breach of such principles. It also discussed each one of the charges in detail. ICAC refuted the claims of legality sighting various legal judgements and emphasising specific points in the audit law. ICAC also used the working papers of C&L to discredit their response to the charges. C&L also presented to ICAC two reports of professional opinion

from the major Spanish professional accounting associations, Registro de Economistas Auditores (REA) and Instituto de Censores Jurados de Cuentas de España (ICJCE), as a defence against ICAC's charges³. ICAC's report did not disclose the full text/details of the opinion of these institutes but responded directly to their arguments in defence of C&L work. ICAC assigned a considerable part of its report to refute REA's opinion. ICAC's report indicated that some of REA's justification for C&L work was difficult to understand, had limited or no basis for its conclusion, and implied non-compliance with GAAP. ICAC felt that some of REA's justifications might have been acceptable if additional measures had been adopted but they were neither adopted by C&L nor discussed by REA (for further details see Appendix 4). The ICJCE report was only briefly addressed in ICAC's report. According to ICAC, ICJCE had referred to alternative accounting treatments that could have been adopted by GT but did not address the one adopted by GT. ICJCE avoided commenting on one transaction, claiming that it was purely a legal issue, while referring to evidence that only emerged after the financial statements had been issued when discussing another transaction. ICAC indicated that the rest of the arguments in the ICJCE report were similar to those advanced by C&L and therefore did not weaken ICAC's findings. Ultimately, ICAC decided to fine Coopers & Lybrand Pts38.50m, amounting to 1.25% of their total audit fees for the previous year.

ICAC's investigation and fines were not limited to GT but also included Ebro, the most successful company in the GT group. ICAC investigated Price Waterhouse's audit of Ebro for the year ended 30 September 1992. This investigation was instigated by CNMV who contacted ICAC requesting technical opinion on the individual and consolidated audit reports of Ebro for that year. ICAC concluded that Price Waterhouse had failed to qualify its audit report in relation to three transactions, which if they had been charged against income,

³ It is unclear from the ICAC report of whether C&L asked REA and ICJCE to prepare these reports or these professional bodies voluntarily prepared these reports. It is also unclear whether either of these bodies prepared similar reports in defense of other firms sanctioned by ICAC. In order to resolve these uncertainties, a contact was made with ICAC, REA and ICJCE whom all declined to comment on these matters. Contacts were also made with Spanish academic

would have turned Ebro's profit of Pts3.59bn into a loss of Pts2.2bn. On the first two transactions, Ebro wrote-off the restructuring charge and the loss on sale of its own shares against reserves rather than against profits. With the third transaction, Ebro wrote down revalued assets to their historical cost in order to show a profit on their sale. Accordingly, ICAC fined Price Waterhouse Pts53.6m, 1% of PW's total audit fee income for 1992. ICAC also fined the partner in charge of Ebro's audit, Pts550,000.

An examination of selected financial statements of key companies in the group thus reveals a number of interesting findings. The auditors of Ercros and Grupo Torras qualified their audit reports from as early as 1988, mainly as a result of uncertainties over the future of Ercros. This might indicate that Torras' auditors had no choice but to qualify their audit reports given that all of Ercros' audit reports were qualified over the uncertainty about its future. Indeed, the collapse of the group in 1992 was triggered by the huge losses of Ercros and its subsequent filing for receivership. Therefore, it seems that the auditors of Ercros and GT had successfully identified a going concern issue that became reality when the group filed for receivership in mid 1992. The case also showed that the British auditors of THL were more inquisitive about the fraudulent transactions (Croesus, Oakthorn 1, Pincinco) than their Spanish counterparts, especially those auditing GT. This was clearly seen in the above three transactions where the auditors tried to inquire about their rational and wanted to obtain proper confirmatory evidence (even though such evidence was usually fabricated). The role of auditors in Spain revealed some peculiar practices, such as in the case of Ercros where KPMG modified its previous audit opinion from qualified to disclaimer in the subsequent financial year. Additionally, it is worth emphasising that the charges laid against the Spanish auditors do not relate to controversial issues such as a failure to detect fraud. The charges against C&L, for example, relate to basic issues of breaches in accounting concepts, auditing procedures and compliance with laws. The fact that the scandal came after a number of qualified

colleagues who were also unable to resolve these uncertainties.

reports can give the impression that auditors are damned if they report and damned if they don't. However, in spite of such qualifications the charges relating to C&L and PW revealed several instances where the auditors had failed to disclose important facts to the public.

8.2.4 Accounting Records

Analysis of the role of KIO's auditors and GT's auditors has revealed that while many auditors were involved in the case the quality of their work was not that evident. The problems faced by KIO's auditors concerned the restrictions on their access to information and sometimes also finding records or documentation not available as a result of poor bookkeeping. GT's auditors seemed to encounter similar problems, with investigations revealing that loans between group companies were registered in GT's books but not in those of the subsidiaries. The second problem that affected all the auditors (both public and private) related to the management and the power of KIO. The managers of KIO felt accountable to nobody, while de la Rosa's total control of GT also seems to have compromised auditors' objectivity. The lack of action on the part of KIO's auditors looks all the more surprising given that subsequent official investigations highlighted KIO's poor standards of bookkeeping and accounting record maintenance. KIO's accounting problems also included deficiencies in its internal audit staff, whom were not professionally qualified. Neither the director nor his assistant held a degree in accounting (even though regulations required that the head of the department should be a certified accountant). Consequently the Bureau felt that the shortcomings in the staffs' qualifications meant that the department was unable to fulfil its task. However, this was a harsh conclusion given that managers controlled everything in KIO and were not accountable to anyone. External parties to KIO failed to control the organisation or stop the mismanagement and there is no evidence to believe that the internal audit department would have been able to achieve what other people (e.g. KIA's managing director) had failed to achieve.

Table 8.1 - Summary of Selected Information from the Accounts of Grupo Torras

Financial Year	Auditor	Date of the Audit Report	Date Filed with the CNMV	Type of Financial Statement	ASSETS (Millions of Pesetas)	ASSETS (Millions of Dollars)	Capital & Reserves (Millions of Pesetas)	Capital & Reserves (Millions of Dollars)	Profit (Loss) (Millions of Pesetas)	Profit (Loss) (Millions of Dollars)	Type of Report
1988	Touche Ross	31 March 1989 (21 June 1989- Note 20)	19 October 1989	Torras Hostench	252,971	2,530	92,347	923	16,530	165	Unqualified
1989 ¹	Touche Ross	3 April 1990 (17 May 1990- Paragraph 2)	29 August 1990	GT	200,387	2,004	80,928	809	5,665	57	Qualified
1989 ¹	Touche Ross	3 April 1990 (17 May 1990- Paragraph 2)	29 August 1990	GT Group	376,511	3,765	72,222	722	5,748	57	Qualified
1990	Coopers & Lybrand	20 June 1991	NA	GT	278,673	2,787	156,110	1,561	3,963	40	Qualified
1990	Coopers & Lybrand	20 June 1991	NA	GT Group	448,908	4,489	168,358	1,684	3,471	35	Qualified
1991	Coopers & Lybrand	25 May 1993	23 June 1993	GT	188,555	1,886	53,384	534	(44,440)	(444)	Disclaimer
1991	Coopers & Lybrand	25 May 1993	23 June 1993	GT	355,318	3,553	53,672	537	(45,077)	(451)	Disclaimer
1992 ²	Coopers & Lybrand	25 May 1993	NA	GT	104,390	1,044	(100,873)	(1,009)	(154,257)	(1,543)	Disclaimer
1992 ²	Coopers & Lybrand	6 June 1994	NA	GT Group	177,415	1,774	(102,772)	(1,028)	(159,094)	(1,591)	Disclaimer
1993	Ernst & Young	10 June 1994	11 July 1994	GT	77,693	777	(195,101)	(1,951)	(52,124)	(521)	Disclaimer
1993	Ernst & Young	10 June 1994	NA	GT Group	164,057	1,641	(195,228)	(1,952)	(62,656)	(627)	Disclaimer

¹ The individual and the consolidated accounts were included in one report.

² Information relating to the 1992 Financial Statements is based on details in the 1993 statements.

Table 8.2 - Summary of Selected Information from the Accounts of Torraspapel

Financial Year	Auditor	Date of the Audit Report	Date Filed with the CNMV	Type of Financial Statement	ASSETS (Millions of Pesetas)	ASSETS (Millions of Dollars)	Capital & Reserves (Millions of Pesetas)	Capital & Reserves (Millions of Dollars)	Profit (Loss) (Millions of Pesetas)	Profit (Loss) (Millions of Dollars)	Type of Report
1989	Touche Ross	3 April 1990	NA	Consolidated	119,573	1,196	55,235	552	9,618	96	Unqualified
1990	Coopers & Lybrand	23 April 1991	NA	Individual	86,262	863	53,935	539	1,610	16	Unqualified
1991	Coopers & Lybrand	6 April 1993	NA	Individual	126,597	1,266	73,590	736	220	2	Unqualified
1992	Coopers & Lybrand	7 June 1993	NA	Individual	86,040	860	23,248	232	(39,781)	(398)	Qualified
1992	Coopers & Lybrand	5 August 1993	NA	Consolidated	119,282	1,193	23,198	232	(39,907)	(399)	Qualified

Table 8.3 - Summary of Selected Information from the Accounts of Ercros

Financial Year	Auditor	Date of the Audit Report	Date Filed with the CNMV	Type of Financial Statement	ASSETS (Millions of Pesetas)	ASSETS (Millions of Dollars)	Capital & Reserves (Millions of Pesetas)	Capital & Reserves (Millions of Dollars)	Profit (Loss) (Millions of Pesetas)	Profit (Loss) (Millions of Dollars)	Type of Report
1988	Audihispana	31 March 1989	NA	Cros	98,370	984	56,029	560	121	1	Qualified
1988	Audihispana	20 April 1989	NA	Grupo Cros	119,371	1,194	56,029	560	6,738	67	Unqualified
1988	KPMG	17 April 1989	NA	ERT	174,138	1,741	44,757	448	5,272	53	Qualified
1989 ¹	KPMG	17 May 1990	NA	Ercros	183,848	1,838	102,870	1,029	14,869	149	Qualified
1989 ¹	KPMG	17 May 1990	3-7-1990	Ercros Group	399,704	3,997	122,469	1,225	19,731	197	Qualified
1990	KPMG	24 May 1991	25-11-1991	Ercros	176,034	1,760	104,389	1,044	(5,925)	(59)	Qualified
1990	KPMG	24 May 1991	NA	Ercros Group	376,315	3,763	112,375	1,124	494	5	Qualified
1991	KPMG	13 May 1992	10-6-1992	Ercros	140,260	1,403	88,388	884	(12,387)	(124)	Qualified
1991	KPMG	29 May 1993	NA	Ercros	140,260	1,403	88,388	884	(12,387)	(124)	Disclaimer
1991	KPMG	13 May 1992	10-6-1992	Ercros Group	346,974	3,470	91,724	917	(16,580)	(166)	Qualified
1992	KPMG	29 May 1993	NA	Ercros	51,619	516	8,304	83	(80,084)	(801)	Disclaimer
1993	Audiberia	2 June 1994	17-6-1994	Ercros	34,317	343	4,349	43	(4,102)	(41)	Disclaimer
1993	Audiberia	2 June 1994	17-6-1994	Ercros Group	202,254	2,023	4,726	47	(11,370)	(114)	Disclaimer
1994	Audiberia	19 May 1995	NA	Ercros	25,301	253	4,176	42	(172)	(2)	Qualified
1994	Audiberia	19 May 1995	NA	Ercros Group	135,017	1,350	4,879	49	(1,820)	(18)	Disclaimer
1995	Audiberia	30 April 1996	12-6-1996	Ercros	21,195	212	4,157	42	(19)	0	Qualified
1995	Audiberia	30 April 1996	12-6-1996	Ercros Group	51,158	512	5,980	60	1,139	11	Qualified

¹ The individual and the consolidated accounts were included in one auditor report.

Table 8.4 – Summary of Transactions that led ICAC to fine C&L for GT Audit

Charge	Transaction	Problem	Conclusion
1	In July 1988 Phoenix Finance International Ltd. Issued a £100m convertible bond into Torras Hostench that was due in 1998. In 1990, GT anticipated losses on the bond and thus prepared a provision to meet these potential losses. ICAC claimed that the Pts3bn provision prepared by GT to meet the potential losses was underestimated.	<ul style="list-style-type: none"> - Non-compliance with the prudence principle as the financial capacity of Phoenix was based on the value of its shares in Prima Inmobiliaria at the date of redemption of bonds in 1998. - The companies offering the Pts6bn guarantee, used in decreasing the provision, did not have the capacity to meet this guarantee. - ICAC concluded that the guarantees did not exist because these companies were in contract with GT to buy and sell its shares. - C&L claimed to rely on KIO's support letter sent in 3/3/1992 eight months after issuing the financial statements 	<p>ICAC saw C&L's failure to qualify the report given the different problems with the provision as constituting a non-compliance with Technical procedures on reports issued by ICAC in 1991, especially points</p> <ul style="list-style-type: none"> • 3.6.3 and 3.6.4 relating to opinions with qualifications • 3.7.5 and 3.7.6 that regulate non-compliance mistakes or non-compliance with GAAP
2	GT had revealed in the notes of its financial statements that KIO was going to seek the approval of GT's board to capitalise Pts162,912,190,000 of the loans it granted to the group. Accordingly, GT capitalised the loans that expired in December, 1990 (Pts115,413,549,589), then transferring them to the account of THL with a charge to the reserves of Pts14,472,629,000 to settle obligations towards third parties.	ICAC claimed that this treatment was right when priority was given to substance over form. However, rectifying the credit to the reserve account through the profit and loss account might not been the right treatment given that the company at all times acted as an intermediary.	<p>ICAC saw the auditor's failure to make an exception in their report despite the fact the report showed a future increase of capital of Pts 162,912,190,000 as non-compliance with Technical procedures on reports issued by ICAC in 1991, especially points</p> <ul style="list-style-type: none"> • 3.6.3 and 3.6.4 relating to opinions with qualifications • 3.7.5 and 3.7.6 that regulate mistakes or non-compliance with GAAP
3	GT made an adjustment in the annual accounts of 1990 that showed a 35% reduction of its own funds as of 31 December 1989 in comparison to what was reported in the annual accounts of 1989. Consequently, the balance sheet and profit and loss account of 1989 which were re-produced in the 1990 accounts for comparison purposes differed from the ones in the issued annual accounts of 1990.	ICAC indicated that GT did not issue new financial statements for 1989 to introduce the adjustments. As such, there would not be another understanding aside from that the adjustment affected the 1990 accounts.	<p>ICAC concluded that the adjustment did not comply with GAAP and it would have affected the 1990 accounts. It also concluded that the failure of C&L to make an exception for this issue was a non-compliance with Technical procedures on reports issued by ICAC in 1991, especially points</p> <ul style="list-style-type: none"> • 3.6.3 and 3.6.4 related to opinions with qualifications • 3.7.5 and 3.7.6 that regulate mistakes or non-compliance with GAAP
4	Four companies (<i>Philiby, CAOS, Mira and Folma</i>) owned by de la Rosa signed contracts with GT to buy and sell GT shares.	<ul style="list-style-type: none"> - ICAC concluded that GT lent financial support for the purchase of its own shares via these companies. - ICAC attributed this contract to GT's desire to avoid the limit (set by the <i>Reformulated Text on Company Law</i>) on the number of a company's own shares that it can acquire. - ICAC saw that the price of the acquisition shares from the four companies was higher than their net accounting net value. 	<ul style="list-style-type: none"> - C&L's failure to highlight GT's attempt to avoid the limit on a company's own share acquisition did not comply with section 4, chapter 4 of the <i>Reformulated Text on Company Law</i>. -ICAC indicated that C&L should have made an exception in their report given that C&L did have evidence to justify the inflated prices for the buy back shares that would explain the loss of shareholders' equity at GT. Therefore, C&L did not comply with Technical procedures on reports issued by ICAC in 1991, especially points • 3.6.3 and 3.6.4 related to opinions with qualifications • 3.7.5 and 3.7.6 that regulate mistakes or non-compliance with GAAP
6	ICAC claimed that working papers of C&L revealed that they detected an undervaluation of Pts4.5bn of the portfolio provisions in the annual accounts of Grupo Torras of the year 1990.	C&L made no reference to this regard in their audit report.	<p>C&L failure to make an exception to this matter in their report constituted a non-compliance with Technical procedures on reports issued by ICAC in 1991, especially points</p> <ul style="list-style-type: none"> • 3.6.3 and 3.6.4 related to opinions with qualifications • 3.7.5 and 3.7.6 that regulate mistakes or non-compliance with GAAP

8.2.5 Non-auditing Professional Service Providers

“Grupo Torras is a complicated animal. Salomon says ‘it can be likened to the conglomerates popular in the 1960s, when it was believed that financial and management acumen could bring additional benefits to this type of organisation (an industrial holding) - however, this was rarely proven to be the case’. But it was also Salomon Brothers who, in November 1988, designed the flotation of Grupo Torras, praising it as ‘a strongly profitable holding company with pan-European ambitions’. Torras, the investment bank said then, had carried out a diversification programme ‘with timely acquisitions in some of the fastest-growing sectors of the Spanish economy’ (Peter Bruce commenting on the role of Salomon Brothers, FT, 26-10-1992, p.14).

In 1988, Salomon Brothers’ involvement with GT, in underwriting £100m of convertible bonds in Torras, attracted international banks such as Bank of America, Chase Manhattan, Credit Suisse, Barclays Bank. The bond was promoted as an opportunity to buy into an excellent investment constructed by KIO, who was then highly regarded. In that same year, the investment bank also helped KIO to float Grupo Torras on the Madrid stock market. In June 1992, KIO’s new managers hired Salomon to examine the financial position of GT. Salomon presented KIO with two options, either to find a partner for GT or liquidate the group. Excerpts from Salomon’s investigation of GT, published in the Financial Times (26/10/1992, p.14), shows how Salomon changed its opinion of GT. While Salomon was claiming that conglomerates like GT had failed since the 1960’s, they did not express such an opinion in 1988 and 1989 when they participated in underwriting the convertible bond and helped in floating GT. Instead in the late 1980’s, they promoted the group as a very promising investment for the future. In response to criticisms of its role in the flotation of GT, Salomon asserted that it did not work for GT in the period of early 1990 to June 1992, when it was believed that the group was starting to face problems. However, the bank’s claim contradicts the fact that GT was facing problems as early as 1989, when its own credit lines were suspended. It would appear that Salomon wanted to dissociate itself from the GT group and downplay any responsibility for having sought to convince people to invest in GT and its convertible bond.

While the speed with which Salomon's views of GT changed may give cause for concern as to the reliability of its earlier declarations on the status and financial strength of GT, by far the most detrimental role played by professional advisors relates to the work of accountants (accounting firms) in devising offshore schemes designed to minimise taxes. These ultimately led to the siphoning of huge funds from KIO and GT and clearly presented considerable problems for auditors seeking to work their way through a maze of major transactions. Whittington (1993) claimed that Touche Ross was the architect of KIO's mode of entry to Spain, via the two sets of companies in Dutch Antilles and the Netherlands. This mode of entry created problems for the Spanish government as it claimed that it did not know that KIO was investing in Spain and therefore was unable to prevent the bypassing of legislative requirements for parliament to approve foreign investments in Spain. In addition, the former managers of KIO used the Antilles and Dutch connections to misappropriate funds. This complex use of offshore centres made it difficult for other auditors in the group to carry out their audit work. The civil case filed by GT originally included among the list of defendants a number of accountants and their Jersey accounting firm – however, they opted for an out-of-court settlement before the start of trial. These accountants acted as directors for some of the shell companies used by the former managers to siphon the funds from KIO/GT. Judge Mance in his judgement in *re Grupo Torras S.A. v. Al-Sabah* [1999] saw these accountants and their shell companies as having been involved in sham agreements. The case also highlighted the prominent role of Plinio Coll, a former auditor at Touche Ross Spain, who ultimately became a consultant for GT and its subsidiaries. Coll was named in the London legal case. While the judge did not find him guilty of conspiracy to defraud GT, he found him responsible for producing false documentation and participating in other conduct which he believed was dishonestly structured for exchange control and tax reasons and to deceive auditors. The involvement of accounting firms and accountants in the case supports previous findings by Mitchell *et al* (1998) regarding accountants' involvement in money laundering. Currently, the Treasury in the UK is examining the possibility of introducing new legislation to combat money laundering – and this will require accountants to report money laundered

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thesis.

transactions. The Treasury's decision is attributed to the accusations that accountants and other professionals are turning a blind eye to, or sometimes even taking a role in, money laundering (Accountancy Age, 12/2/1998).

The KIO case has also revealed a practice witnessed in other scandals where auditors can be hired, fired and rehired either as auditors or investigators (even of their own failed audit work). Coopers & Lybrand the auditor of GT and other subsidiaries was appointed in 1990, only to be replaced in 1994 by Ernst & Young after GT and Torrassapel called for an extraordinary general meeting following apparent dissatisfaction with C&L's work. KPMG was the auditor of Ercros since 1989 but was replaced by Audiberia in 1994. KPMG-London was, nevertheless, hired by KIO in 1993 to act as administrator, only then to be removed after its fees were deemed to be too high for the services being provided. KPMG was also used by KIO in 1991 to place a value on the GT group and was used again in 1992 for such a valuation purpose, even though it was suspected that the group was in trouble and had been hit by major fraud. KPMG was also used by KIO to carry out a forensic audit of GT in conjunction with the law firm of Stephenson Harwood. Price Waterhouse was hired to investigate Ercros and found 300 breaches of laws in the company – which again questioned the past work of auditors.

8.3 General implications

8.3.1 The Subjectivity of Accounting Valuations

“One set of annual accounts for Grupo Torras carried out in 1989 doesn't tell the reader anything.” (Ricardo Bolufer, President of the Spanish Institute of Accountants and Auditors (ICAC), quoted in *The European*, 17 February, 1995).

“There weren't any losses when we left the group, you can check KPMG's report, which was prepared six months before the change of management. It estimated the value of the group at between \$2.9bn and \$4.4bn. However, the new management relies on a new report of KPMG that estimates the group's losses at \$4bn. Why don't they ask KPMG about the previous report? Is it possible to believe these advisors who prepare contradictory reports.” (Javier De La Rosa, Quoted in *Al-Hayat*, January 28, 1993, p.12).

Recent corporate collapses in Spain have raised concerns about the reliability of

accounting valuations. These concerns can be demonstrated in two incidents related to the collapse of Grupo Torras. In 31 July 1992, the new managers of KIO and GT ordered C&L to re-evaluate the group accounts based on market values rather than on book values and to remove extraordinary items. The revaluation reversed GT's reported profit of Pta3.9bn to a loss of Pta44.4bn. The result of Coopers & Lybrand revaluation of GT accounts was rejected by GT's management, who claimed that their lawyers had advised them against signing off these accounts to avoid giving the impression that they accepted them as representing a true and fair view of the company's behaviour (Financial Times, 28/10/92, p.26). Consequently, GT submitted the unsigned financial statements to the CNMV in late October 1992. Eight months later C&L presented their audit report on the 1991 accounts to the CNMV, in which they refused to give an opinion on the financial statements. C&L listed several factors for this refusal. The first factor related to GT's adoption of a substantial change in accounting criteria in preparing its accounts, which under Spanish law should have been charged to the profit and loss account. However, the managers of GT chose to charge the adjustments directly against reserves, claiming that it gave a more true and fair view. C&L also indicated that it had not been possible for them to evaluate the outcome and financial effect of a number of different transactions, especially in terms of the contingencies mentioned in the financial statements. They also had not been able to obtain a written confirmation of GT's group liabilities. Other uncertainties included Ercros' filing for suspension of payments and its effect on GT and CNMV's investigation of GT and another subsidiary.

De la Rosa's above cited point concerning the massive disparity in KPMG's valuations of GT (from between \$2.9 - 4.4bn (see Table 8.5) in 1991 to a negative value of \$4bn in late 1992) also raises serious questions about accounting valuation. KPMG defended its actions on the grounds that the December 1991 valuation was based on figures presented by Torras' former managers. KPMG stated that it had been concerned that these figures might be over-optimistic but felt that it was not obliged to report such concerns to CNMV as GT had been transformed into a private company by KIO. The two different evaluations were also carried out under two different management teams at KIO.

In the 1991 evaluations, KIO was under the control of the former managers of KIO/GT – with a close source to KIO claiming in interview that KPMG during that year had been granted a very huge computing consulting assignment and might not have been that willing to upset KIO’s former managers or had been heavily restricted by the former managers¹.

Table 8.5 – KPMG’s evaluations of GT in Late 1991

Possible Values	Basis 1	Basis 2
Torraspapel	1.7	1
Ebro	1.2	1
Ercros	0.5	0
Prima	0.4	0.4
Services	0.3	0.3
Bonds & Loans	0.6	0.6
Other	0.3	0.2
	5	3.5
Liabilities : Bonds and Loans	0.6	0.6
	4.4	2.9
Cost		
Liabilities - Bank Loans	1	1
KIO Debt	0.7	0.7
KIO Equity	2.7	2.7
	4.4	4.4

Such dramatic changes in valuation were not just limited to GT but rather seems to have been something of a malaise in Spanish accounting at the time, with examples being found in other notable corporate scandals. The near collapse of Banesto in December 1993 questioned the nature of accounting valuation, with a reported difference in valuation of about £650m between that of the Bank of Spain and that of Banesto’s biggest investor J.P. Morgan, the American investment bank (for more details see García Benau *et al*, 1999). Similarly in late 1994, Grand Tibidabo, the company that was chaired by de la Rosa, revised its accounts transforming a Pta16m profit to a Pta11bn loss. Juan Luis Marchini, Chairman of the Confederación Española de Auditores later claimed that the controversy created by these scandals had made Spanish companies “more rigorous” in preparing their financial statements (The European, 8/5/1997).

¹ This claim couldn’t be pursued as both KPMG and KIA refused to discuss any issue relating to

However, Marchini's claims are undermined by the latest controversy over the accounts of Dragados y Construcciones, Spain's second largest contractor, where Arthur Anderson publicly opposed the company management over its treatment of redundancy provision as reserves rather than as a profit and loss item. The dispute between the auditors and the management was put to the shareholders for a decision (the management's method was legally acceptable but did not comply with Spanish accounting standards) – the management's method giving Pts8.7bn higher profits (for details see *The European*, 8/5/1997).

The revision of accounts with accounting methods showing dramatically different results seriously undermines confidence in accounting. In a Spanish context, the above problems strengthen previous empirical research claims by Blake and Amat (1996) that creative accounting in Spain was generating problems for auditors, as it had been in the UK. Blake and Amat argued that their research undermined the widespread claim that the inflexible Continental Europe form of accounting regulation (adopted by Spain) was less susceptible to abuse than the Anglo-American context.

8.3.2 Auditor Independence

“a climate of euphoria reigned (in Spain during the 1980s), foreign money was pouring into the country. Groups such as Torras or Banesto wielded great power and prestige, and auditors were very anxious to have them as their clients.” (Spanish senior auditor quoted in *Corporate Accounting International*, May 1995).

The role of KPMG in auditing KIO, which does not publish any financial information, resembled that of an internal auditor reporting to corporate management. Access to KPMG's audit report was limited to just a few people at KIA/KIO, the board and executive committee of KIA, and the Audit Bureau. This type of environment raise some doubts about the role of KPMG as an external auditor, especially given the secrecy of its audit reports and its inability to access all the information about KIO's operations. The scepticism about the independence of KPMG was highlighted in the resignation letter of KIO's executive committee. The fact that KPMG was not allowed either to audit the

\$1.9bn account or investigate GT accounts in 1990 did not lead to KPMG's resignation. The concern about the role of KPMG can be seen in the way they changed their evaluation of GT within one year under two different management teams at GT. They prepared their reports based on information given to them by GT managers without making their concerns known publicly, giving the impression that GT was in a sound position. The attitude of KPMG towards the report prepared by Coopers & Lybrand indicates that it was indifferent to the creative accounting being pursued by KIO. The position of KPMG might have been different if KIO was publishing financial statements but it seems KIO's secrecy doctrine made the accountancy firm confident that even if something went wrong, KIO/KIA would avoid publicity.

The Audit Bureau seemed to lose its independence when the Kuwaiti Parliament was dissolved between 1986-1992. During that period, the Bureau was under the control of government rather the parliament, which clearly limited its capacity to highlight or criticise mismanagement. KIO restricted the Bureau's access to information about its operations and, indeed, when the Bureau was informed of problems it was not able to act as KIO was under the control of a member of the Kuwaiti ruling family, who in turn had the backing of the Finance minister (another member of the ruling family).

The huge scale of KIO's investment portfolio and its reputation made prestigious organisations proud to be associated and work for KIO. This was evident in KPMG's relationship with KIO before the collapse of GT. The motivation behind KPMG's change of heart seems to have had less to do with the collapse of GT and more to do with the allegations that KIO unlawfully avoided paying £600m in taxes. This issue was related to KIO's controversial acquisition of 22% of BP, then Britain's biggest corporation. The British government decision's for KIO to divest half of its stake led to BP buying back its shares from KIO, in turn enabling KIO to give a tax credit of £458m to the Kuwaiti office because of its tax exemption status. During an investigation into the affair by the Kuwaiti parliament's Financial and Economical Affairs Committee, Fouad Jaffar in London and Javier de la Rosa in Madrid were asked to clarify some of the mysteries that surrounded KIO's Spanish investments. Both men threatened the

committee that if KIO chose to go ahead with the court cases against them, new revelations of illegal transactions would surface and cost KIO a great deal of problems. They apparently referred directly to the issue of BP claiming that these stakes were bought for Kuwait Petroleum Corporations (KPC), the country's oil holding company, to avoid paying taxes on the investments as KPC was not exempted from taxes like KIO. In September 1993, these claims appeared on the front page of the Financial Times, where it was alleged that KPC had saved £600m through the investment strategy of KIO. The issue raised uproar in Britain claiming that the Inland Revenue had lost £600m in tax revenues. American authorities also investigated these allegations as BP was listed in the New York Stock Exchange and if KPC was the real holder of BP, it had broken the regulations of the exchange concerning the identity of ownership. It was reported that KPMG was negotiating, on behalf of KIO, with the Inland Revenue for a settlement of £402m to resolve the issue (The Independent on Sunday, 23/1/94, p.2). However, no public action concerning the BP question has been revealed by either the Kuwaiti or British authorities and KIO sold 3% of its 9.3% stake at BP for \$2bn in May 1997.

In the BP affair, KPMG appeared to depict itself as not the full auditor of KIO, possibly so that it could claim that it did not know if KIO had bought the stake for KPC or not. This may also explain why KPMG argued that it was not the full auditor of KIO but rather auditor of the two main accounts, namely the General Reserve Account and Reserve Fund for Future Generations Account. While these two funds represented the main sources for funds for KIO, they did not include funds that KIO would occasionally invest on behalf of other organisations (e.g. KPC). The statement by KPMG's spokesman sought to restrict its involvement with KIO to these two funds to emphasise that it was not auditing transactions such as those of KPC and therefore avoid any possible legal action related to the BP affair. That said, KPMG's claim still stands in contrast to statements by KIA and other government officials that KPMG was (and still is) the external auditor of KIO.

8.3.3 Fraud Detection

“...the probability appears to me to be that most, if not all, of the forgeries were the work of Mr de la Rosa, undertaken with a view to reassuring or, after the event, persuading accountants, auditors and others that all was in order in relation to the Croesus, Oakthorn and Pincinco operations.”(*Grupo Torras S.A. v. Al-Sabah*, 1999, p.109).

“...Mr Coll believed that the transactions as a whole, and the improprieties in which he involved himself in relation to them, related to movements of money being made in the commercial best interests of his clients. The cultural context in which he was operating tolerated evasion of exchange control and tax and the preparation of false accounting documentation for such purposes. Mr Coll devoted his considerable abilities to the enthusiastic gulling of professionals to whose ranks and standards he was supposed to adhere. He did not realise that he too was being gulled.” (*Grupo Torras S.A. v. Al-Sabah*, 1999, p. 202).

The funds (approx. \$500m) that were illegally channelled from KIO/GT to unknown destinations raise fundamental questions about the role of auditing. The initial belief is that it was not surprising for these funds to disappear given the chaos that accompanied the Iraqi invasion of Kuwait. However, this belief is far from the truth as these funds were first transferred in 1988 (two years before the occupation) and continued to be transferred until mid-1992 (more than one year after the liberation of Kuwait). Some of the transactions used to siphon funds from KIO drew the attention of Touche Ross, THL's auditor in 1990, who raised the issue with KIO, GT's auditor in Spain. However, forged documentation was presented to Touche Ross. The chairman of KIO blocked crucial information and the chief financial officer was reluctant to act apparently fearing that confirmation with the chairman would jeopardise his job (*Grupo Torras S.A. v. Al-Sabah*, 1999, p.36). Such power and collusion illustrates a real difficulty for auditors seeking to detect senior management fraud. Likewise, the use of shell companies and external accounts also played a major role in complicating the fraud and making it more difficult to detect (especially when these schemes were designed and implemented by professional accountants).

8.3.4 Evidence Collection Process

The case raises serious questions about audit evidence collection processes and methodologies. ICAC found that GT's auditors (Coopers & Lybrand) had been wrong to accept GT's provisions as sufficient. C&L claimed in defence that GT was being supported by KIO, but ICAC did not find any evidence of such support in C&L's working papers. C&L referred to a letter dated March 3 1992, but this was eight months after issuing the financial statements. More seriously C&L found information that contradicted what was reported in GT's accounts but neither asked GT to amend its accounts nor referred to it in its audit report. KPMG's reliance on information and reports prepared by the management of GT failed to take into account the questionable history of Javier de la Rosa, a major player in the KIO scandal. Such a failure is not unique to the KIO case, with several scandals around the world revealing the problems that dominant chief executives (with questionable personal histories) can cause for auditors (e.g. Robert Maxwell in the Mirror Group scandal and Mario Conde in the Banesto case). Such questionable histories of managers should make auditors more concerned and more questioning of what managers provide as evidence. The issue of *amiguismo* discussed in the previous chapter, likewise, should also make auditors more stringent in terms of relying on evidence - given the likelihood that 'friends' managing corporate operations might co-operate to provide fake documentation and evidence.

8.3.5 Disciplinary Proceedings

The disciplinary actions against audit firms involved in the KIO case (and others in Spain) gives some assurance to the investing public – and possibly more than has been evident in recent years in Anglo-American countries. ICAC swiftly investigated claims of misconduct by audit firms - the investigation of C&L's audit of GT coming only three months after GT had filed for receivership. In contrast, the UK disciplinary investigations have taken much longer. A recent example is the Mirror Group case, where C&L (unsuccessfully) sought in 1995 to get the courts to stop the Joint Disciplinary Scheme's (JDS) inquiry into the firm

- claiming it would be prejudicial to civil or criminal actions against the firm in relation to their audit of Maxwell Group's pension funds. The JDS eventually arrived at a decision in November, 1998, over 7 years after the outbreak of the scandal. This long period for disciplinary process has been held to undermine public confidence in the profession and the effectiveness of disciplinary proceedings (for details see FT, 20/8/1998). Another recent example can be seen in the controversy over C&L's role as joint administrator of the bankrupt group Polly Peck in the UK. The controversy stemmed from that fact that C&L had failed to declare its extensive links with Polly Peck and its chairman Asil Nadir. Accordingly, Mitchell *et al* (1993) wrote extensively (a total of 12 letters between March 1991 and April 1992) to the Minister of Corporate Affairs and the ICAEW requesting an investigation of C&L. The ICAEW's disciplinary hearings eventually found two of C&L auditors guilty of breaching ethical guidelines and they were each fined £1000. Findings of the disciplinary hearings, however, were kept secret (for more details see Mitchell *et al*, 1993). The experience of Mitchell *et al* (1993) has questioned the appropriateness of a self-regulatory system in disciplining its members, especially those belonging to the Big Six firms (whose members often reside over the disciplinary process). Rollins and Bremser's (1997) study of SEC enforcement against auditors added to such questioning, suggesting that the auditor's reputation did influence actions against auditors. They found that the SEC generally took less severe actions against Big Six auditors compared to other auditors.

In their analysis of disciplinary proceedings of public accounting firms in three different contexts (USA, UK, Germany), Baker and Hayes (1998) argued that disciplinary practices had been set in era of smaller practice and were ineffective in the face of the growing multinational practices of accounting firms. Rollins and Bremser (1997) have also revealed that the SEC's targets for investigations were higher than it could actually pursue given the high cost and publicity surrounding its investigations. Such thoughts have given rise to talk of the need for an international regulator of the multinational firms, especially when the firms are able to restrict national regulatory investigations by arguing that their international offices/partnerships fall outside the scope of such investigations (as

in the case of BCCI).

8.3.6 Auditors' Immunity to Scandals

The Spanish accounting profession has claimed that ICAC's sanctions were damaging the reputation of audit firms. Yet these claims are questionable when considering the empirical findings of García Benau *et al's* (1998) study of the images that Spanish financial directors held of their audit firms. This study revealed that directors differentiated between the image of Big Six and Non-Big Six firms based on the firm's geographical or client base rather than on technical aspects relating to the conduct of audit. Moreover, the constant growth of Big Six audit firms in Spain has not been hindered in recent years (see IAB, 8/11/93, 27/11/95, 31/10/96, 31/10/97). This suggests no significant influence of the recent corporate collapses and subsequent sanctions on the reputation of the Big Six firms. A clear example of such immunity can be demonstrated with C&L, the main auditor in the KIO case, where a string of corporate collapses around the world led to C&L being entangled in a web of litigation over allegations of substandard work (for example see Table 8.6). However, such scandals did not prevent C&L from maintaining its position as the fourth largest firm in the world, with annual growth rate of revenues of 12.7% in 1995 and of 9.7% in 1996 (IAB, 21/12/95, p.7, 13/12/96, p.8). C&L in Spain also maintained this fourth position with a constant growth rate during the period 1993-1997. Furthermore, Moizer's (1998) study illustrated that many of the recent controversial corporate scandals in the UK did not affect corporation satisfaction with auditors, from the evidence of ratings given in 1987 and 1996 (also see, Corporate Accountant, 20/8/97). All these findings re-emphasise the argument that auditors are relatively immune to scandals and questions auditors' claims that these scandals are negatively affecting the reputation of audit firms.

“It is important to have an internationally recognised accounting firm to control the investments. Although I greatly respect the role of the Audit Bureau, investments need an advanced technical expert to attest” (Jasem AlSaquar, Kuwait MP speaking to the parliament on protecting Kuwait's investments, Al-Qabas, 2/12/92, p10).

“It not his (the auditor) duty to detect fraud and improprieties. His main task is restricted to the financial statements and that is a known

convention and has generally accepted principles and guidelines” (Waleed Al-Oasami, senior partner of Ernest & Young, quoted in Al-Qabas, 3/2/93).

In December 1992, the role of international firms in auditing and controlling Kuwait’s foreign investments was raised in Kuwait’s parliament as a solution to safeguarding Kuwait’s foreign investments. Members felt that these firms could provide the required protection against fraud for Kuwait’s public capital. Nevertheless, such calls were in contradiction with the claims of the accounting firms in Kuwait, especially, the Big Six firms, that their job was not to detect a fraud. Seven months after advocating the use of Big Six firms to help control Kuwait’s foreign investments, a report by a parliamentary committee was criticising one of these firms. In June 1993, the parliamentary committee’s report on KIO’s Spanish investments suggested that KPMG had failed to carry out the job it was hired to do (FEAC, 1993b). The committee also recommended investigation of the role of auditing firms in the collapse of GT but no such investigation was undertaken. Further, despite ICAC’s investigation of C&L and the imposition of sanctions on the firm, there were no parliamentary debates about the role of international auditors in controlling KIO’s investments. Apparently there was no change in the status of the big six firms regarding their suitability for auditing KIA or KIO, other than KIA’s managing director claims that KPMG only started to undertake full audits in 1992. Similarly, the revelations of fraud and misappropriations of funds in the Kuwait Oil Tankers Corporation (KOTC), a subsidiary of KPC, did not lead to any debates or investigations about the role of auditors. Arthur Anderson-Kuwait had a monopoly over the audit work of the Kuwait Petroleum Corporation (KPC) and its subsidiaries including KOTC. The KOTC scandal did make KPC transfer the audit of some of its subsidiaries away from Arthur Andersen – but these were simply passed to other Big Six firms in Kuwait.

Table 8.6 - Some of the Recent Legal Proceedings Against C&L Around the World

Audit Year	Country	Accountant's client	Transaction	Plaintiff	Action
1986	USA	Silverado Banking, S&L	Loan loss provision was undervalued by at least \$35m. The report inflated Silverado's capital by \$14m. Regulators seized the company in 1988.	US Savings & Loans Regulators	Out of court settlement in late 1990.
1989-1990	UK	Audix, a maker of public address systems	Coopers signed off Audix's 1989-1990 results but the profits reported for the financial year were later restated as a loss. TGI took over Audix in 1989.	TGI, Electronics Company	Out of court settlement for £725,000 in late 1994.
1986-1988	USA	Miniscribe, Computer Disk manufacturer		Bankruptcy Trustees and Bond Holders	\$95m out of court settlement and \$45-50m out of court settlement
	UK	Wallace Smith Trust Company	The investment bank collapsed in 1991.	KPMG, as the liquidator	£32.5m out of court settlement
1988, 1989 and 1990	Canada	Caster	Failure to detect widespread irregularities in preparation of Caster's financial statements and in the evaluation of the company's shares. Caster went bankrupt in July 1992. One of the largest claims ever in Canada against audit firm	Initially there were 99 claims against C&L. The number of claims fell to 56 after 43 claims were withdrawn or reached a settlement	\$804m claim, the case is still in court
	USA	Phar-Mor, Drug store chain	C&L were found guilty of fraud by US Federal District court for its audits of the drugstore company. In 1992, an embezzlement and fraud scheme by the company's president was discovered, estimated at \$1.1bn.	Phar-Mor Investors, creditors and landlords	39 out of the 40 Suits filed against C&L were settled out of court while the rest (who sought \$180m compensation) settled in May 1996 after the court found C&L guilty.
1994	Singapore	Barings Futures Singapore, Subsidiary of Barings Group	Price Waterhouse alleged that the company was negligently audited by C&L	Price Waterhouse, the liquidator of Barings Futures Singapore Another lawsuit is also filed by Ernst and Young	Price Waterhouse seeking claims of £710m in compensations.
1991, 1992, 1993 & 1994	UK	Barings Group		Ernst & Young, administrators of the Barings Group	
1991	USA	Macmillan, Subsidiary of Maxwell Communications Corporation	Failure of C&L to note the improper transfer of control over shares in Berlitz International, a language school, to Robert Maxwell's private companies	Price Waterhouse acting as the company's administrator	Paid \$68m as an out of court settlement
	UK	Resort Hotels	Failure of C&L in its role as auditor	One groups of 200 people and another group of nearly 500 representing private and institutional investors	Claims for £20m

Sources: FT, 13/12/90, p.4, 9/9/94, p.25, 11/10/93, p.17, IAB, 17/12/1997, IAB, 23/2/96, P.3, IAB, 17/6/96, P.1, IAB, 6/9/96, p.2, Accountancy Age, 26/6/97, 14/5/98)

8.4 Implications for Spain and Kuwait

The previous section discussed some of the general implications of the KIO scandal with regard to reputational effects for audit firms. This section examines the aftermath of the case (and the responses to it) in more detail in both Spain and Kuwait.

8.4.1 Development of Auditing in Spain in the Aftermath of GT collapse

There was a jubilant feeling in Spain following the enactment of the Audit Law in 1988 – a belief that financial reporting will be more transparent and a hope that auditing will bring accounting and reporting standards to a higher level. In the early 1990's, the audit expectations gap, a widespread notion in Anglo-American countries, was largely unheard of in Spain. A few years later it is very widely promoted by the Spanish profession as the culprit behind the ills and negative publicity attached to the profession. It seems that much of the change in opinion is attributed to the polemical financial scandals that have dominated the Spanish business environment in recent years. However, it has to be said that these financial scandals (despite the sanctioning by ICAC) did not generate the same level of publicity and media attention on auditing as is usually the case in Anglo-American countries. Most of the press coverage focused on the role of managers in the collapse of these corporations.

Spanish supervisory organisations acted to address some of the practices that seemed to be abundant in the financial scandals. ICAC's fining of C&L represented the beginning of such sanctions for Big Six audit firms involved in the audit of the recently collapsed organisations (See Table 8.7) – indeed, prior to these sanctions, ICAC had only sanctioned small audit firms.

Table 8.7 - Major Sanctions imposed by ICAC on the Big Six Accounting Firms

Auditing Firm	Client	ICAC Decision
Coopers & Lybrand	Grupo Torras	Fined Pts37m
Price Waterhouse	Ebro Agrícolas	Fined Pts53m
Ernst & Young	IGS-PSV	Fined Pts71m
Price Waterhouse	Banesto	Fined Pts96m
Arthur Anderson	La Corporación Banesto	Fined Pts112m
Arthur Anderson	BEF	Issued warning
Ernst & Young	Safei-Sanedi	Issued warning
Ernst & Young	AVA	Fined Pts40m

Source: BOICAC, 1994a, 1994b, 1995, El-Pais, 3/8/95, p.27, IAB, 23/4/96, p.2, El-Mundo, 15/5/99).

The scandals also had an effect on the other supervisory bodies in Spain. The CNMV, Spain's securities market commission, tightened its investigation of allegations of irregularities, de-listing 123 out of 763 companies listed in 1993. The CNMV's fines rose from Pts1.79bn in 1993 to Pts4.36bn in 1994. While 1994 was seen as a record year for initiating actions by the commission, it managed to triple its actions to over 348 in 1995 (for details see FT, 31/3/95, p.28). The CNMV's actions emphasise the widespread failure to declare significant share acquisitions, something very evident in the GT case.

In a move that emulated other countries in the European Union, the CNMV has sought to develop a code of best practice in corporate governance, led by the calls of its chairman, Juan Fernandez Armesto. Unlike previous regulations in Spain, the code that has been issued is voluntary, although the CNMV will require listed companies to disclose the extent of their compliance with these recommendations. The new conservative government's belief in less state intervention might be the reason behind the voluntary nature of the code as it trusts that the market will provide an efficient control mechanism. Some auditors disagree with the voluntary nature of the code, claiming that deficiencies should be corrected through legislative change while others see it as public relations exercise by the government to keep foreign investors interested in its privatisation programme (European Accounting Bulletin, 18/3/97). The committee's recommendations, based on the UK's Cadbury report, call for smaller company boards, comprising a larger degree of independent non-executive directors who would also be responsible for monitoring the work of internal auditors (FT,

12/3/98, p.2).

The above actions were geared towards matters of the public interest and the protection of shareholders. However, the same cannot really be concluded from the actions of the Spanish accounting profession. The Spanish profession's response in the aftermath of a string of financial scandals has seemed to be primarily concerned with professional self interest rather than that of public interest. The profession's response has been pointed in two main directions. First, it has used the familiar tactic of 'blaming the victim', namely promoting the notion of an education gap on the part of users of audited financial statements as the major reason behind the problems haunting the profession. Secondly, it has lobbied for changes in regulation that seem of more direct benefit to the profession than the public. These actions include rejecting ICAC's sanctioning powers and calling for self-regulation, the abolition of compulsory auditor rotation and launching a campaign to limit auditors' liability. Each of these issues is now explored in turn.

8.4.1.1 An Expectations Gap

"The auditors have been subjected to extraordinarily severe judgements in large part owing to the fact that their role is not well understood" (J. Alvarez, Coopers and Lybrand).

The aftermath of corporate failures in Anglo-American countries often sees debates about the failure of audit firms in detecting and reporting problems in these collapsed corporations. The familiar response of the audit profession is to argue that the function of auditing is misunderstood. Not surprisingly, the Spanish accounting profession played the audit expectation card in response to criticism of the audit function arising from the collapse of GT and other corporations in Spain. Members of the profession were making statements such that "the auditor is not a god". Audit failures have been portrayed as "one offs" and calls made for appropriate blame to be placed on the role of corporate managers.

Ironically, the notion of an education gap can be dismissed when one considers the findings of ICAC's sanctioning report in the GT case. Its criticisms of auditors related to non-compliance with Generally Accepted Accounting Principles (GAAP) prescribed by the Audit Law and ICAC's Technical Procedures and regulations set by the Reformulated Text on Company Law - and not to failures in the detection of fraud. A clear example can be seen in the GT case where the group did not comply with the prudence concept in setting loss provisions for Phoenix Bonds. Despite the fact that the prudence convention has priority over other conventions in the Spanish *Plan General de Contabilidad* (moulded on the European Fourth Directive - Blake and Amat, 1993), C&L did not qualify its reports on GT's non-compliance with such a convention. In short, there were no unreasonable expectations of auditors in ICAC's actions but rather it was addressing issues very much at core of the audit function. This observation strengthens the argument that auditors use the expectations gap as a way of screening off their failure and promising improvement and seeking means to close the gap (for more discussion, see Power, 1994).

8.4.1.2 *Rejecting ICAC and Calling for Self Regulation*

In mid-1992, prior to the outbreak of the GT and other scandals in Spain, ICAC started to impose fines on small audit firms for substandard work. The big audit firms did not object to ICAC's sanctions as they saw them as essential to protect the profession's image. ICAC's subsequent sanctions against the Big Six firms, however, was not seen by them as helping to improve the image of the profession. The former head of ICAC, Ricardo Bolufer - who imposed fines on 30 different accounting firms - clearly disagreed with their views. He said "the challenge we faced in 1990 was to switch this market from total opacity to absolute transparency. We have a big hill still to climb" (quoted in *European*, 17/2/95). Some of the Spanish press, when it commented on ICAC's role, saw the sanctions as a much needed action to counter negative images resulting from the financial scandals (e.g. *El-Pais*, 9/2/94, p.19).

The Big Six accounting firms in their heavy criticism of ICAC's disciplinary process argued that it is not the job of administrative employees to investigate the matters of professionals. They denounced the technical credibility of ICAC and its right to impose sanctions. Consequently, they called for restrictions in ICAC's powers or its outright abolition. REA and ICJCE threatened that if ICAC fines audit firms and publishes the findings, which an appeal court subsequently overturned, then the audit firms would sue ICAC. They claimed that publicising the fines while they were under appeal was damaging to the firms' reputations (Expansión, 21/2/95,p.35). The president of REA wrote to the Justice Ministry requesting that ICAC should no longer be able to impose sanctions – claiming that “only the courts should impose sanctions. He also requested that the government make it compulsory for managers of companies to acquire civil responsibility insurance (Expansión, 6/10/95, p.35). The professional bodies also called for restricting ICAC's role to setting accounting standards while they take over the disciplinary powers (Expansión, 17-19/10/96). This argument would give the auditors control over the sanction process, while keeping the standard setting with ICAC – potentially establishing a situation where the profession would not be investigated vigorously in cases of possible failure and allowing ICAC to be blamed for setting inappropriate work standards. Ricardo Bolufer disagreed with the claims of the profession:

“They want everything without having to answer for it, it could take up to ten years for a case to work its way through the courts, which is just what the firms would like. But ICAC is obliged to announce the sanctions as soon as they have been confirmed by the Finance Ministry. The law does not allow us to wait because it holds that the injured parties should be able to take rapid action against all the parties responsible for their losses” (Quoted in European Accountant, February 1996, p. 10).

The profession ended up accusing Bolufer of having a vendetta against auditors. When the conservative Partido Popular replaced the socialist party as the government in 1996, Bolufer was replaced by Antonio Gomez Ciria. The new president of ICAC soon made a decision to stop publishing the detailed reasons for sanctions and agreed to publish only the name of the audit firm and the amount of the sanction (Expansión, 17/1/97, p.44).

García Benau and Barbadillo (1996) saw the profession's ability to gain self-regulatory status as resting on its capacity to respond to the expectations gap. However, the change in the governing party in Spain in 1996 made the audit profession's dream for self regulation become much closer to reality – with the Partido Popular indicating that it would be willing to revise the law if the three accounting professional bodies (ICJCE, REA, RTM) in Spain were united. In a survey conducted by ICJCE, 87% of accountants saw a need for reforming the audit law while over 87% and 85% wanted the profession to regulate technical aspects of audit work and to be in charge of professional discipline ethics (for more details see European Accounting Bulletin, 14/4/1997, p.II). The profession wanted less restriction on incompatibility rules, a clearer definition of both auditor's duties and liabilities and greater respect for professional secrecy (The Accountant, December 1996, p.10). However, the inability of the Spanish professional bodies to agree on even the simplest decision (i.e. unified day for holding professional examination) made PP declare that they were no longer considering the amendment of the law as a priority (Corporate Accountant, June 1997, p.V).

Such calls for self-regulation seem strange given the rise of financial scandals in Spain in recent years. With the increasing saturation of the audit market in Spain, the subsequent competition for the consulting market to secure further growth and international concerns with the pressures to 'low-ball' audit fees, it seems that such calls are not a suitable way of ensuring audit quality. Furthermore, calls for self regulation in Spain stand in contrast to calls in the UK for its abolition and the increasing attention given to the contradictions in the role of professional bodies as a promoter of members' interests and a protector of the public interest (Mitchell *et al*, 1993).

The profession's lobbying has also managed to secure an amendment of the Spanish company law in relation to mandatory auditor rotation. Now auditors do not need to rotate automatically after a tenure of nine years - but can continue to be appointed annually. This was a somewhat surprising concession for the profession and what it will achieve in terms of improved audit quality has to be

doubted. After all, in the KIO case, many auditors had served fairly short periods of tenure and yet they had struggled to find fraud and error.

8.4.1.3 Auditor Liability

The scandals in Spain and the sanctioning exercises of ICAC eventually led to calls for change in the current audit liability environment. The Spanish auditors were not concerned about their unlimited liability and their civil liabilities to third parties when the audit law of 1988 was drafted - the debate prevailing at that time did not pay much attention to this issue (see García Benau *et al* 1993). Legal cases against auditors were unheard of in Spain before the recent financial scandals. However, corporate collapses like GT, Banesto and PSV have led to the filing of lawsuits against the auditors but no formal judgements have been issued against them in favour of shareholders or third parties. The audit profession is vigorously calling for change in the current legal environment against auditors. The auditors' arguments for limiting liability makes reference to the claim that auditors are being targeted in cases of corporate collapse because they are seen as having deep pockets. They have also cited the famous Caparo case in the UK in seeking to advance the arguments for restricting liability to third parties. In its 1997 white paper, ICJCE outlined the profession's demands in relation to audit liability. These included defining auditor's responsibilities to third parties, substituting unlimited auditor responsibility for a proportional based system on the damage caused by any negligent audit work and setting a maximum period outside of which it would not be possible to file a claim against the auditor (ICJCE, 1997).

This situation is unique in comparison to that of other countries (i.e. UK, USA, Canada, Australia) where legal liability is highly controversial (given the number of legal cases filed against auditors) and many high claims have been paid out. The Spanish profession seems to be preparing for a situation that does not exist at the time being - they want to limit liability before the courts require auditors to compensate other parties. As such, the Spanish profession's attitude might be

seen as a preventive measure. It could also be seen as keeping up with the international fashion for limiting auditor's liability in many countries around the globe.

8.4.1.4 The Influence of the International Accounting Firms/Big Six on the Spanish Audit Environment

All the strategies pursued by the profession serve to support the main theme in this thesis' literature review (see chapter 2) that the profession in times of crisis tends to disclaim responsibility, protecting its self-interest rather than explicitly serving the public interest. Further, the apparent constant state of crisis in auditing has not prevented it from growing, both in the provision of auditing services (in developing nations) and through the provision of other services to audit clients, i.e. management consulting and lately legal services. The same phenomenon is evident in the case of Spanish accounting profession. Despite the failure of the major accounting firms to highlight the major problems in their audit clients accounts before they collapsed and being sanctioned by the national regulator, the profession (especially its large firm members) flourished during the first half of the 1990s. It adopted various strategies to deflect attention and discussion on cases of audit failure, notably attacking ICAC for its sanctioning regime and the damage being caused to the profession's image. Interestingly, the profession has not viewed the sanctioning powers of ICAC as having a potentially beneficial effect for the profession as whole in terms of depicting an image of efficient and effective professional regulation.

In the latter part of the 1990's, the Spanish audit market has become more competitive. Revenue growth declined not because of a downgrading in professional image, but more because of a saturation point being reached in the audit market (with the number of new firms requiring audits declining). The enactment of new change in Spain's audit legislation (Real Decreto 572/1997) restricted the number of companies that statutorily audited to those with minimum turnover and net asset levels increasing by over 70. Such

developments have encouraged audit firms to expand their consulting work. Another recent trend in Spain has seen the Big Six firms develop in terms of the provision of legal services. In early 1997, Arthur Anderson merged its legal division with Spain's second largest law firm, J. & A. Garrigues. In 1997, legal consultancy was the fastest growing activity for the top 30 Spanish professional services firms. Revenue from auditing increased by 1.2%. The Big Six's revenue from legal services rose by 17.37% and consultancy by 12.1% (see Table 8.8). Now legal consultancy is Price Waterhouse's business focal point in Spain, accounting for 45% of total revenue (Expansion, 6/2/98).

Table 8.8 – Leading providers of Legal Services in Spain in 1996

Name of Firm	Revenues
J&A Garrigues Andersen y Cia,	Pts 9.836 billion
Cuatrecasas Abogados	Pts 4.6 billion
Uria & Menendez	Pts 3.436 billion
Gomez Acebo & Pombo	Pts 2.76
Ernst & Young	Pts 2.328 billion
Price Waterhouse	Pts 2.325 billion
Clifford Chance	Pts 1.75 billion
Lusfinder	Pts 1.75 billion
Coopers & Lybrand FL	Pts 1.71 billion
KPMG JT	Pts 1.36 billion
Baker & Mc Kenzie	Pts 1.3 billion

Source: Expansion, 6/2/98

In terms of leading public representatives, the Spanish accounting profession increasingly appears to be dominated by the large international firms. Presidents of the two main institutes are routinely partners in Big Six firms, as are spokespeople on a range of issues in the financial press. Not surprisingly, the strategic responses of the Spanish accounting profession in the aftermath of recent corporate collapses has increasingly assumed an international flavour/spirit. The attribution of audit failure to unreasonable expectations by the public, the preference for self-regulation, the rejection of auditor rotation and the campaign to limit liability are all indications of such a pattern of development. Increasingly, it can be argued that debates and changes in the audit environment in Spain reflect rather more closely the changing global strategies and campaigns of the Big Six firms than they do changes in the Spanish auditing environment. The situation in Kuwait, however, appears somewhat different.

8.4.2 Development of Auditing in Kuwait in the Aftermath of GT's Collapse

In Kuwait, unusually, the collapse of KIO's Spanish investments and other major scandals and failures of Kuwaiti corporations did not advance much, if any, debate about the role of external auditors. Instead, the recent scandals focused attention more on the role of management and its failure to adhere to laws and regulations. The government played a very limited role in this period with respect to auditing, proposing only an amendment to the Audit Law that would have scrapped the requirement for auditors to pass an examination before gaining the right to practise auditing in Kuwait. The profession in Kuwait did not embark on any major defensive campaign since there was not much criticism of the role of auditors in the recent scandals. Ironically, a proposal advanced by the KAAA, which called for expanding auditors' joint liability to third parties seemed to be a case of the profession prioritising matters of public interest rather than self interest. Accordingly, this section will discuss the development of external auditing in Kuwait after the KIO collapse, considering in particular the expanding role of the Audit Bureau.

8.4.2.1 *Expanding the Role of the Audit Bureau under the Auspices of the Parliament*

“Performance and accountability are only the beginning of a new discipline we are going to have to inject into our school system....” (Hasan Al-Ebraheem, quoted in Time, 24/12/90, p.32)

During the occupation of Kuwait and after the liberation, claims (such as the above) sought to shape a new accountability process. However, promises for more accountability had gradually faded by the time GT's problems surfaced in mid-1992. This crisis triggered much more detailed discussion about the absence of control and accountability in Kuwait's organisations and corporations. Accordingly, the issue of KIO's Spanish investments became a hot topic in the parliamentary election campaigns that took place in October 1992 (and saw Kuwait's return to democracy after a six-year suspension).

“The opposition, of course, had a totally different prospective, which, over the last four decades, put it in constant conflict with the Sabahs. It sought to embarrass the ruling family at every opportunity and wanted total Sabah adherence to the constitution as well as accountability to the parliament. To achieve this, the opposition sought at every turn to undermine the Sabah’s legitimacy and expose them to criticism among the wider population. In this zero-sum game, anything that enhanced the government’s position was bad for the opposition”. (Ghabra, 1994, p. 104)

“...KIO representatives told the El País newspaper that Torras companies were in serious trouble and required \$3bn to put them on a sound financial footing. ...for KIO to appear in the Spanish press yesterday running down the quality of its investments and stating that some, such as Prima, are on the verge of collapse is an unusual way of generating confidence....Grupo Torras probably does not need the \$3bn to survive but the blacker the empire created by the old pro-Sabah management is painted and the bigger the crises in Spain appears, the more effective a political weapon Torras may become in the run up to the elections (in Kuwait).” (Comments by Peter Bruce of the Financial Times, 31/7/92)

Arguments such as the above emphasise the exploitation of the collapse of KIO’s Spanish investments and other scandals to secure the adherence of the government and members of the ruling family to some kind of accountability process. However, the magnitude of the scandals and funds involved made it more than a legitimate goal for the new parliament to assert more control over governmental organisations and to make members of elite families in Kuwait (including members of the ruling family) accountable for their actions. The parliament’s order for the Audit Bureau to examine KIO’s investments was the parliament’s first step towards making institutions like KIA and KIO accountable. It was the first time that the Audit Bureau was allowed to visit KIO, examine its books and allowed to publish its audit report in the press. Six months later, the parliament also instructed the Bureau to examine KIA’s investments.

The parliament expanded the role of the Audit Bureau in the process of auditing and accountability in Kuwait's public organisations and corporations. The enactment of the *Protection of Public Capital Law* required all institutions and companies which are at least 25% owned by the government to report changes in their investments to the Audit Bureau within 10 days of the transaction. In

addition, the status of every investment made by a governmentally owned institution which exceeds KD100,000 (\$330,000) must be reported semi-annually to the Bureau, who, in turn, has to pass the reports (along with its comments) to the parliament.

The extension in the role of the Audit Bureau saw a number of new measures being adopted. The parliament approved a 100% increase in the Bureau's wages to attract new accountants to work in what had been an unpopular organisation. A new department, called the *Investment Department*, was established in the Bureau to carry out the audit of Kuwait's foreign investments. Moreover, the Bureau opened an office in London to audit Kuwait's investments in Europe. The parliament also proposed a law that would enable the Audit Bureau to refer any detected illegal acts to the general attorney.

The *Protection of Public Capital Law* also propagated the establishment of a permanent parliamentary committee, called the protection of public capital committee. The main task of this committee is to study the reports presented by the Audit Bureau about the investments discussed above. The law has imposed severe criminal charges, ranging from life sentence to a minimum, five-year jail sentence for people who misuse public funds. The short period it took to enact the *Protection of Public Capital Law* (about one month) was a reason behind it being criticised in Kuwait. One argument was that the law would make matters unduly complicated and bureaucratic for governmental organisations and for the Audit Bureau. In early 1996, the concerns with the law were raised again by the government in a proposal to amend it so that it only related to institutions/companies where the government owned at least 50% of the share capital - citing privatisation of government investments and the difficulties in forcing companies to provide the required reports. The parliament did not approve the proposed amendment. Interestingly, the Audit Bureau also proposed an amendment of the law, but this was also not approved.

The practicality of the law, however, was questionable. It had changed the control mechanism in organisations like KIO from one where regulations were

very lax (enabling one person, the chairman of KIO, to grant a \$450m loan without any reference to anyone else) to a situation where all investments in excess of \$330,000 would have to be reported to the Bureau within six months. This clearly would create a mass of documentation for the Bureau, especially given the limited number of staff working there. It also is worth noting that the real problem in Kuwait is the lack of implementation of laws not the dearth of laws. This is clearly supported by the findings of the KIO's case in the way that the former managers ignored guidelines and regulations of both KIA and KIO.

8.4.2.2 Regulation of the Profession in Kuwait

All the financial scandals and collapses that surfaced after the liberation of Kuwait related to public corporations and not companies listed on the Kuwaiti stock exchange. However, the parliament enacted in 1994 an amendment to Kuwait's Commercial Companies Law to require companies listed on Kuwait's stock exchange to appoint two auditors from different auditing firms to attest their financial statements. Members of the parliament who backed such a change claimed that this law would protect the interests of shareholders from the actions of company management. They based their arguments on the roles of managers and auditors of companies involved in illegal matters in the Al-Manakh dealings in the early 1980's. The parliament's motivation for the amendment of the Companies Commercial Law was geared towards assuring the public that the parliament is vigilant in attacking corruption and concerned with the protection of the public interest.

Opponents of the modification claimed that a few questionable auditing firms in Kuwait are creating the impression that all the auditing firms in Kuwait are dubious while in fact there are many firms with a high degree of professionalism. Consequently they thought that such amendments would only contribute to a bureaucratic expansion of the audit market in Kuwait without meeting the desired objective of protecting the shareholders' interests. The opponent's position seems compatible with the claims of small and medium size audit firms that the

new requirement has led to an expansion in the big audit firms' portfolio of clients. These small and medium size firms claim that the position of the big firms (as the incumbent auditors of the companies listed on the stock exchange) led to a situation where they merely recommended to their current clients another big firm to act as their second auditor - while the second firms returned the favour by recommending the first firm to the companies they were auditing. In other words, the big firms exchanged clients among themselves. All the Big Six firms gained new audit clients as a result of the change of law (see Table 8.9). The notion that the law benefited the big firms was confirmed by one of the partners of Ernst & Young, claiming in interview that "from a selfish point of view, we benefited a lot". However, the partner claimed that such financial benefit had created problems on their audits. He indicated that prior to the enactment of this law one auditor would carry out the whole audit work while now two auditors are dividing the work between themselves - which allows each auditor to see only a part of the picture rather than the whole picture (as in the past). It has also been difficult to set up meetings between the two auditors and the company, which he thought had created communication problems.

KAAA issued a statement after the enactment of the law stating that neither the parliament nor the Ministry of Commerce consulted it before approving the law. However, KAAA thought that this law was going to advance the profession. The general secretary of KAAA, Abdul Latif Al-Majed, claimed that the enactment of the law came as a response to the recent economic position of Kuwait. It was also an attempt to curtail the problems faced in the annual meetings of shareholding companies and, finally, to protect the interests of shareholders (Al-Anaba, 2/6/94, p.22). The audit market in Kuwait is currently dominated by a small group of big firms associated with international auditing firms. The five Big Six firms¹ represented in Kuwait audited 71% and 70% of companies listed in Kuwait's stock exchange in 1993 and 1994 respectively (See Table 8.9). Their share of the audit market for listed companies after the change of law rose to them being

¹ Price Waterhouse is the only Big Six firm that was not represented in Kuwait.

involved in auditing 90% of the listed companies in 1995 and 1996. Furthermore, governmentally controlled institutions and organisations, such as Kuwait Investment Authority (KIA) and Kuwait Petroleum Corporation (KPC)², closed share-holding companies, and limited companies are also audited by these firms. The services of these big auditing firms goes beyond auditing to include consulting services, privatisation studies, war compensation estimation, and training programs.

Table 8.9 - Number of Share-holding Company Clients by Audit Firm, 1993-1996

Auditing Firm	Number of Companies 1993	Number of Companies 1994	Number of Companies 1995	Number of Companies 1996
Ernst & Young	12	12	19	20
Arthur Anderson	11	12	15	19
KPMG Peat Marwick	1	1	6	7
Coopers & Lybrand	2	2	10	13
Deloitte & Touche	3	3	14	17
Anwar Al-Qatami (Member of Grant Thornton)	11	12	11	13
Abdul Aziz Al-Muatawa	1	1	1	1
Allied Accountants			4	6
Al-Fouz International Audit Bureau			1	3
Al-Faraj Auditing Office			4	3
Al-Ateeqi			1	1
Burgan Auditing Office			1	2
Al-Ahli Auditing Office			3	4
Abdul Rahman Al-Qaoud & Co				2
Al-Bayan Accountant & Auditing Office				3
Number of Audit Clients	41	43	90	114
Number of Companies not Audited by the Big Six	12	13	5	6
No. of Listed companies	48*	50*	57*	67*
Big Six's Share in the Audit Market	71%	70%	71%	67%
Big Six's & Anwar Al-Qatami's Share in the Audit Market for Shareholding Companies	98%	98%	83%	78%
Big Three share's in the Audit Market for Shareholding Companies	83%	84%	50%	46%

* Seven companies out of these are non-Kuwaiti and not audited in Kuwait

Source: Kuwait Stock Exchange, Investor Guides, 1993-96.

The above developments expanding the role of audit are, however, contradicted by one of the government's latest proposals, namely, to remove the requirement of the qualification exam for the right to obtain an auditing practising certificate. Officials from the Ministry of Commerce claimed that the desired amendment to the law would be to exempt university graduates with ten years of experience,

² KPC and eight of its subsidiaries in Kuwait were all audited by Arthur Anderson in Kuwait before the fraud scandal in Kuwait Oil Tankers Corporation. While Currently Arthur Anderson is auditing KPC its subsidiaries are audited by different Big Six firms in Kuwait.

holders of masters' degrees with six years of experience and holders of doctorates with four years of experience. However, a higher official at the Ministry amended the proposal, claiming that the experience requirement was enough and that there was no need for the exam at all (Al-Qabas, 2/5/95,p.17). This amendment was presented to the cabinet ministers who approved it and transferred it to the Kuwaiti parliament in May 1995. The proposed amendment met with opposition from auditing firms (big and medium size firms), the Kuwaiti Association of Accountants and Auditors (KAAA) and the auditors' department in the Ministry of Commerce. The auditing firms argued³ that abolition of the examination requirement was a backwards step as all developed countries call for such an examination to gain the right to practice. The absence of such a requirement was said to effectively shift the accounting practice from a profession to that of a business. It was also stressed that the licensing emphasis should be placed on the quality of practitioners and not their number. While some argued that the examination was not impossible to pass, others suggested that the low success rate in the past (See Table 8.10) can be attributed to the way the exam was designed by academics distant from practice. Therefore, a suggestion was made to switch the design of the exam from academics in the Ministry of Commerce to the professionals at the KAAA. An exemption from such an examination would be granted if accountants held a CPA or CA qualification. It was also suggested that a number of refresher courses be taken by licensed accountants each year to enable them to retain their license to practice. KAAA's comments included extending the experience period to 10 years to be able to practice, with the examination being required for accountants with less than 10 years of experience (10 hours of refresher courses provided by KAAA currently must be attended annually by practitioners to be able to retain their licence). The KAAA also suggested the retention of the current system where auditors are categorised as either "A" or "B" practitioners.

³ The Kuwaiti parliament asked the auditing firms and KAAA for their opinions in the proposed amendments. The above opinions and recommendations are based on the responses received by the parliament from the auditing firms and KAAA.

Table 8.10- Success Rate in Kuwait's accounting practice exam and auditing and auditor information

Description	Years														
	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
Exam attendants		3	7	13	4	12	11	23	15	11		28	26	15	13
Passed Exam			4			2	2	4				4	10	3	6
Success Rate %			57%	0%	0%	17%	18%	17%	0%	0%		14%	38%	20%	46%
Audit Firms	25	26	28	28	30	34	37	43	44	43	44	44	46	46	51
Auditors	41	43	46	46	46	48	50	56	57	57	59	60	63	62	68
Suspended auditors										1			1	3	

Source: Ministry of Commerce

The parliament ended up refusing the government's proposal and is now considering amendments put forward by KAAA. The parliament seemed to agree with KAAA and the audit firms as it did not approve the government's proposed amendment. The government's desire to make it easier for accountants to be licensed to conduct auditing seemed strange, especially given that there are claims of unprofessional conduct against some of the existing (limited) number of auditors. Some audit firms are suspected of indulging in unprofessional practices whereby the auditor agrees a fixed fee to sign an audit report and financial statements prepared by the client without attesting to the accuracy of their records and stated financial position. These financial statements are prepared by the audit clients to present to banks in order to secure loans and/or to the Ministry of Commerce to satisfy legal requirements. During interviews, auditors from audit firms and the Audit Bureau, together with bank loan managers claimed to be aware of such practice by small audit firms. The Ministry of Commerce, which regulates the profession and has the power to discipline auditors, was also well aware of the unprofessional practice. The director of the Shareholding Companies and Auditors' Department at the Ministry of Commerce claimed that they had called for a meeting of the disciplinary committee to discipline auditors who indulge in this practice – but were still awaiting a response to this request. He claimed that the committee seems basically to accept such practices as it has not even met once since Iraq's invasion of Kuwait in 1990.

Of considerable interest is the fact that KAAA, the professional body in Kuwait, has proposed several changes to the auditing law in Kuwait – all being changes

which the Big Six audit firms have strongly campaigned against on the global stage. At one time the secretary general of KAAA called for auditors to rotate every five years in every company (Al-Anaba, 2/6/94, p.22) – although, such calls were not presented in KAAA’s draft amendment of the Audit Law to the parliament. The draft law, however, has proposed a more controversial issue relating to auditor liability. This proposes that auditors should be liable to third parties and to make partners jointly responsible for such liability. It stated that

“The auditor has a legal responsibility towards the client and others for professional mistakes he commits, and he is obliged to compensate the client and the others on the losses they encountered. The partners have a joint responsibility among themselves”

The recent developments in auditing have shown that audit firms did not have very much impact on the regulation of the profession. The recent amendment of company law for two auditors to audit shareholding companies was introduced and approved by the parliament without consultation with the audit firms or KAAA. The government’s proposal to remove the requirement for a practising examination was also proposed by the government without consultation with audit firms and KAAA. Even the amendment proposed by KAAA to establish auditors’ liability towards third parties does not seem to be in agreement with the international campaigns of the Big Six. Overall, such developments clearly show that the representative of the Big Six firms in Kuwait do not have that much influence on the regulation of auditing in Kuwait. It stands in some contrast to the situation in Spain where the Big Six is becoming an increasingly significant force behind (the pressure for) auditing reforms.

8.4.2.3 *Kuwaiti Society for the Protection of Public Funds*

People’s frustration in Kuwait with the overwhelming feeling of corruption and mismanagement and the perceived failure of all organisations to protect public funds and stop them being mismanaged, led to attempts to establish a Kuwaiti society for the protection of funds in 1997. This non-profit society has attracted different people from different background including the speaker and members of

the parliament and a member of the Al-Sabah family. Four members of the parliament, including the speaker, proposed a law for exempting this society from the usual requirements for establishing societies in Kuwait (Al-Taleea, 16/6/98, p.6). The application for this society is still under-consideration by the government and has generated mixed reactions. There are some who are enthusiastic about the establishment of the society and who see it as a civilised step to aid the government and parliament in the protection of public funds (see Al-Qabas, 24/3/97, p.32, 31/3/97, p.40). Others see it as interfering in the duties of the government and the parliament – and the constitution gave them the task of protecting public funds (see Al-Sayash, 17-3-1997, p.32). The proposed society identified the following as the goals for its establishment: (for more details see Al-Taleea, 26/3/97, p.6).

1. Raising public awareness among citizens of the importance of protecting public funds
2. Examining and commenting on all reports and news conducted with relevance to public funds and highlighting the problems and the mediums to rectify them
3. Undertaking studies and drafting laws that would help to protect against the misappropriation of public funds
4. Investigating all received information about the misappropriation of public funds, including individuals for whom guarantees of anonymity have had to be given.

The serious attempt to establish a society of this kind and the backing it has received from concerned people from different backgrounds, serves to show the level of public concern about the level of corruption and mismanagement in recent years in Kuwait. Concern with corruption is not a solely Kuwaiti phenomena and is clearly becoming an international issue (see Time, 22/6/98). However, people in Kuwait do not seem to be that confident with the ability of the auditing function (represented through the Audit Bureau and audit firms) to control corruption and mismanagement. The government and the parliament are seen to have failed to have put an end to corruption. These feelings might be reflected in the recent attempt on the life of an outspoken member of parliament,

who is well known for his strong views about corruption. The failure of the government to bring people responsible for embezzling funds and committing fraud in the KOTC scandal might also be attributed to the public's worries about the government's ability to fight corruption.

8.5 Conclusion

The chapter has discussed the role of KIO's auditors and the role of GT auditors in the collapse of KIO's Spanish investments. It has argued that the role of KPMG and the Audit Bureau effectively acted as a façade to show that KIO was properly audited and controlled. In reality, both organisations were restricted in their access to much of the data about GT's investments and, indeed, when they did have some crucial information about GT, they failed to act correctly. In some contrast, the external auditors of GT (unlike those in other corporate collapses) did issue (several) qualified audit reports. However, ICAC's investigations still identified several technical deficiencies in the audit reporting of GT's group auditor, Coopers & Lybrand and imposed significant fines. It also imposed fines on Price Waterhouse for its audit of Ebro, GT's most successful associate company.

Financial scandals usually raise debates about the role of auditors and the function of auditing. This chapter has considered the implications of the KIO scandal for accounting and auditing in Spanish, Kuwaiti and international environments. The Spanish implications from the case showed a pattern that has prevailed in mainly Anglo-American contexts. This involves criticism of the profession, an audit expectations gap, relative immunity of the Big Six firms to scandals and competing debates on the need for reform of auditor liability and (self) regulatory regimes. The implications in Kuwait were rather different. There was no criticism of the auditing profession or the auditing function and there was a limited change in the audit law that was related indirectly to the KIO scandal – giving a bigger role to the Audit Bureau in auditing KIO/KIA.

In order to explore further the apparently different views held of auditing in Kuwait, a questionnaire study was undertaken. The aftermath of big scandals usually sees people questioning the role of auditors, revealing evidence of an audit expectations gap. The questionnaire will examine the situation in Kuwait to see if people have a reasonable expectation of auditors. It will also examine people's perception of the role of the Audit Bureau given the fact it has been given a bigger role after the KIO scandal. Comparing people's perceptions of the respective role and reputation of the Audit Bureau and the audit firms will be of particular interest given that the former claim to conduct 100% audit testing in contrast to the audit firms who base their audits on sampling techniques. Calls for joint audit in Spain as a way to boost auditor's independence were dismissed by the large firms (see *European Accountant*, February 1996). However, joint auditing was introduced in Kuwait as indirect impact of GT and other scandals to protect shareholders' interests. The questionnaire offers an opportunity to see how such a development has been greeted in Kuwait. Finally, the relative lack of debate in Kuwait about the role of auditors in the collapse of GT/KIO will be addressed in the questionnaire. This will involve questions about the respondents' knowledge of the work of KIO's auditors, the objectives of KIO's external audit and the type of information that should be published by KIO.

Chapter 9

Analysis of the Questionnaire

9.1 Introduction

Generally, financial scandals and corporate collapses lead to debates about the audit function and the role of auditors. Criticisms of the profession in the aftermath of such scandals usually see emphasis being placed on the notion of an audit expectations gap. The breakout of major corporate collapses of Kuwaiti owned organisations (e.g. KIO's Spanish investments and KOTC) in the aftermath of the Gulf-War provides a useful opportunity to see if such an expectations gap emerged in Kuwait. The questionnaire survey presented here, in fact, is the first major study of auditing expectations in the Gulf region. It examines people's view of auditing and a number of general issues related to the role of audit firms and their success in performing different tasks. It also explores views concerning the introduction of the requirement for two audit firms to audit the accounts of listed shareholding companies in Kuwait (discussed in the previous chapter). Similarly, it examines perceptions of the role of the Audit Bureau in auditing government owned organisations and listed shareholding companies in Kuwait. Examining the role of public sector auditors in this respect will contribute to the few studies (e.g. Chowdhury and Innes, 1998) that have examined the audit expectations gap in the public sector. It will also give a very rare, direct comparison of the perceived standing of private sector and public sector auditors and allow for some valuable reflections on the future role of auditing in processes of corporate governance in Kuwait.

The main studies of the audit expectation gap (e.g. Gloeck and Jager, 1993; Humphrey *et al*, 1993; Porter, 1993; Monroe and Woodliff, 1994; Yoshimi, 1994; McInnes and Stevenson, 1996) tend to focus primarily on whether an audit expectations gap exists or not. Some studies (e.g., García Benau *et al*, 1993), however, have sought more directly to explore individual dimensions of the results in more detail and to relate these to issues in the wider auditing environment, both domestically and internationally. This study seeks to apply a similar approach in relation to audit expectations in Kuwait.

This chapter outlines the questionnaire survey and analyses its results in three main sections. The first section reviews the construction of the questionnaire survey, issues of sample selection, distribution of the questionnaire and the problems encountered in carrying out the survey. The second section presents the analysis of each section of the questionnaire highlighting the prominent fact in each section. The final section of the chapter maps out the key themes to emerge from the survey.

9.2 Construction and Distribution of the Questionnaire

The questionnaire had five main sections, addressing issues relating to: the work of Audit Firms and the Audit Bureau, the KIO case, the future of corporate governance in Kuwait and demographic matters. The audit firms' section (Section A) was partially (Questions 1, 2, 3, 5, 6) based, after appropriate adjustments, on Humphrey *et al*'s (1993) audit expectations gap study in the UK. It tackles issues such as the role of external auditors, the nature of the auditing process, the legal responsibility of auditors to shareholders, the regulation of audit firms and the success of audit firms at particular activities. The Audit Bureau section (Section B) also derived from Humphrey *et al*'s (1993) work but with considerable amendment to accommodate the function of the Bureau. The KIO section (Section C) addressed issues relating to the collapse of KIO's investments in Spain, including: the respondents' familiarity with the KIO case and the degree of information made public about KIO's activities, and the relative status and independence of KIO's auditors. A number of more general questions were also asked about the KIO scandal, including whether respondents blamed particular parties for the collapse of Grupo Torras and whether common causes were behind the number of financial scandals to have hit Kuwait since its liberation in 1991. The fourth main section (Section D) dealt with a range of proposals for improving the future of corporate governance in Kuwait. The final section of the questionnaire (Section E) focused on the demographic characteristics of the respondents, to facilitate attempts to explain the difference (if any) in their answers.

Questionnaires were circulated to four main groups: auditors from the Audit Bureau, auditors from audit firms, users of financial statements and financial directors. Questionnaires only differed in terms of the demographic section. The involvement of auditors from the private and public sector in the audit of organisations such as KIO/KIA made it necessary to circulate questionnaires to auditors from both sectors. Likewise, users and financial directors were selected from both sectors. The questionnaire was piloted with ten individuals and duly adjusted following comments and suggestions reviewed. Respondents participating in the survey were offered the choice of completing the questionnaire in Arabic or English version (copies enclosed in the Appendix 5). Two tutors at Kuwait University examined the questionnaire to check that there were no problems in the way the questionnaire had been translated and adjustments were made accordingly.

9.2.1 Selecting the Sample and Distributing the Questionnaire

The difficulty of obtaining a good response rate from mail questionnaires in Kuwait led to the questionnaires being distributed personally by myself through individual contacts made with people in the selected organisations. Only financial directors from stockholding companies, due to their larger number, were sent questionnaires by mail. Questionnaires were distributed to all of Kuwait's 32 audit firms, with the number of questionnaires given to these firms depending on how many questionnaires each firm was willing to accept. In the case of the Audit Bureau an agreement was struck to circulate questionnaires to all auditors (approximately 100 auditors) attesting the financial statements of companies listed on the Kuwaiti stock exchange or those of government owned companies and organisations. Auditors responsible for auditing government ministries were not included in the sample because their work did not involve contact with the work of external auditors of corporations like KPC or Kuwait Airways. Questionnaires were also circulated to the financial directors of all 292 shareholding companies (41 public and 251 closed companies) listed in the *1996/1997 Directory of Shareholding Companies published* by the Ministry of Commerce and Industry in Kuwait. Financial directors of government owned

organisations and companies were also sent questionnaires. The most diversified group was users of financial statements, which included loan managers, financial analysts, brokers, governmental supervisory bodies, regulators, governmental agencies and academics.

The questionnaires were circulated in early February 1997 and their collection spanned until June 1997. There was difficulty in getting people to participate in the study given the secrecy and sensitiveness of KIO's operations. For instance, questionnaires were circulated at KIA but respondents there left all the KIO questions unanswered. KIA's managing director had suggested that no questionnaires should be returned to me. He also, falsely, accused my supervisor of working for the former managers of KIO and of using me to carry out this research on their behalf. Non-Kuwaitis were generally hesitant to participate and if they did participate they tended to leave KIO's questions unanswered. Their reluctance to respond to the questionnaire was clearly demonstrated in the case of my research sponsor (Kuwait University's Accounting Department) where only two out of the thirteen Non-Kuwaiti accounting staff at the department chose to participate. Another problem related to the accuracy of some participant's responses. In preparing the questionnaires for analysis, it became clear that some of the respondents had copied each others' answers (e.g. in the cases of a limited number of responses from a Big Six Audit Firm, the Audit Bureau and the Ministry of Commerce & Industry). One auditor in a local Kuwaiti firm indicated that the responses of all auditors in his firm were the same and that I could fill the rest of the questionnaires I circulated to his firm on the basis of this single response! A related problem concerned the existence of large amount of missing data in the sections on the Audit Bureau and KIO (see Table 9.1). 16% of respondents failed to answer the Audit Bureau questions, citing their poor knowledge of its work as the reason.

Table 9.1 – Unanswered Questions in Each Section of the Questionnaire

	Full	(B)	(C)	(D)	(E)	(B) & (C)	(B) & (D)	Total
Audit Bureau	27		5					32
Audit Firms	37	7	1			27	1	73
Users of Financial Statements	120	2	2	1		1		126
Financial Directors	80	4	3		1	8	1	97
Total	264	13	11	1	1	36	2	328
Rate	80%	4%	3%	0.3%	0.3%	11%	0.6%	45%

Eighty-six percent of the people who failed to answer this section (Section B) were also non-Kuwaitis. Analysis of the responses to the KIO section (Section C) revealed three types of respondents: those who answered all KIO's questions, those who probably knew about the KIO case but avoided providing answers; and those who did not know enough information about KIO and did not answer. The number of respondents (14%) who failed to answer the KIO questions were mainly from the audit firms (60% of audit firms respondents left the KIO section unanswered - see Table 9.1). Several Audit Bureau respondents wrote "*I don't know*" across the whole section. This was difficult to understand given that their demographic data showed that they had: worked in the Bureau for a period spanning from 10 to 25 years; held senior auditor posts; and were responsible for auditing government owned organisations like KIO (which is also audited by the Audit Firms). Some of the respondents might have been reluctant to answer KIO questions as they were non-Kuwaiti (Egyptians) and wanted to stay loyal to the government and not get involved in sensitive issues. Some respondents seemed to perceive the KIO section as dealing with political issues and preferred not to answer it – a sentiment expressed clearly by a financial director of a partly government-owned insurance company who wrote that the "KIO section was full of political questions". An auditor from one of the Big Six firms refused to answer the KIO section, citing a potential conflict of interest (even though his firm was not an auditor of KIO). Alternatively, there were other respondents who may not have answered because their knowledge of the KIO case was limited by the fact that (from their demographic information) they were non-Kuwaitis living outside Kuwait when the scandal broke out.

9.3 Analysis of the Main Findings of the Questionnaire

A response rate of 45% was achieved after eliminating unusable responses as detailed in Table 9.2. The highest response rate was 70% (from users of financial statements) while the lowest response rate was 29% (from financial directors). The overwhelming majority of respondents were males (94%) - attributed to the very low rate of women working in the four groups (especially in audit firms where women very rarely act as external auditor). The nationality of respondents was strongly dominated by Kuwaitis (47%) and Egyptians (28%), while the rest stood at Indian (6%), Jordanian (4%) and other nationalities at less than 3% each. The nationality of the Bureau's auditors were exclusively of Kuwaiti or Egyptian origin. The largest age group was between 30-39 years old (42% of respondents), with the second largest age group being between 40-49 years (33% of respondents). The other respondents were either under 30 years or older than 50 (12% for each group). Consequently, it can be concluded that the sample was dominated by Kuwaiti and Egyptian male respondents of between 30-49 years of age. The majority of respondents were university graduates (74%), with 17% and 3% respectively holding a post-graduate qualification in the form of a masters or doctoral degree.

Table 9.2 – Questionnaire Response Rate

Group	Distributed	Response	Usable Response	Usable Response Rate
Audit Bureau	100	34	32	32%
Audit Firms	221	80	73	33%
Users of Financial Statements	179	129	126	70%
Financial Directors	332	102	97	29%
Total	832	345	328	39%

Table 9.3 - Sex of Respondents Across the Groups

Sex	The Audit Bureau	Audit Firms	Users of Financial Statements	Financial Directors	Total	Percentage of Respondents
Male	28	73	111	94	306	93.3%
Female	4	-	14	3	21	6.4%
Unknown	-	-	1	-	1	0.3%
Total	32	73	126	97	328	100%

Table 9.4 - Nationality of Respondents Across the Groups

	The Audit Bureau	Audit Firms	Users of Financial Statements	Financial Directors	Total	Percentage of Respondents
Kuwaiti	19	12	88	36	155	47%
Indian		7	7	7	21	6%
Lebanese		3	3	2	8	2%
Jordanian		5	1	7	13	4%
American		1		2	3	1%
Egyptian	13	29	19	31	92	28%
Pakistani			3	3	6	2%
Syrian		3	1	4	8	2%
British		7		2	9	3%
Palestinian		3		1	4	1%
other		3	3	2	8	2%
Unknown			1		1	0%
Total	32	73	126	97	328	100%

Table 9.5 - Age of Respondents Across the Groups

Age	The Audit Bureau	Audit Firms	Users of Financial Statements	Financial Directors	Total	Percentage of Respondents
21-24	2	1	5	-	8	2%
25-29	3	10	15	2	30	9%
30-34	4	11	23	14	52	16%
35-39	7	18	44	17	86	26%
40-45	4	10	20	34	68	21%
46-50	4	12	11	13	40	12%
51-60	4	9	7	14	34	10%
61-70	2	-	1	1	4	1%
Unknown	2	2	-	2	6	2%
Total	32	73	126	97	328	100%

Table 9.6 - Education of Respondents Across the Groups

Education Level	The Audit Bureau	Audit Firms	Users of Financial Statements	Financial Directors	Total	Percentage of Respondents
High School	-	1	1	1	3	1%
Diploma	-	-	7	2	9	3%
Bachelor	26	59	89	70	244	74%
Master	5	7	21	22	55	17%
Doctoral	-	2	7	-	9	3%
Other	1	3	-	-	4	1%
Unknown	-	1	1	2	4	1%
Total	32	73	126	97	328	100%

Given the non-parametric nature of the data, it was analysed initially using the Kruskal Wallis one way analysis of variance test - known for its usefulness in determining whether a number of independent samples have been drawn from the same population (Siegel and Castellan, 1988, p. 206). Accordingly, the Kruskal Wallis test was used to compare the responses of the four groups.

A striking overall finding is that there were no significant differences ('an expectations gap') for a large percentage of the questions across the four groups (see Table 9.7) – 54 of the 131 questions did not produce a significant difference. Further, when significant differences did arise, they tended to relate to differences in emphasis rather than basic differences in opinion. In total, only 13 of the 77 questions which showed significant across groups differences at either the 1% or 5% levels of statistical significance revealed basic differences in opinion across the groups (i.e. some groups disagreeing and others agreeing with a particular statement). 64 of the differences, therefore were due to differences in emphasis (with some groups more strongly agreeing than others – but all groups agreeing with a particular statement). This is an important point, as often expectations gap studies can claim a major expectation gap, when basic differences in opinion are not so common.

In analysing the data, there was an initial concern that the Audit Bureau or the Audit firms might be driving the differences among the groups – through a self-rating bias, given that they were having to rate their own performance. Therefore, the Kruskal Wallis test was re-run, first without Audit Bureau respondents and secondly without Audit firm respondents. This decreased the number of significant differences across groups quite substantially on both occasions, although not in uniform ways (see Table 9.7). Accordingly, the results for each section of the questionnaire are shown in the Tables in way which details the mean responses of the four different groups (directors, users, Audit Bureau and audit firms), together with the significance of the Kruskal Wallis statistic for the three combinations (i.e., 1. - all four groups; 2. - directors, users and audit firms; 3. – directors, users and Audit Bureau). The benefit of this presentation is that it shows the questions where the views of the two sets of auditors were clearly different. It also reveals that a large proportion of the significant differences across all groups relate to questions concerning how successful particular sets of auditors are at certain performance attributes (see Tables 9.16 and 9.17). Thus, when respondents are asked to judge the success of the Audit Bureau, the responses of the four groups are significantly different at the 1%

level on all 19 attributes. However, when the Audit Bureau respondents are excluded, significant differences in the views of directors, users and audit firms only arise on three of the attributes. In what follows, the results of the re-run of the Kruskal Wallis test without the Audit Bureau are shown throughout the chapter highlighted in *bold italics fonts* whenever a different result is obtained from that for the four-group comparison. When the results of the re-run of the Kruskal Wallis without the Audit Firms produce different results these are highlighted in *bold italics fonts*.

Table 9.7 - Frequency of Differences and Similarities Across Groups

	Not Significant		Significant at 5%		Significant at 1%		Total
	Frequency	Rate	Frequency	Rate	Frequency	Rate	
The four groups	54	41%	15	11%	62	47%	131
The three groups without the Audit Bureau	73	56%	18	14%	40	31%	131
The three groups without the Audit Firms	79	60%	18	14%	34	26%	131

The Wilcoxon-Mann-Whitney test of sample means was subsequently used to test whether two independent groups were drawn from the same population (Siegel and Castellan, 1988, p. 128). This test was carried out comparing each of the four groups in turn with the other three groups (e.g. audit firms with the Audit Bureau, then audit firms with directors and audit firms with users) - resulting in six different tests. Analysis of the Mann Whitney test shows that the most frequent differences were observed between audit firms and users, with a total of 53 significant differences from 131 questions. Interestingly, the second highest number of differences were observed in the Audit Bureau-audit firms comparison (with 51 significant differences), while the least differences were observed between directors and users (for further details, see Table 9.8). This does suggest that any differences in auditing expectations cannot simply be attributed to 'uneducated' or ill-informed user groups.

Table 9.8 – Results of Six Mann Whitney Tests for the Four Groups

Frequency of Significant Differences	AB-AF	AB-D	AB-U	AF-D	AF-U	D-U
	51	48	41	37	53	31

AB = Audit Bureau, AF = Audit Firms, D = Directors, U = Users of Financial Statements

9.3.1 Views on the Nature of Company Audit Practice

The questionnaire initially sought respondents' views on 12 statements regarding the role of external audit firms and the audit process in Kuwait. Most of the responses to the statements showed no difference in opinions across the four groups. Even in the four of the twelve statements that showed significant differences (at the 1% level) as in Table 9.9, such difference was mainly related to a difference in emphasis rather than in opinion. A good example of this can be seen in the statement that "auditors do not understand the problems of business", with the majority of each group disagreeing with the statement - external auditors having the strongest level of disagreement (73%), followed by directors (57%), Audit Bureau (53%) and users (50%). Similar patterns can also be seen in the statements that "auditors provide a significant protection against fraud" (supported by 55% of respondents from audit firms, 84% from the Audit Bureau, 83% of users and 70% of directors) and that "auditors should report to shareholders on management efficiency" (supported by 64% of audit firms, 84% of the Audit Bureau, 85% of users and 73% of directors).

The major differences of opinion were exhibited in just two statements. The first one concerns whether company auditors are adequately accountable for their work. Financial directors (51%) generally did not agree with the statement while the majority of respondents from the other groups agreed with the statement (see Table 9.9). 61% of financial directors and 56% of users felt that "auditors are too concerned with keeping company management happy", while both auditors from the Audit Bureau and audit firms were divided in their agreement with the statement.

Table 9.9 –Views on the Nature of Company Audit Practice

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. The quality of company audits has increased since the Manakh crises of 1982	5.1	5.2	5.5	5.3	NS	NS	NS
2. Too much is expected of auditors by the investing community	5.3	5.8	5.8	5.5	NS	NS	NS
3. Auditors are too concerned with keeping company management happy	4.6	4.6	4.1	3.8	S _{5%}	S _{5%}	NS
4. The auditing process is seriously weakened by imprecise accounting standards	4.9	5.2	5.4	4.6	NS	NS	NS
5. An audit is of very little benefit to a company	1.9	1.7	1.4	1.7	NS	NS	S _{5%}
6. Audits generally take too long to complete	3.6	3.9	4.4	3.8	NS	NS	S _{5%}
7. Auditors do not understand the problems of business	3.4	3.4	3.7	2.5	S _{1%}	S _{1%}	NS
8. Audits provide significant protection against fraud	5.0	5.7	5.5	4.6	S _{1%}	S _{1%}	S _{5%}
9. Auditors should be identifying ways to improve management efficiency	5.5	5.5	5.0	5.1	NS	NS	NS
10. Auditors should report to shareholders on management efficiency	5.4	5.9	5.8	4.9	S _{1%}	S _{1%}	NS
11. Auditors are not made adequately accountable for their work	4.5	3.8	3.0	3.3	S _{1%}	S _{1%}	S _{1%}
12. Friendships and relationships with senior corporate management usually govern the appointment of external auditors	5.2	5.4	5.5	5.5	NS	NS	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

In terms of absolute ratings, this part of the questionnaire showed a high level of satisfaction with auditing and external auditors in Kuwait, with some instances users expressing more positive views than those of audit firms. For example, in the statement “too much is expected of auditors by the investing community”, both users and respondents from the Audit Bureau agreed to a larger degree with the statement than did respondents from audit firms. The four groups generally agreed that the quality of company audits has increased since 1982, that audits provide protection against fraud and that too much is expected of company auditors. The satisfaction across groups can also be demonstrated in their disagreement with the notions that the company audit is of a little benefit and that auditors do not understand the problems of business. The groups also believe that auditors should provide more services, namely identifying ways to improve

management efficiency and report on such efficiency to the shareholders. Somewhat surprisingly, a large number of external auditors accepted the idea of expanding their duty to improve and report on management efficiency. This is clearly incompatible with the position of auditors in Anglo-American countries where auditors have been quite strongly opposed to such duties (for example, in discussions over Corporate Codes of Governance and the work of the Cadbury Committee).

The generally positive views held of the quality of auditing in Kuwait were expressed even though there were some worries in terms of the nature of auditor independence. More than half of directors (61%) and users (56%) concurred that auditors are too concerned with keeping company management happy. The Audit Bureau and audit firm respondents were more divided on this issue, but for 42% of auditors from audit firms to think that auditors are too concerned with keeping management happy does suggest that it is a significant problem area. The strong consensus among the four groups that friendships and relationships with management usually govern the appointment of audit firms is a further reflection of such worries about independence - with 76% of respondents from audit firms, 71% from the Audit Bureau, 76% of users and 69% of directors agreeing with the statement.

9.3.2 The Role of the Auditor in the Private and Public Sectors

Respondents were asked to indicate the extent of their agreement with a combined total of twelve statements about the role that should be played by either the external auditor (Table 9.10) or the Audit Bureau (Table 9.11) in auditing companies in the private sector and government owned corporations or organisations. Significant differences were observed on five of the seven statements on the role of the external auditor towards the audited company (four at the 1% level of significance). Interestingly, these differences were clearly being driven by the views of audit firm respondents – as Table 9.10 shows there were no significant differences in the responses of directors, users and Audit Bureau respondents. Further, even when the audit firms were included in the

analysis, there was only one statement where their views were of a significantly different opinion than the other groups (this being on the statement that auditors should detect all significant fraud). On all the other statements with significant differences, the difference was one of emphasis rather than opinion (i.e., all groups agreed with the statement, with the audit firms' respondents being either stronger or less strong in their level of agreement).

Table 9.10 - The Role of External Auditors

The auditors' role with respect to the audited company should be to ensure that:	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. all significant fraud is detected	5.6	5.9	5.7	3.6	S _{1%}	S _{1%}	NS
2. company financial statements contain no significant deliberate distortions	6.7	6.6	6.7	5.9	S _{1%}	S _{1%}	NS
3. a satisfactory system of internal control is being operated	6.5	6.6	6.8	6.1	NS	NS	NS
4. the future viability of the company is not in doubt	5.8	6.1	5.3	5.6	NS	NS	NS
5. the company is being run efficiently	5.2	5.5	5.5	4.4	S _{1%}	S _{1%}	NS
6. the appropriate regulatory authorities have been informed of any significant malpractice	5.8	5.9	5.9	5.1	S _{5%}	S _{5%}	NS
7. the company's accounts give a reliable indication of its market value	6.0	5.7	5.7	4.6	S _{1%}	S _{1%}	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

The results are striking because, in absolute terms, they show auditors' agreeing with controversial issues that the profession in Anglo-American countries has long been fighting against. For example, 86% of external auditors accepted that they should have a role in ensuring that a satisfactory internal control is in place, while 76% felt that the auditor should ensure that the viability of the company is not in doubt.

The one clear difference of opinion was, as noted above, in the area of fraud detection – with 56% of respondents from audit firms believing that auditors do not have a duty to detect all significant fraud, while 76% of financial directors, 82% of users and 81% of the Bureau's auditors felt that they did have such a duty. The so-called "red rag" phenomena identified by previous researchers (e.g., see García Benau *et al*, 1993) was seemingly evident here in that 56% of

external auditors believed that they did not have a duty to detect all significant fraud (Question 1, Table 9.10), yet 83% of them agreed that auditors did have a duty to ensure that their client's financial statements are free from significant deliberate distortions (Question 2, Table 9.10).

The responses to the five statements regarding the role of the Audit Bureau with respect to its audits of government owned corporations (including shareholding companies) and organisations produced some significant differences (see Table 9.11), but these were very much differences in emphasis – with the majority of respondents across the groups being in agreement over the role of the Audit Bureau. For instance, 74% of external auditors, 82% of directors, 89% of users and 97% of the Audit Bureau agreed that the Bureau's auditors should ensure that the company is being run efficiently – while at least 71% of respondents in each group felt that the Audit Bureau should be detecting all significant fraud.

Table 9.11 – The Role of the Audit Bureau

The Audit Bureau's role with respect to its audits of government owned corporations and organisations should be to ensure that:	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. all significant fraud is detected	6.2	6.3	6.4	5.4	S _{1%}	S _{1%}	NS
2. Company financial statements contain no significant deliberate distortions	6.5	6.6	6.4	6.1	NS	S _{5%}	NS
3. a satisfactory system of internal control is being operated	6.5	6.8	6.9	6.6	S _{5%}	NS	S _{5%}
4. the company is being run efficiently	5.8	6.3	6.5	5.5	S _{1%}	S _{1%}	S _{5%}
5. the appropriate regulatory authorities have been informed of any significant malpractice	5.9	6.5	6.2	6.4	S _{5%}	S _{1%}	S _{1%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

An interesting finding emerges when comparing the results of the audit firms with those of the Audit Bureau – for the Bureau's auditors are the more willing to accept responsibilities. For example, 91% of the Bureau's auditors felt that they have a duty to detect all significant fraud, while only 37% of external auditors felt that they should have a similar role on company audits. Moreover, audit firms also felt that the Audit Bureau should have more responsibility than themselves

(e.g. 71% believing that the Audit Bureau should detect all significant fraud on its audits and 74% believing that the Audit Bureau should ensure that government owned corporations are being run efficiently – compared to 49% of auditors who saw this as a responsibility for the company auditor). This was generally the case with the other groups (the one exception being in relation to the responsibility for making sure that the financial statements do not have significant deliberate distortions). Finally, the Audit Bureau's auditors did not seem so concerned by the term fraud – with virtually the same percentage of respondents feeling that they should detect all significant fraud (91%) and also ensure that the financial statements are free from significant deliberate distortions (90%).

9.3.3 Auditor Responsibility

The respondents were asked about the extent of their agreement with the company's external auditors being responsible to existing shareholders and to potential shareholders for any loss arising from their reliance on the audited financial statements. The majority of respondents in each group generally agreed that external auditors should be liable for both existing and potential shareholders, as outlined in Table 9.12 (although support for potential shareholders was significantly less than that for current shareholders). Respondents from audit firms were the most divided of the four groups over the auditors' responsibility towards potential shareholders – with 45% supporting such a responsibility and 37% against. Of the four groups, auditors from the Bureau's were the most supportive of such a responsibility (88% in favour).

Table 9.12 - Auditor Responsibility

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Existing shareholders	5.9	6.0	6.1	5.0	S _{1%}	S _{1%}	NS
2. Potential shareholders	4.8	4.4	5.6	4.1	S _{1%}	NS	S _{1%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

9.3.4 Auditor Independence

The questionnaire asked respondents to rank auditors (from the Audit Bureau, Big Six audit firms and non-Big Six firms) from those they saw as the most

independent to those they regarded as the least independent (see Table 9.13). The analysis shows that respondents were split in their perceptions of the most independent auditor in Kuwait. Of the respondents who assigned a ranking to the Audit Bureau, 49.6% chose to rate it as the most independent auditor in Kuwait (21% of respondents chose to rank it as the least independent). Of the respondents who chose to rank the audit firms associated with the Big Six, 52.7% saw them as the most independent auditors in Kuwait (11% of respondents ranked them as the least independent). Firms not associated with Big Six firms were clearly seen as the least independent (only 3.2% of respondents awarding them a ranking, chose to rate them as the most independent). Such a result is interesting as it shows that firms associated with Big Six firms clearly have a significant reputational advantage over their counterparts not associated with such multinational audit firms, but that the reputation of the Audit Bureau for independent work is almost as strong as that of firms associated with the Big Six. Indeed in Analysing the responses of the individual groups users chose to rank the Audit Bureau as being more independent than firms associated with the Big Six (not surprisingly this also the view of the Audit Bureau respondents, while respondents from the audit firms and financial directors chose to rank firms associated with the Big Six as the most independent).

Table 9.13 - Rank of Independence of Auditors in Kuwait

	Most Independent %		Least Independent %	No. of Total Answers for each group
Audit Bureau	49.6	29.4	21.0	252
Associated with the Big Six	52.7	36.4	11.0	264
No Association with the Big Six	3.2	30.2	66.5	248

9.3.5 Statutory Requirement for Two Independent Auditors

Attitudes towards the recent amendment to the commercial law (article No. 161) discussed in chapter 8 concerning the statutory requirement for two independent auditors for listed companies were examined through six questions in the questionnaire. The reason behind the examination of this change was to see what the various groups thought of this development given that the amendment to the law was introduced by the parliament as an indirect response to the financial

scandals surrounding the collapses of major Kuwaiti organisations. This section was of particular value in that a similar change had been rejected in Spain but has long been accepted in France. The results (see Table 9.14) show three significant differences at the 1% level of statistical significance and one at the 5% level, although again the differences tended to be ones of emphasis rather than basic opinion. There was majority support in each of the four groups for the claims that two set of auditors would: make fraud detection easier; enhance the overall independence of audit work; not hinder auditors in gaining a clear picture of the financial position of the company; and not lead to unnecessary duplication of work. The only major split in opinion across the groups related to the claim that the appointment of two auditors would not generate a significant benefits to shareholders. External company auditors were split among themselves concerning the generated benefits gained from the appointment of two auditors, with 49% in agreement and 42% disagreeing with the statement. Similarly, the Bureau's auditors were split with 47% disagreeing while 41% agreeing. Users (69%) and directors (56%) were generally stronger in their disagreement with the statement.

Table 9.14 - Statutory Requirement for Two Independent Auditors

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Having two external auditors will make the detection of material fraud and errors much easier	4.6	5.4	5.5	4.1	S _{1%}	S _{1%}	S _{5%}
2. The appointment of two external auditors will enhance the overall independence of audit work	4.8	5.7	5.6	4.3	S _{1%}	S _{1%}	S _{1%}
3. The use of two external auditors will limit either auditors' ability to obtain a clear picture of the financial position of the company.	3.1	3.0	2.7	2.6	NS	NS	NS
4. The appointment of two external auditors will lead to unnecessary duplication of audit work	3.7	3.2	3.1	2.8	S _{5%}	S _{5%}	NS
5. The requirement to appoint two external auditors will increase the share of the audit market held by large accounting firms in Kuwait	5.4	5.1	5.7	5.0	NS	NS	NS
6. The appointment of two external auditors will generate no significant benefits for shareholders	3.6	3.0	4.0	4.2	S _{1%}	S _{1%}	S _{1%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

The respondents from audit firms tended to be the least supportive group (but also the most divided) towards this new requirement in Kuwait. Thus, claims that the new requirement would make the detection of fraud much easier were supported by a majority (51%) but rejected by a very significant 'minority' (40%). Likewise, 55% of auditors agreed that the amendment would enhance the independence of audit work, while 38% disagreed. Such division is intriguing in that the audit firms are the party most likely to benefit the most from such an amendment to the law. For example, 72% of directors, 63% of users, 81% of respondents from the Audit Bureau (and 62% of respondents from audit firms) thought that the amendment would lead to an increase in the market share of the large accounting firms in Kuwait. The roots of their opposition to the claimed benefits to shareholders is not that easy to understand. It may be said that they are the ones closest to the audits affected by the amendment and that their rejection of such an amendment was, admirably, on (selfless) grounds that it will not produce better audits. However, this is hard to accept given that 70% of audit firm respondents did not think that it would lead to unnecessary duplication of audit work and 70% thought it would not prevent auditors from getting a clear picture of the company's financial position. One possible explanation is that a significant proportion of respondents from audit firms thought that the amendment was very much about image management (improving perceived independence) but not really about improving the actual effectiveness of audit work. However, this is not something shared by other groups (nor by half of the audit respondents) with clear majorities of users, directors and respondents from the Audit Bureau believing the reform will generate real benefits to shareholders.

9.3.6 Prohibitions and Regulations Governing the Activities of Audit Firms

This part of the questionnaire laid down eleven propositions about what auditors should be allowed to do and what they should not do (see Table 9.15). The analysis revealed just three statistically significant differences across the four groups – these related to statements that: audit appointments should have a specific time limit; audit firms should be self-regulated; and should be allowed to own shares in audit clients. On two of these there was evidence of groups taking

very different overall opinions. Thus, in relation to auditor rotation, the majority of external auditors (56%) were opposed to it while 57% of financial directors, 53% of users and 66% of the Bureau's auditors were in favour of such proposal. Similarly, with the establishment of a self-regulatory system for auditing in Kuwait, 63% of external auditors were in favour while the other groups only gave it a minority support (41% of the Audit Bureau respondents, 34% of users and 42% of directors).

Table 9.15 - Prohibition and Regulation on the Activities of Audit Firms

Audit firms in Kuwait should:	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. be able to provide management advisory services to their audit clients	5.6	5.6	5.3	5.9	NS	NS	NS
2. be allowed to own shares in their audit clients	2.5	1.9	1.6	1.4	S _{1%}	S _{1%}	S _{5%}
3. not be able to earn more than 10% of total income from any one audit client	4.5	4.7	4.0	4.4	NS	NS	NS
4. have a specific time limit to act as an external auditor of any client (e.g. no more than 5 consecutive years)	4.5	4.6	4.8	3.5	S _{5%}	S _{5%}	NS
5. be self-regulated instead of being regulated by the Ministry of Commerce	4.1	3.7	3.2	5.0	S _{1%}	S _{1%}	NS
6. not act primarily to make a profit	3.6	3.8	4.6	3.9	NS	NS	NS
7. have their appointment and fee determined by a body independent of the client company	5.4	5.4	5.1	4.9	NS	NS	NS
8. have limited liability determined by statute	4.0	3.9	4.4	3.9	NS	NS	NS
9. have their audit methods checked by a professional standards body	5.7	6.0	5.8	5.7	NS	NS	NS
10. be required to be associated with a major international audit firm	5.8	5.7	5.3	5.4	NS	NS	NS
11. not have close personal friendships with their audit clients	4.8	5.0	4.9	5.0	NS	NS	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

In analysing the responses to this section, however, it was interesting to see that in several instances where there were no statistically significant difference across groups (in terms of the distribution of responses), the propositions were ones on which all groups were very much divided. For instance, all groups were split on whether audit firms should have limited liability determined by statute. 48% of auditors disagreed with such a position, while 44% agreed (the comparative splits for the other groups being: users (41% disagreed, 39% agreed), directors (39% disagreed, 46% agreed) and the Audit Bureau (32% disagreed and 52% agreed).

Similar division was evident over the proposition that audit firms should not act primarily to make profit. 47% of audit firm respondents agreed with the proposition (44% disagreed) – the comparative splits for the other groups being: directors (34% agreed, 51% disagreed), users (32% agreed, 42% disagreed) and Audit Bureau (53% agreed, 40% disagreed).

The above views of directors and users are worth a second look – because on a number of statements in this section, they were less accepting of prohibitions on the activities of auditors than the audit firms themselves. Audit firms showed the strongest support (93%) against owning shares in their clients, the strongest support (62%) for auditors not having close personal relationships with their clients and the strongest support (49%) for auditors not to earn more than 10% of total income from any one audit client. Users and directors were also very much in favour of auditors being allowed to provide management advisory services to audit clients (83% and 77% respectively in favour – with audit firms, on this issue, being slightly more supportive, with a 85% support rate). This has been a perennial debate in Anglo-American contexts and it is striking to find that it is something of a non-issue in Kuwait. Recent global auditing developments have seen the auditing profession promoting more consulting-oriented audit services (under labels such as “value-added auditing”), arguing that this is what audit clients want. While there have been questions raised as to whether such a process is largely supply-side driven, the evidence in Kuwait does suggest that clients are wanting to receive a broader-based audit service. Another issue which has proved to be very controversial in Anglo-American contexts (whether audit appointments and fees should be determined by a body independent of the audit client) similarly proved to be not so controversial in Kuwait. All four groups, including the audit firms, were supportive of such a body carrying out these functions – (64% of auditors, 70% of users, 72% of Audit Bureau respondents and 75% of directors). This is further evidence that while auditing may be becoming more global in its practice, the expectations gap debate is not as uniform as earlier work may have suggested.

9.3.7 How Successful are Auditors from Audit Firms and the Audit Bureau

Respondents were asked to indicate how successful they think audit firms and the Audit Bureau are on 19 specific activities. The responses on the success of audit firms (see Table 9.16) showed 15 significant across group differences (12 at the 1% level and 3 at the 5% level). For the Audit Bureau (see Table 9.17) significant across group differences (at the 1% level) were observed on all 19 activities. At first sight, such a large number of significant differences implies a big performance gap. However, it has to be recognised that auditors were rating their own performance, so the results are always going to be susceptible to claims of a self-rating bias. Indeed, on most activities, both the audit firms and the Audit Bureau, perceived themselves more successful than the other groups saw them. Further, it is also important to look at the absolute ratings being given of auditors' performance. On most questions, users and directors gave positive ratings to the audit firms and the Audit Bureau. For instance, 71% of users thought that audit firms were providing a useful service to society, 79% thought they reported truthfully and 78% thought they were successful at detecting errors and irregularities). The significant differences tended to arise because the respondents from the two auditor groups tended to rate their performance even more highly than did users and directors.

Mann Whitney tests were run to compare the differences in responses of pairs of respondent groups. These showed that respondents from audit firms and the Audit Bureau had pretty similar views on the successfulness of audit firms. Directors and users were also quite similar their rankings of the success of audit firms at the 19 specified tasks, a result which serves to undermine the traditional claim of the audit profession in Anglo-American environments that users have unreasonable and uneducated expectations of auditors (i.e., it is hard to substantiate claims of ignorance if the views of users are very similar to the views of people – directors – who deal directly with auditors on a constant basis).

Table 9.16 - How Successful Are Auditors from Audit Firms?

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Diagnosing problems	4.9	4.9	5.2	5.8	S _{1%}	S _{1%}	NS
2. Prescribing remedies to problems	4.7	4.6	5.0	5.8	S _{1%}	S _{1%}	NS
3. Acquiring information	5.6	5.5	5.7	6.0	S _{5%}	S _{1%}	NS
4. Coping with risk and uncertainty	4.1	4.6	5.1	4.6	S _{5%}	NS	S _{5%}
5. Predicting the future	4.2	4.0	4.6	4.4	NS	NS	NS
6. Making a profit	4.9	5.2	4.6	5.1	NS	NS	NS
7. Detecting errors and irregularities	5.3	5.5	5.7	5.6	NS	NS	NS
8. Preventing errors and irregularities	4.6	4.8	5.3	4.9	NS	NS	NS
9. Complying with professional rules	5.6	5.2	5.9	6.3	S _{1%}	S _{1%}	S _{5%}
10. Enforcing legal requirements	5.6	5.3	6.1	6.2	S _{1%}	S _{1%}	S _{5%}
11. Forming correct judgements	5.2	5.2	5.7	5.9	S _{1%}	S _{1%}	NS
12. Acting independently without regard to self-interest	5.0	4.7	5.2	5.8	S _{1%}	S _{1%}	NS
13. Communicating effectively	5.2	5.2	5.6	6.0	S _{1%}	S _{1%}	NS
14. Reporting truthfully	5.6	5.4	5.7	6.1	S _{1%}	S _{1%}	NS
15. Providing cost-effective audit investigations	5.1	5.0	5.5	5.6	S _{1%}	S _{1%}	NS
16. Being even-handed with the interests of others	5.4	5.1	5.7	6.0	S _{1%}	S _{1%}	S _{1%}
17. Limiting their own legal responsibility	5.0	5.2	4.7	5.2	NS	NS	NS
18. Providing a useful service to corporate management	5.1	5.4	5.7	5.9	S _{5%}	S _{1%}	NS
19. Providing a useful service to society	4.7	5.1	5.0	5.7	S _{1%}	S _{1%}	NS
20. Providing protection for Kuwait's public funds	4.8	5.0	5.5	5.7	S _{1%}	S _{1%}	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

Further Mann Whitney tests were undertaken to examine the different group perceptions of the success of the Audit Bureau. Audit firms were more critical of the Audit Bureau than were respondents from the Bureau (all activities bar one producing significant differences - at the 1% level - between the two sets of auditors). However, most of these differences were ones of emphasis - with the Bureau's audit staff seeing themselves as highly successful while the external auditors saw them as successful, but less so. User and directors also differed on their respective views of the Audit Bureau - with 9 significant differences (8 at the 5% level) being revealed - with users tending to rate more highly the Bureau's performance.

Table 9.17 - How Successful Are Auditors from the Audit Bureau?

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Diagnosing problems	4.4	5.0	5.9	4.5	S _{1%}	S _{5%}	S _{1%}
2. Prescribing remedies to problems	4.0	4.4	5.6	4.3	S _{1%}	NS	S _{1%}
3. Acquiring information	4.7	5.2	5.9	5.3	S _{1%}	NS	S _{1%}
4. Coping with risk and uncertainty	3.7	4.3	5.6	4.2	S _{1%}	NS	S _{1%}
5. Predicting the future	3.6	4.2	5.3	3.7	S _{1%}	NS	S _{1%}
6. Detecting errors and irregularities	4.6	5.3	5.8	4.7	S _{1%}	S _{5%}	S _{1%}
7. Preventing errors and irregularities	3.9	4.2	5.6	4.5	S _{1%}	NS	S _{1%}
8. Complying with professional rules	4.7	5.2	6.3	5.4	S _{1%}	NS	S _{1%}
9. Enforcing legal requirements	5.1	5.4	6.4	5.6	S _{1%}	NS	S _{1%}
10. Forming correct judgements	4.3	5.0	6.1	4.8	S _{1%}	S _{5%}	S _{1%}
11. Acting independently without regard to self interest	4.8	5.1	6.4	5.3	S _{1%}	NS	S _{1%}
12. Communicating effectively	4.7	5.1	6.1	4.7	S _{1%}	NS	S _{1%}
13. Reporting truthfully	4.9	5.4	6.4	5.2	S _{1%}	NS	S _{1%}
14. Providing cost-effective audit investigations	4.3	4.7	6.2	4.3	S _{1%}	NS	S _{1%}
15. Being even-handed with the interests of others	4.6	5.0	6.4	4.9	S _{1%}	NS	S _{1%}
16. Limiting their own organisational responsibility	4.3	4.5	5.6	4.7	S _{1%}	NS	S _{1%}
17. Providing a useful service to corporate management	4.3	4.8	6.1	4.7	S _{1%}	NS	S _{1%}
18. Providing a useful service to society	4.7	5.2	6.4	5.0	S _{1%}	NS	S _{1%}
19. Providing protection for Kuwait's public funds	4.9	5.1	6.5	5.0	S _{1%}	NS	S _{1%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

Overall, financial directors, users of financial statements and respondents from audit firms all thought that the audit firms are generally more successful than the Audit Bureau. Interestingly, directors and users all rated the Bureau as more successful than audit firms in providing protection for Kuwait's public funds. Moreover, users seemed happier than directors with the performance of audit firms on several issues, including detecting and preventing errors/irregularities, providing a useful service to corporate management and providing a useful service to society. As with respondents from the audit firms, the Bureau's auditors rated their performance higher than that of audit firms. However, the Bureau's respondents gave higher ratings to the audit firms than respondents from the firms gave to the Audit Bureau. For instance, while 83% and 71% of auditors from the Bureau saw audit firms as being successful in detecting fraud

and preventing fraud, only 53% and 58% of external auditors perceived the Bureau's auditors as successful in such activities.

9.3.8 The Role of External Auditors at the KIO

The questionnaire asked respondents whether KIO was audited by an external auditor before the collapse of its Spanish investments (see Table 9.18). The aim of this question was to help explain the lack of debate about the role of auditors in the aftermath of the KIO scandal. If people did not know that KIO was externally audited, then it might explain the lack of debate or criticism of the role of auditing and audit firms. The findings lend some support to such a perspective in that 60% of respondents did not know that KIO was externally audited. Users were the group which contained the largest number of respondents (66%) who did not know that KIO was externally audited. This was significantly higher than the percentage of respondents from audit firms (53%) who believed that KIO was not externally audited.

Table 9.18 – KIO was Externally Audited

	Directors	Users	Audit Bureau	Audit Firms	Total
Yes	43%	35%	46%	47%	40%
No	57%	66%	54%	53%	60%

Given that KIO does not publish any financial information nor an audit report on its operations, propositions about the degree of information that should be made public by KIO were explored in the questionnaire (see Table 9.19). A basic majority of directors and users (58% and 54% respectively) wanted KIO to publish both the auditor's report and summarised financial statements, while an additional 21% of directors and 19% of users wanted KIO to publish full audited financial statements. The majority of respondents from audit firms also supported greater publication by KIO, with 27% favouring the publication of full audited financial statements and an additional 48% wanting publication of the auditor's report and summarised financial statements. The group which, surprisingly, took a different view was the Audit Bureau respondents. 37% did not want KIO to publish any financial information, while a further 26% had no opinion on the issue – leaving just 11% in favour of full audited financial

statements being published. Given that the official role of the Audit Bureau is to aid parliament in enhancing transparency and promoting accountability, one could have expected the Bureau's respondents to have been more supportive of moves designed to enhance transparency and give more information to the Kuwaiti public.

Table 9.19 – Level of Information to be Published

	Directors	Users	Audit Bureau	Audit Firms	Total
1. KIO should publish full audited financial statements	21%	19%	11%	27%	21%
2. KIO should publish the auditor's report and summarised financial statements	58%	54%	26%	48%	52%
3. KIO should not publish any financial information	10%	13%	37%	9%	13%
4. I have no opinion on this issue	11%	14%	26%	16%	14%

As discussed earlier (see Chapter 8), there has been no public explanation about the objectives of KIO's external audit. Accordingly, the questionnaire sought to explore perceptions of a list of possible objectives of the external audits of KIO (see Table 9.20).

Table 9.20 – Objectives of KIO's External Audit

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Detect all significant fraud	5.9	6.1	5.3	4.9	S _{1%}	S _{1%}	NS
2. Detect any major breaches of legislation governing KIO's operations	6.5	6.6	5.8	6.2	NS	NS	S _{5%}
3. Report to the appropriate regulatory authorities on significant malpractice	6.2	6.6	5.9	6.2	S _{5%}	NS	S _{5%}
4. Assist in preparing financial statements	5.0	5.7	5.1	5.2	NS	NS	NS
5. Evaluate management performance	5.1	5.7	5.4	4.9	S _{5%}	S _{5%}	NS
6. Attest that KIO's financial statements comply with Generally Accepted Accounting Principles (GAAP)	6.5	6.7	6.0	6.8	S _{1%}	NS	S _{5%}
7. Assist in minimising KIO's tax obligations around the world	5.1	5.7	5.3	4.7	NS	S _{5%}	NS
8. To ensure that public funds managed by KIO are adequately protected	6.4	6.4	5.6	6.1	NS	NS	S _{5%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

While the analysis revealed four significant across-group differences (2 at the 1% level and 2 at the 5% level of statistical significance), it is apparent that these differences were very much ones of emphasis. Clear majorities in all four groups

saw the external audit of KIO having all the objectives listed in Table 9.20). The support for each objective ranged from 65% to 96% for directors, 76% to 96% for users, 69% to 88% for the Audit Bureau and 57% to 98% for respondents from audit firms. The least number of respondents agreeing with an objective was in the case of respondents from audit firms, where 57% thought that the KIO external audit should detect all significant fraud. Interestingly, this compared favourably with the views that such respondents had of the external company audit, with only 37% of them seeing this as a company audit objective (see Question 1, Table 9.10). Audit firms, though were not alone in such rankings, as both greater percentages of directors and users saw the external audit of KIO as having a responsibility to detect all significant fraud compared to their views with respect to the limited company external audit. The only exception was the Audit Bureau respondents, where 81% of respondents attributed such an objective to the limited company external audit, compared to 69% for the external audit of KIO.

9.3.9 The KIO Scandal

The questionnaire included eleven statements about differing aspects of the KIO scandal and respondents were asked to indicate the extent of their agreement with them (see Table 9.21). On many of these issues, respondents seemed to have similar views – for instance largely believing that: KIO's auditors should be legally liable if their work was deemed to be substandard; people responsible for the collapse of GT's were not held adequately accountable; international audit firms have the capacity to understand fully the type of complex investments and transactions undertaken by KIO; and that having power and good connections make it easier to get away with corporate fraud. Only three statements generated significant across-group differences (2 at the 1% level and 1 at the 5% level of statistical significance). There was disagreement as to whether the secrecy at KIO prevented auditors from detecting and reporting breaches in laws and regulations. Respondents from audit firms were more certain than the other three groups that traditions of secrecy had not hindered the auditor's work in these regards. For instance, 57% of auditors felt that secrecy traditions had not prevented auditors

from detecting breaches in the law, while 55% of users felt that they had. Likewise, 75% of auditors felt that secrecy traditions had not prevented auditors from reporting breaches in the law, while 50% of respondents from the Audit Bureau felt that they had. Respondents from audit firms were also the least supportive of the claim that scandals on the scale of GT/KIO are unlikely to happen again. 50% of them supported such a statement, compared to 55% of directors, 62% of respondents from the Audit Bureau and 77% of users.

Table 9.21 – General Issues about the KIO Scandal

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. In the “GT” affair, auditors generally placed too much reliance on the assurances of corporate management	5.0	5.1	4.9	4.0	NS	NS	NS
2. Auditors should be legally liable for the collapse of KIO’s investments in “GT” if their work was substandard	5.8	5.6	5.8	5.7	NS	NS	NS
3. People responsible for the collapse of KIO’s investments have not yet been held adequately to account	6.0	6.4	6.4	6.3	NS	NS	NS
4. People responsible for the collapse of KIO’s investments will never be held accountable.	4.0	4.5	4.2	3.2	NS	S _{5%}	NS
5. Traditions of secrecy at KIO prevented auditors from detecting breaches in corporate law	4.2	4.8	4.2	3.1	S _{5%}	S _{1%}	NS
6. Traditions of secrecy at KIO prevented auditors from reporting discovered breaches in corporate law to the appropriate authorities	3.4	4.3	4.3	2.3	S _{1%}	S _{1%}	NS
7. International audit firms generally have the capacity to understand fully the type of complex investments and transactions undertaken by KIO	6.2	5.9	5.6	5.8	NS	NS	NS
8. The Audit Bureau generally has the capacity to understand fully the type of complex investments and transactions undertaken by KIO	3.8	4.5	4.2	4.6	NS	S _{5%}	NS
9. KIO’s Spanish investment problems are an isolated incident, not reflective of the general way in which Kuwaiti institutions manage their investment portfolios	5.1	4.7	5.4	4.6	NS	NS	NS
10. In Kuwait, power and good connections make it easy to get away with corporate fraud.	5.3	5.8	5.3	5.0	NS	S _{5%}	NS
11. Scandals on the scale of “GT” and “Kuwait Oil Tankers Company” are likely to re-occur in Kuwait in the future	4.6	5.5	5.2	4.7	S _{1%}	S _{1%}	S _{1%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

Viewed in the broader context of the KIO scandal, the responses to several of the statements included in this section of the questionnaire are worthy of more reflection. Large number of participants from the four groups did not believe that people responsible for the collapse of KIO's investments had been made accountable for their actions. The majority of respondents, excluding those from the audit firms, seemed also to agree that the people responsible for the collapse of KIO's investments would never be held accountable. This sceptical attitude towards seeing justice served might be explained by the large agreement among the four groups that in Kuwait power and good connections, which was indeed evident in KIO, might make it easier to get away with fraud. However, a big majority in each of the four groups agreed that auditors should be legally liable for the collapse of KIO's if their work was deemed to be substandard. Ironically, the work of Coopers & Lybrand, the auditor of GT, was deemed to be substandard and the firm was duly fined by the Spanish regulator. However, the Kuwaiti authorities does not seem to agree with the views of respondents - as it has not pursued Coopers & Lybrand in any shape or form.

The findings in this section also tend to support the notion that, despite the shortcomings of international audit firms involved in the KIO case, the four groups of respondents still have a high regard for these firms. While at least half of the respondents from each group accepts that scandals on the scale of KIO (and the Kuwait Oil Tankers Company) are likely to re-occur in Kuwait, they still strongly believe that international audit firms are capable of understanding the type of complex investments encountered in the KIO case. A larger number of directors (88%) and users (90%) rated the audit firms higher than the audit firms (77%) rated themselves in having the capacity to understand complex investments. Further, all four groups (including the Audit Bureau) were far more confident that audit firms had the capacity to understand complex investments in comparison to their perceptions of the Audit Bureau (e.g. 90% of users felt audit firms had such a capacity, while only 55% had such a belief in the Audit Bureau – the comparative figures for directors were 88% and 36%, while for the Audit Bureau, 79% of its respondents agreed that the audit firms had such a capacity,

while just 47% had such a belief in the Audit Bureau). This strong faith in the international firms seems rather unfounded when one looks at the role played by auditors in the KIO case, their levels of understanding of the Spanish investment process and the critical findings of ICAC, the Spanish audit regulatory body.

9.3.10 Blame for the Collapse of GT and Causes of Financial Scandals in Kuwait

Respondents were asked in the questionnaire to attach (to a list of eight parties) a degree of blame for the collapse of GT (on a scale of 1 equalling no blame, 4 equalling some blame and 7 representing total blame). The four groups virtually blamed everybody for the collapse of GT, with managers at GT, KIO and KIA being assigned the highest degree of blame and the Spanish government seen as the least to blame. The responses only produced one significant difference across the four groups – relating to the degree of blame attached to the Audit Bureau. While clear majorities of directors, users and respondents from audit firms placed a significant degree of blame on the Audit Bureau, 58% of respondents from the Audit Bureau attached little blame to the Bureau (see Table 9.22).

Table 9.22 – Blame for the Collapse of Grupo Torras

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. KIO’s External Auditors	5.6	5.7	6.1	5.2	NS	NS	NS
2. GT’s External Auditors	5.7	5.8	6.6	5.5	NS	NS	NS
3. Audit Bureau	5.2	5.5	3.3	5.0	S _{1%}	NS	S _{1%}
4. Managers at Kuwait Investment Office	6.5	6.7	6.5	6.4	NS	NS	NS
5. Managers at Grupo Torras	6.6	6.7	6.6	6.6	NS	NS	NS
6. Managers at Kuwait Investment Authority	6.0	6.2	6.0	6.0	NS	NS	NS
7. The Spanish government	4.1	4.3	5.1	4.0	NS	NS	NS
8 The Kuwaiti government	5.7	5.7	5.8	5.2	NS	NS	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

It is worth noting that all the groups blamed the Kuwaiti government more than they blamed the Spanish government. The degree of blame attached to auditors fell somewhere between the blame attached to management and to the Spanish government – in some cases being quite similar to the blame attached to the

Kuwaiti government. Representatives from audit firms, not that surprisingly, were the group of respondents who placed the least blame on the external auditors of KIO and GT, while respondents from the Audit Bureau placed the highest degree of blame on such auditors. It would be unwise to make too much of such distinctions, as basically the respondents were not that discriminating in their views – everyone, as noted above, was seen to be to blame. However, it does serve as another reminder of the ability of the large multinational firms to manage to avoid serious reputational damage in notorious corporate scandals. While they were attributed some considerable blame, this (as the previous section has shown) was not damaging significantly the degree of confidence that people had in the effectiveness of their working methods.

The questionnaire also sought respondents' views on the possible causes of the various financial scandals to have occurred in Kuwait since 1991 (see Table 9.23). The four groups of respondents generally agreed that the proposed causes could all have been responsible for the financial scandals. The four groups seemed to rate the absence of adequate accountability as the most important cause, with poor management as the second most important cause. There was only one significant across group difference (at the 1% level). Audit firms were significantly less in agreement with the claim that the absence of the parliament between 1986 and 1992 was an important factor (just 54% agreed compared to 61% of financial directors, 78% of users and 80% of the Bureau auditors). The perception of each group that sub-standard external audits were a major cause of the financial scandals looks rather strange given the groups' apparent satisfaction with auditing and auditors in the first part of the questionnaire. It might suggest that the groups feel that the sub-standard audits in these scandals were isolated incidents which do not represent the overall quality and status of auditing.

Table 9.23 – Causes of Financial Scandals in Kuwait

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Excessive secrecy in Kuwait's government institutions	5.4	5.2	5.6	4.5	NS	S _{5%}	NS
2. Absence of adequate accountability	6.3	6.5	6.3	6.1	NS	NS	NS
3. Absence of the Kuwait National Assembly (1986-1992)	4.9	5.8	6.2	4.6	S _{1%}	S _{1%}	S _{1%}
4. Poor management	5.9	6.2	6.2	5.7	NS	S _{5%}	NS
5. Failure to maintain adequate accounting records	4.5	5.1	5.5	4.7	NS	NS	S _{5%}
6. Sub-standard external audits	5.5	5.4	5.7	5.1	NS	NS	NS
7. Failure to enforce existing Kuwaiti corporate laws and regulations	5.3	5.6	5.6	5.3	NS	NS	NS

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

9.3.11 The Future of Corporate Governance in Kuwait

The last part of the questionnaire focused on improving the future of corporate governance in Kuwait. It consisted of ten proposals to change long-standing practices, traditions or regulations in the current corporate environment in Kuwait and respondents were asked to indicate their agreement with the various proposals. The analysis of this section revealed significant across group differences on 8 (6 at the 1% level and 2 at the 5% level of statistical significance) out of the 10 proposals (see Table 9.24). However, only one proposal showed a clear difference in overall opinions rather than differences in emphasis. This related to the proposal that the Audit Bureau should be responsible for appointing and setting the fees of external auditors in government owned organisation and companies, where 54% of respondents from audit firms disagreed, compared with 61% of financial directors, 70% of users and 84% of the Bureau's auditors agreeing with the proposal. This endorsement by three of the groups of respondents for an expansion in the Bureau's role is backed up by majority support from all four groups for the Bureau to play a greater role in evaluating the efficiency of corporate management (supported by 79% of directors, 88% of users, 98% of respondents from the Audit Bureau and 66% of respondents from audit firms). The responses to this part of the questionnaire showed a strong support for more audit services and for more extensive audits. All four groups generally were against the proposal to abolish the requirement for

two independent auditors to audit shareholding companies. They also quite strongly agreed that such a requirement should be extended to government owned organisations and corporations not listed on the stock exchange (such as KIO, KIA, KPC). The four groups all supported the proposal that Audit Bureau reports on government owned organisations/corporations should be publicly available. They also strongly opposed the proposal for abolishing the statutory requirement for external audits and the proposal to abolish the Bureau's audit of shareholding companies.

Table 9.24 – Future of Corporate Governance in Kuwait

	Dir	User	AB	AF	KW	KW w/out AB	KW w/out AF
1. Legally require that external audits of companies and organisations with a capital above KD 5 million are audited by internationally affiliated audit firms	5.9	5.6	4.3	5.6	S _{1%}	NS	S _{1%}
2. Increase audit fees to enable more extensive audits to be performed	5.1	5.0	4.4	6.0	S _{1%}	S _{1%}	NS
3. Change the law to allow companies listed on the stock exchange to be audited by just one Audit firm	3.6	3.0	3.6	3.4	NS	NS	NS
4. Require that government owned corporations and organisations not listed on the stock market (such as Kuwait Petroleum Corporation (KPC) KIO, and KIA,) are audited by two different external audit firms	5.9	6.0	4.8	5.1	S _{1%}	S _{5%}	S _{1%}
5. Place directors of Kuwaiti corporations on performance-related contracts	6.2	6.3	6.1	5.7	S _{5%}	S _{5%}	NS
6. Allow the Audit Bureau a greater role in evaluating the efficiency of corporate management	5.8	6.1	6.7	5.2	S _{1%}	S _{1%}	S _{1%}
7. Allow the Audit Bureau a greater role in appointing audit firms and setting their fees for work on government owned companies and organisations	5.0	5.2	6.0	3.3	S _{1%}	S _{1%}	S _{5%}
8. Require that all stockholding companies, listed on the Kuwaiti stock exchange (and in which the government hold 50% or more of the equity capital) are exempted from any Audit Bureau attestation	2.5	2.6	1.7	3.3	S _{1%}	NS	S _{1%}
9. External audit is abolished as a mandatory legal requirement for Kuwaiti companies	1.7	1.9	1.8	1.7	NS	NS	NS
10. Require that all reports prepared by the Audit Bureau on government owned organisations and corporations are publicly available	5.8	5.8	4.7	5.2	S _{5%}	NS	S _{5%}

NS = Not Significant, S_{1%} = Significant at 1%, S_{5%} = Significant at 5%

Table 9.24 also shows that all four groups were in favour of paying higher fees to enable more extensive audits to be performed and they also support the proposal that all companies with capital above KD 5m should be audited by internationally affiliated audit firms. This again shows a strong belief in the role of international audit firms even though the KIO case has highlighted the limitations of these firms to function properly in complex and deceptive environments.

9.4 Key themes

The final part of this chapter combines findings from different parts of the questionnaire survey in order to highlight several key themes emerging from the responses received. Such themes will help to draw out more clearly some of the policy implications of the thesis.

9.4.1 Strong Belief in Auditing and the Need for More Audits by International Audit Firms

The analysis has shown that people in Kuwait believe that auditing has improved since the collapse of the Al-Manakh stock market in 1982, a time when auditing work was criticised and blamed for aiding the crises. People also seemed to be satisfied with the current level of services provided by auditors in Kuwait. This can be seen in their disagreement with the statements that: “too much is expected of auditors”; “the audit is of little benefit to a company”; “auditors do not understand the problems of business”; and that “auditing be abolished as a mandatory legal requirement in Kuwait”. Directors and users in Kuwait even appeared more relaxed than audit firms about certain reductions in audit regulation in Kuwait. This was evident in the smaller percentages of directors and users (in comparison to the percentage of respondents from audit firms) who were against audit firms owning shares in their audit clients and acting primarily to make profit.

Analysis of the questionnaire results has revealed that respondents wanted more extensive audits and were supportive of extending the statutory requirement for

two auditors to attest the financial statements of listed companies in Kuwait – so that it covered other organisations that are not listed in the stock market (e.g. KIO, KIA, KPC) (see Question 4 in Table 9.24). The respondents also wanted to keep the current arrangement where listed stockholding companies, in which the government hold 50% or more of the equity capital, are audited by the Audit Bureau and also by two external auditors (Question 8 in Table 9.24).

The respondents were clearly supportive of local audit firms being associated with the Big Six international audit firms - 79% of financial directors, 82% of users, 69% of the Bureau's auditors and 71% of audit firms supporting such an association (see Table 9.15). This support was compatible with the general acceptance that statute should require that companies with a capital of KD5m are audited by internationally affiliated audit firms. This is not surprising given the more positive image associated with audit firms (in comparison with the groups' ratings of the performance of the Audit Bureau – see Tables 9.16 and 9.17) and the fact that 88% of financial directors, 90% of users, 79% of the Bureau's auditors and 77% of respondents from audit firms feel that international audit firms have the capacity to understand fully the type of complex investments and transactions undertaken by KIO (Question 7 in Table 9.21). In contrast, the four groups, including the Bureau's auditors, saw the Audit Bureau as much less capable of understanding complex investments and transactions such as those undertaken by KIO (Question 8 in Table 9.21). However, these beliefs are rather contradicted by the degree of blame that all four groups place on auditors of both GT and KIO for the collapse of GT (Questions 1 & 2 in Table 9.22) – a finding which provides a very useful practical illustration of the international accounting firms' relative immunity to corporate scandals and any ensuing audit failure.

9.4.2 Auditors to Provide More Services

Although, the survey shows that people in Kuwait were satisfied with the level of services provided by the auditors, it also shows that people wanted auditors to provide more services. The type of services fell into two categories – namely, those that the international audit firms have traditionally declined to accept as a

part of their duty as external limited company audit and those that they strongly support providing to their corporate audit clients.

The first category of services includes fraud detection, reporting on internal control, evaluating and reporting to shareholders on management efficiency. The findings of the survey were similar to some previous audit expectation gap surveys in revealing the apparent sensitivity of obligations of auditors regarding fraud detection (auditors declining such responsibility but accepting a duty to ensure that the financial statements are free from significant deliberate distortions). However, audit firms were seen by 70% of financial directors, 83% of users and 84% of the Bureau's auditors as providing significant protection against fraud. Interestingly, only 55% of audit firms agreed with such a statement (Question 8 in Table 9.9), although all four groups tended to agree that audit firms are successful in detecting errors and irregularities (Question 7 in Table 9.16) and, to a lesser degree, successful in preventing errors and irregularities (Question 8 in Table 9.16). Directors, users of financial statements and external auditors rated the Audit Bureau as less successful than audit firms in both detecting and preventing errors and irregularities (Question 6 & 7 in Table 9.17).

These findings raise two interesting points. The first is that while external auditors deny responsibility for detecting fraud they are claiming to be successful in detecting fraud (a claim supported by the other groups). In contrast, while the Bureau's auditors agreed that they have responsibility to detect fraud (Question 1 in Table 9.11), the other three groups saw the Bureau's auditors as less successful than audit firms in detecting and preventing fraud (Question 7 in Table 9.17). The second point, is that if audit firms are providing significant protection against fraud and are successful in detecting errors and irregularities, then why did they not discover scandals before they happened in cases like those of KIO and Kuwait Oil Tankers Corporation?

International audit firms have often been against having a responsibility to report (publicly) on the effectiveness of internal controls and the efficiency of

management. Auditors in Kuwait, however, did not seem to share this view – with there being mutual agreement among respondents that auditors should identify ways to improve management efficiency (78% of financial directors, 77% of users, 67% of external auditors and 61% of the Bureau auditors supporting such a development – see Question 9 in Table 9.9). The four groups also supported auditors reporting to shareholders on management efficiency and should ensure that a satisfactory system of internal control is being operated.

The second category related to the controversial issue of providing management advisory services to audit clients. There have been frequent claims in the international auditing literature that the provision of such services by auditors to their clients compromises auditor independence and should be outlawed or suspended. However, in this survey all groups were unanimous in their support for auditors to have the right to provide such services to their audit clients (Question A51). Currently, under Kuwaiti regulations, audit firms can not provide management consulting services to their audit clients. One possible reason for the stance taken by survey respondents relates to the general standard of management in Kuwaiti organisations. The Kuwaiti government controls the public sector and most of the private sector, using employment in Kuwait as part of the welfare system to distribute the country's wealth among its citizens. Therefore, there is virtually no relationship between performance and employment in government-owned organisations. In addition, employment policies, especially in Kuwait's prestigious organisations, are based more on relationships and friendships (usually known as *Wasta*) rather than on candidate's qualifications. Consequently, respondents might see a management consulting service from accounting professionals as an aid to poor management teams. This argument is reinforced through the agreement, although audit firms agree to a lesser degree, across the four groups that directors of Kuwaiti corporations should be placed on performance based contracts (over 90% of financial directors, users and respondents from the Audit Bureau agreed with this statement in comparison to 81% of external auditors – Question 5 in Table 9.24). The respondents general support for the Audit Bureau to be allowed a greater role in evaluating the

efficiency of corporate management (Question 6 in Table 9.24) can also be seen as an indication of concern with the standards and standing of management practice in Kuwait.

9.4.3 Auditor Independence in Kuwait

The positive perception of the role of auditors in Kuwait and the support for audit firms to provide management consulting services to their audit clients is undermined or contradicted by the worries expressed over auditor independence. All groups agreed that auditors are usually appointed in Kuwait through friendships and relationships with senior corporate management (76% of respondents from audit firms, 69% of directors, 76% of users and 71% of respondents from the Audit Bureau holding such a view – see question 12 in Table 9.9). This finding is consistent with parliamentary debates in Kuwait and comments by the general secretary of the Kuwaiti Association of Accountants and Auditors. Such appointments could lead to cosy relationships between auditors and their clients, which could impair auditor independence (as is usually claimed in the auditing literature). This argument was effectively supported in the survey as majorities of each respondent group felt that audit firms in Kuwait should not have close personal friendships with their audit clients (Question 11 in Table 9.15). The majority of financial directors and users saw auditors as being too concerned with keeping management happy, although auditors from both sectors were reluctant to implicate auditors in this way - 47% of respondents from external audit firms disagreed with such a claim (while 42% agreed); Audit Bureau respondents were split in their view, with 38% disagreeing with the claim and 38% agreeing (Question 3 in Table 9.9). All four groups also strongly believed that audit firms in Kuwait should not own shares in their audit clients (Question 2 in Table 9.15), although this view was most strongly held by auditors and not users and directors.

The implications of the above views and some of the inconsistencies within them are basically twofold. At one level, it could be argued that people in Kuwait are not as well informed about the threats to independence if auditors are allowed to

provide management advisory services. However, the likelihood of this may not be that high. For instance, the existence of a legal provision preventing such service provision does suggest that the issue has been given some previous consideration at senior policy making levels of government. Alternatively, it may be that people are far more relaxed about notions of auditor independence and do not place so much faith on rules governing the appearance of independence, placing more value on the underlying strength of personal relationships. This, in some ways, is similar to the stance recently advocated by the AICPA in the USA (for a discussion, see Klarskov Jeppesen, 1998), in seeking to reduce the restrictions and prohibitions on audit behaviour – although, such an argument has clearly received some major setbacks following the SEC's recent ruling that PricewaterhouseCoopers had wholeheartedly breached an ethical guideline governing share ownership by auditors. It has to be doubted whether such arguments have penetrated debating circles in Kuwait – meaning that the stances are probably a reflection of Kuwaiti business traditions and/or a certain naivety about the quality and fundamental underpinnings of external audit practice.

9.4.4 The Image of Audit Firms Against that of the Audit Bureau

The questionnaire survey clearly showed that audit firms were more highly rated than the Audit Bureau in Kuwait. Financial directors and users of financial statements perceive audit firms as more successful than the Audit Bureau in the majority of tasks listed in the questionnaire. Even in the cases where the Audit Bureau was rated higher than audit firms, this rating difference was not statistically significant. For instance, 61% of directors and 72% of users (Question 18 in Table 9.17) saw the Audit Bureau as providing useful services to society in comparison to the 57% of directors and 71% of users who saw audit firms providing such a service (Question 19 in Table 9.16). The strong belief in audit firms, especially international ones, can also be seen in the way the four groups saw these firms as having the ability to understand complex investments and transactions like those undertaken by KIO (Question 7 Table 9.21). The Audit Bureau was not seen as equally qualified to understand the complex investments of KIO (Question 8 Table 9.21), even by the Bureau's own auditors

(only 47% of Bureau's respondents felt that their body was able to understand complex transactions undertaken by KIO). This relatively poorer image of the Audit Bureau might be attributed to the fact that most of the shareholding companies and government owned organisations are audited by audit firms associated with the big international firms. These firms appoint auditors from Anglo-American countries and rely on the resources and the expertise of their international counterparts whenever they are needed. In contrast, the Audit Bureau has to rely on Kuwaiti's and Egyptians with probably less experience and training. The low salaries of the Bureau's employees also does not usually attract the promising new graduates to seek employment at the Bureau.

Although audit firms, directors and users perceived the Audit Bureau as inferior to the audit firms, the majority of respondents from the four groups believed that the Audit Bureau should have a larger role than that of audit firms. In all the propositions concerning the role that should be played by auditors from both the Audit Bureau and audit firms, a higher number of participants from the four groups felt that such propositions are the responsibility of the Audit Bureau. Interestingly, at least 90% of the Audit Bureau's auditors agreed that such propositions are among their duty - something which was not evident in the case of the external auditors (see Tables 9.10 and 9.11). Rather the audit firms felt that they did not have a duty for some of the propositions. For instance, only 37% felt that they had a duty to detect all significant fraud and 49% felt they have responsibility to ensure that the company is being run efficiently.

9.4.5 Audit Reporting and the Role of the Auditor at KIO

The fact that KIO does not publish any financial information about its operations might explain why 60% of respondents did not know that KIO was audited externally by KPMG. The secrecy that surrounds KIO and its operations might also explain respondents' lack of awareness of KPMG's role. As consequence this might explain the lack of discussion and blame in Kuwait for auditors in detecting the Grupo Torras scandal.

The questionnaire analysis shows clear support from financial directors, users and external auditors for publication of some financial information about KIO's operations, as 21% of respondents said the KIO should publish full audited financial statements while 52% of respondents wanted KIO to publish the audit report and a summary of the financial statements. On the other hand, the Audit Bureau seems to support KIO's position for not publishing any financial information as 37% of them said KIO should not publish any financial information while 26% said they had no opinion on the issue. The Bureau's position might be explained by their close relationship with the government especially during the period when the parliament was suspended by the government. Another reason might be attributed to the fact that the Bureau does not publish its audit reports of KIO and therefore does not expect the external auditor to publish his report. The Bureau was also less supportive of publishing its audit reports of government owned organisations and corporations - only 56% supporting such publication in comparison with 78% of financial directors, 81% of users and 63% of external auditors.

Respondents across the four groups seemed to agree that the eight objectives given in the questionnaire are the main reasons behind having an external audit of KIO's accounts (see Table 9.20). Some of these objectives, however, were clearly not met in the case of the KIO scandal. The external auditor did not detect significant fraud, did not detect major breaches of legislation governing KIO's operations and did not protect the public funds managed by KIO. As such, it is rather paradoxical that respondents from the four groups, especially from the audit firms, believe that the traditions of secrecy in KIO did not prevent auditors from detecting fraud and reporting it to the appropriate authorities (Questions 5 & 6 in Table 9.21) – particularly when they agreed that KIO should be more open and publish financial information.

9.4.6 Corporate Governance in Kuwait

The majority of respondents across the four groups seem to be sceptical about the issue of accountability in Kuwait. The four groups rated the absence of adequate

accountability (Question 1 in Table 9.23) as the highest factor behind the string of financial scandals that emerged in Kuwait in the post-Gulf war era. They also felt that the people responsible for the collapse of KIO's investments had not been made adequately accountable (Question 3 in Table 9.21). However, they were divided on whether they will ever be held accountable (Question 4 in Table 9.21). This sceptical attitude towards accountability might be explained in the agreement among the four participants that power and good connections (Wasta) in Kuwait make it easier to get away with fraud (Question 10 in Table 9.21). Other reasons might be attributed to the agreement of the majority of respondents across the groups that the absence of the parliament (Question 3 in Table 9.23) and the failure to enforce laws and regulations (Question 7 in Table 9.23) were among the factors responsible for the financial scandals in Kuwait.

The survey also highlighted the importance of the issue of management performance. The respondents seem to agree that poor management was one of the reasons behind the collapse of KIO's investments. They also wanted managers to be placed on performance related contracts, something that is unheard of in Kuwait. Managers in Kuwait in many cases are evaluated and promoted not on performance but on social aspects (such as 'Wasta' factors or, as revealed by Tetreault (1995), a mechanism for getting rid of unproductive employees). An interesting question raised by the KIO case is whether it was an isolated incident or a reflection of how Kuwaiti institutions manage their investment portfolios. 63% of financial directors, 58% of users, 64% of Audit Bureau respondents and 48% of audit firm respondents support the argument that KIO scandal is an isolated case (Question 9 in Table 9.21). However, this is contradicted by their agreement that Kuwait will encounter scandals in the scale of KIO scandal in the future (Question 11 in Table 9.21). Moreover, the groups agreement that power and good connections in Kuwait make it easy to get away with corporate fraud gives strength to the claim that the KIO case is not likely to be a one off (Question 10 in Table 9.21).

The above findings support some of the concerns and debates that usually emerge in the aftermath of revelations of financial scandals or allegations of corruption and mismanagement in Kuwait, such as those echoed in Kuwaiti press coverage:

“...the main reason in all the disasters that have faced our investments abroad are related to the absence of public control (parliament) and accountability...the absence of control and accountability provides the environment for violations and irresponsibility” (Saoud Al-Samakah, Al-Qabas, 14/7/1992).

“What happened to our investments in Spain was no accident, it is part of a continuous serious of mismanagement, malice, concealment of information from the public, absence of accountability, the obstruction of the role of the judiciary” (Ahmed Al-Rubi, Al-Qabas, 15/7/1992).

“The governmental administration works, without relation/relevance to qualification criteria, to kinship and political discrimination in granting positions which worsen performance and increase the internal divisions in society.” (Al-Saadoun, 1993, p.46).

The questionnaire findings make several issues stand out - namely the role of management, accountability and social norms in Kuwait, which all have implications for auditing in Kuwait. Poor management might lead to several problems such as inability to install proper control mechanisms to combat fraud, inability to compete in the market, leading to losses which might lead to an indulgence in creative accounting schemes. Such factors can place pressure on the audit function and reduce its effectiveness. The social constraints in Kuwait (such as the role of ‘Wasta’) and its influence on the accountability process might have also some influence on auditing. For instance, the difficulty in holding members of the élite accountable for their mismanagement of corporations or their blocking of access to information might undermine the work of auditors. The respondents expressed concerns about these difficulties are inconsistent with their apparent general satisfaction with the audit function in Kuwait. However, this very much reflects the tendency in Kuwait for public discussions in the aftermath of scandals to focus on the failings of Kuwaiti society and employment practices without linking them to existing accountability mechanisms such as the auditing function – and what auditing achieved or did not achieve.

9.4.7 Regulation of the Audit Profession

Proposals for self-regulation of the accounting position in Kuwait do not seem to have a strong support other than from audit firm respondents (Question 5 in Table 9.15). In contrast, there was large support for an independent body appointing audit clients and setting fees for audit work (Question 7 in Table 9.15). Surprisingly, at least 64% of auditors supported this idea (although they clearly did not want such task being delegated to the Audit Bureau - as evidenced from their response to the proposal that the Bureau would have a greater role in appointing and setting their fees for auditing government owned companies and organisations, see Question 7 Table 9.). The audit firms refusal to accept such a role by the Bureau is clearly likely to be related to the way they perceived the Bureau as less successful than themselves at various auditing activities. The findings also show the willingness of the audit firms and the other groups (with at least 78% agreeing) to have the audit methods of audit firms checked by a professional standards body. This task might be performed by the PTCSAR, as it the only committee responsible for dealing with accounting standards in Kuwait. Alternatively, another body or committee could be established to set acceptable auditing standards and supervise the firms' audit methods.

9.4.8 The Perception of Big Six Audit Firms Against Other Firms

The survey has shown that audit firms in Kuwait are willing to accept some tasks as a part of their responsibility (e.g. reporting to shareholders on management efficiency, ensuring that a satisfactory system of internal control is being operated) – tasks that the profession in Anglo-American countries and other parts of the world has been rather reluctant to accept. This different stance of audit firms in Kuwait might suggest that the Big Six in Kuwait have less of an influence on the profession in Kuwait. Accordingly, the views of respondents from the Big Six audit firms were examined against those of non-Big Six audit firms using a Mann Whitney test. The results of this test did not show any difference in opinion between auditors from Big Six and non-Big Six on the vast majority of questions. Even with questions where the test showed a difference at the 5% level these were generally not indicative of a difference of opinion but

rather one of emphasis. For example, 78% of the Big Six auditors agreed that they should have a responsibility to ensure a satisfactory system of internal control is being operated, compared to 92% of non-Big Six auditors. The few clear issues where the two types of firm seem to have a difference of opinion are related to the issue of fraud and error detection. Only 37% of Big Six auditors see audits as providing significant protection against fraud in comparison to 70% of non-Big Six auditors. Similarly, only 39% of Big Six auditors saw themselves as successful in preventing errors and irregularities in comparison to 85% of non-Big Six auditors. The Big Six audit firms also largely (70%) disagreed that they have a duty to detect all significant fraud, while the non-Big Six auditors were divided with 46% disagreeing and 44% agreeing. On the other hand, at least both types of audit firms (76% of the Big Six and 90% of the non-Big Six firms) agreed that they have responsibility to ensure that the financial statements did not contain significant deliberate distortions – highlighting the sensitivity of the ‘fraud’ issue to both types of audit firm. Differences in opinion were also evident in relation to the auditor’s responsibility to ensure that the audited company is being run efficiently (55% of Big Six firms disagree, while 66% of non-Big Six agree) and that its accounts give a reliable indication of its market value (55% of Big Six firms disagree, while 71% of non-Big Six agree).

It is important, however, to remember that the above are exceptions and that, overall, these findings suggest that the responses of auditors from both Big Six and non-Big Six firms do not seem to be influenced by the ‘international’ arguments of the Big Six firms – adding weight to arguments increasingly being advanced that the Big Six firms are not as similar as their global marketing campaigns suggest.

9.5 Conclusion

The survey has shown a very limited audit expectations gap in Kuwait – despite the clear question marks that have been placed over the audit function in the KIO/GT scandal. Many of the statistical differences shown in the Kruskal Wallis

test related to differences in emphasis rather than to differences in opinion. It is clear from the findings of this study that, as with previous audit expectation gap studies, some sort of gap is inevitable given the fact auditors or accountants will usually rate themselves higher than how other people rate them. Generally, the study has shown people to be satisfied with auditing and auditors in Kuwait. The results also contrast with claims that users do not have reasonable expectations of auditors. Additionally, not only were people satisfied with the work of auditors but they also wanted more auditing (e.g. extending the 'two auditors' requirement to government owned corporations and organisations) with preference for such auditing to be performed by audit firms affiliated to international audit firms.

The respondents want audit firms to provide more services to their clients. These services fall into two categories - those that audit firms usually are reluctant to provide or to consider as part of their duty and those that the profession usually has lobbied to provide. In the first category, the respondents from audit firms tended not to accept that the detection of significant fraud was a part of their duty. Interestingly, audit firms in Kuwait seem to accept service obligations that the profession in Anglo-American contexts has fought against (e.g., reporting on internal control and management efficiency). The second category of services involves providing management advisory services to audit clients, something that audit firms are not legally able to provide to their clients currently in Kuwait. A clear majority of respondents from each group supported the removal of such a legal restriction, suggesting their desire to have auditors provide such services to their audit clients.

The survey shows that despite the apparent satisfaction of respondents with auditing in Kuwait, there seems to be a cause for concern over auditor independence, with a large number of respondents from each group (including audit firms) agreeing that friendship and relationship with senior corporate management ('Wasta') usually govern the appointment of auditors. Despite, this the majority of respondents preferred auditors not to have a close relationship with their audit clients. The survey also showed audit firms, directors and users of financial statements perceiving audit firms to be more successful and more

technically competent than the Audit Bureau. The Audit Bureau respondents also rated the audit firms higher than the audit firms' respondents rated the Audit Bureau. Despite the Audit Bureau having a less glamorous image than that of the audit firms, the four groups felt that it has a larger responsibility than that of the audit firms (especially in controversial issues such as fraud detection and whether the company is being run efficiently).

The questionnaire findings show a considerable number of respondents were not aware that KIO has an external auditor. However a large number of respondents, except those at the Bureau, wanted KIO/KIA to publish at least summary of the financial results and the audit report. The findings also showed people in Kuwait are concerned with issues related to corporate governance, especially a lack of corporate accountability and the quality of management performance.

Self-regulation of the profession was only supported by the audit firms, with the other groups either divided on this issue or against such a form of regulation. A larger degree of support from the four groups was given to auditors being appointed and having their fees set independently (although audit firms did not want the Audit Bureau to perform such a function). The chapter also examined the respective responses of Big Six and non-Big Six audit firms, which showed few major differences of opinion.

Overall, the survey results provide clear evidence of the ability of the multinational audit firms to preserve their reputational standing in the aftermath of major corporate collapses. However, they also question the claimed inevitability of an audit expectations gap and show that perceptions of auditing in Kuwait have some quite distinctive qualities – with auditors much more willing to accept certain functions than their counterparts working in Anglo-American contexts.

Chapter 10

The Conclusion

10.1 Introduction

The collapse of GT raises doubts about what auditing can achieve in practice. In Kuwait, international audit firms from both the UK and Spain did not play a major role, if any, in the detection of fraud and illegal acts and struggled to provide a true and fair view of GT's operations. The same conclusion can be extended to Spain where most of GT's operations took place. Two of the international audit firms based in Spain (C&L and PW) were fined for audit work relating to the GT group, while other firms have exhibited some unusual practices – including KPMG's ex-post alteration to its opinion on a preceding year's set of financial statements. Despite the shortcomings of these audit firms and their practices, there seems to be a belief in Kuwait that more auditing is better or is going to resolve any shortcomings of audit. This feeling is strongly communicated in the questionnaire where people support the appointment of two auditors for stock holding companies and would willingly pay more for auditors to provide a better service.

This chapter is divided into four sections. The first section starts by highlighting the response of people and the profession, in particular, to the KIO scandal in both Kuwait and Spain. It also examines the general finding from the questionnaire survey on the audit expectations gap in Kuwait. The second section highlights the main issues of relevance to the practice of auditing beyond Kuwait and the KIO case. The third part mainly contemplates the future of auditing and corporate governance in Kuwait, while the final section addresses the research implications of the study.

10.2 The Fallout from the Scandal on Auditing and Auditors in Spain and Kuwait

Although, auditing in Kuwait does not seem to be enjoying the same popularity experienced in Anglo-American countries, it has also not experienced the same criticism that surrounds auditing in other parts of the world. This might be attributed to the corporate and business structures in Kuwait. The Kuwaiti

government used to control many of the shareholding companies, enabling it to appoint government representatives to the boards of these companies. The Audit Bureau has also been required to audit corporations where the government holdings exceeded 50% of ownership. It seems that the involvement of the government and the Audit Bureau led to traditionally less reliance on the external auditor and less blame being attached to such a function in times of crisis. Another important factor is related to the fact that the Kuwaiti government usually supports shareholding companies and other government owned organisations. Therefore, it is very rare to see these companies collapse regardless of the financial difficulty they face. Kuwait has experienced very few major corporate collapses that have significantly affected shareholders or have cost a large number of jobs. Accordingly, people did not pay much attention to auditing given that they felt safe that no matter what happens to a corporation, the government will intervene and save it from collapse. This government involvement and its effect on the status of auditing function bears some similarity to the situation in countries like Japan and Poland. For example, Gottlieb (1999) claimed that there was no concern in Poland, before it transformed into a free market economy, about loss making companies going bankrupt because the government would provide funds in times of crisis. On the other hand, auditing in Spain started to receive more attention in the aftermath of Spain joining the EEC in 1986. Different laws were introduced to bring the Spanish regulations in line with those of the EEC. Most importantly the laws increased the number of companies that were required to have statutory audits. There was high hope and belief that auditing would enhance transparency and accountability in Spain. There was not much evidence of an audit expectation gap and concern about the practical possibilities of the auditing function.

Both Kuwait and Spain witnessed a string of financial scandals and collapses in the early 1990s. The emergence of such scandals in Anglo-American countries has historically seen criticism and doubts being directed at the audit function and the role of auditors, with perennial talk of an audit expectations gap. The collapse of KIO's investments in Spain provided a useful opportunity to examine what

kind of response would be directed at auditors in the non-Anglo-American environments of Kuwait and Spain. In Kuwait, auditing traditionally had not generated much interest and concern, while in Spain auditing was something new and relatively exciting. Spain's response was examined solely in a case study while the response of Kuwait was examined both through a case study and a questionnaire survey on auditing expectations.

The response in Spain to the string of scandals that emerged in the early 1990s was one of outcry, with blame primarily attached to corporate management – although several of the scandals had clear political dimensions. The role of auditors and that of the auditing function initially received less attention and criticism. Very few studies have examined the role of auditors in these collapses (for an exception, see García Benau *et al*, 1999). The work of auditors in such collapses, however, came to receive considerable attention from ICAC, the Spanish regulator, who fined several Big Six audit firms. The profession did not feel happy about ICAC's actions and launched attacks on it and campaigned for professional self-regulation. The change of government in 1996 saw the profession's desire for self-regulation come closer to reality but the rivalry between the three Spanish bodies helped to prevent it from happening. However, the new government did ban ICAC from publishing the results of investigation before any judgements had completed the full appeals process. The profession also launched a campaign to limit auditor's liability, even though to date, no courts have found in favour of third parties in any actions against auditors. The Spanish profession also attributed criticism of the role of auditors to the audit expectations gap rather than to their performance. The case showed that the scandals in Spain did not lead to huge debates about auditing and a string of legal cases against auditors, as is usually the case in Anglo-American countries – the most visible response was disciplinary activity of ICAC. The profession's response, nevertheless, seemed to take on a number of the characteristics of their counterparts in the UK and the USA, being primarily concerned with the pursuit of self-interest rather than the protection of the public interest.

The collapse of KIO's investments caused a lot controversy in Kuwait. The debates and press coverage focused mainly on issues such as mismanagement, lack of accountability and secrecy. Very limited attention, however, has been given to the role of auditors either in the KIO case or in other scandals such as that of KOTC. The results of the questionnaire survey tend to support such a pattern of behaviour, with respondents generally being content with the quality of auditing and the role of auditors. The survey in Kuwait represented one of the few studies that have examined the issue of the audit expectations gap in a developing country and a non-Anglo-American context. The general conclusions from the survey is that a limited expectations gap is evident in Kuwait in relation to both audit firms and the Audit Bureau. However, generally this limited gap seems to result from differences in emphasis rather than from basic differences of opinion – and with the absolute ratings of auditors being generally positive. The four groups in Kuwait believed that auditing has improved since the Manakh Crises in 1982, when the unofficial stock market collapsed. They also seemed to be generally satisfied with the level of services provided by audit firms in Kuwait. In some cases even users and directors seemed more relaxed than auditors in Kuwait about issues that might be in the profession's self interest rather than the public's interest. The responses also endorsed the recent changes in Kuwaiti law requiring two audit firms to audit companies listed on the stock market. Survey respondents also supported extending such requirements to government-owned organisations (such as KIO and KPC). The respondents' desire to have more audit seems to correspond to a typical response to audit failure noted by Power (1993)

“Audit failure paradoxically but inevitably leads to a reintensification of audit. At the point where systemic doubts about audit might be possible, the response is to have more of it.” (p.283).

However, there are also some very distinctive elements in the views of respondents to the questionnaire. While supporting the greater involvement of international firms, respondents generally seem to want a different form of auditing – something that goes beyond information credibility assessment to an

involvement with assessments of value for money and management efficiency. Somewhat surprisingly, respondents from audit firms were clearly willing to provide such services in Kuwait - something that is not seen by audit firms in Anglo-American countries as a normal part of the statutory limited company audit function. The analysis of the questionnaire also revealed a larger acceptance by respondents from all groups (including those from the Audit Bureau) that the Bureau has a larger responsibility than audit firms, especially in relation to issues like the detection of fraud and making sure the company is being run efficiently - see Chapter 9. This feeling seems to support the recent moves by the parliament to extend the responsibility of the Bureau to investments where the government has stakes of more than twenty five percent.

Sikka *et al* (1998) have argued that it is impossible to eliminate the audit expectation given the difficulty of establishing an all embracing and encompassing definition of the audit. Power (1998) seems to agree that the temptation for auditors "to create expectations for what they can achieve" makes it difficult for the expectations of auditors and society to coincide. Indeed, an examination of audit expectations gap surveys in several countries suggests that a gap is always there. It almost seems inevitable to have such a gap if auditor self-interest can easily be in conflict with the public interest. However, the size of the gap seems to be an important distinction across the various national surveys. In some surveys the gap is not wide, limited to few issues, and most of the differences are in emphasis (such as the case in Kuwait) - while in other surveys the gap is very wide, spans many issues and most of the differences are in opinion (as in the case of the UK). This difference might be explained by different factors in these countries such as the length of the history of auditing, the size of the private sector in the whole economy, the rate of business collapses and the litigation environment. These factors may make the expectations gap in some countries easier to bridge than in others.

10.3 Key Findings in Relation to the Existing Literature (or the General Implications for Auditing)

10.3.1 Regulation of the Profession

The government rather than profession largely undertakes the regulation of the profession in both Kuwait and Spain. While this type of regulation seems to be working in Spain it failed to provide a proper regulation in Kuwait. The Spanish regulator, ICAC, was successful in disciplining improper audit work in the aftermath of a string of financial scandals in the early 1990's. However, the profession thought that it was improper for a non-professional body to investigate its actions and impose fines on it. The Spanish accounting profession clearly prefers to be in charge of disciplinary procedures. Governmental regulation in Kuwait has failed to discipline any firm in the post-liberation period (1991 and after). Despite the widespread awareness of several parties in Kuwait (Ministry of Commerce, the Audit Bureau, audit firms, banking lenders) that many small audit firms in Kuwait are engaged in questionable practices (e.g., signing audit reports without conducting any audit), not a single firm has been disciplined for such actions. This shortcoming of governmental regulation, however, has not lead to calls for self-regulation of the profession. The questionnaire analysis showed audit firms are the only group that has a strong support for self-regulation of the profession, while financial directors, users of financial statements and Bureau's auditors were less supportive of self-regulation of the profession. This finding is not surprising given that the support of governmental regulation is endorsed by Shuaib (1995), an academic but also the managing partner of Arthur Andersen in Kuwait. Significantly, the survey showed that a large number of respondents from each group supported the idea of an independent body being entrusted with the job of appointing auditors and setting their fees. The lesson from the KIO case is that whatever the type of regulation, it is crucial that the regulatory body is willing to improve the efficiency of the services provided and the parties providing them. In Spain, ICAC clearly had such an intention, while in Kuwait the governmental regulator failed to act, probably because most abuses

were limited to the audit of small companies and did not present large problems for the Kuwaiti economy.

The successful merger of Price Waterhouse and Coopers & Lybrand has been heralded as creating the first global audit firm (although other firms such as Arthur Andersen make similar claims). This belief has also led KPMG to set up an international committee with the intention of making the firm an international one in the true sense. Global business processes and global audit firms means that the probability of having financial scandals that affect several countries around the world increases – which, in turn, presents considerable challenges for national accounting and auditing regulatory bodies. This was well illustrated in the BCCI case, where the principal audit firm of the bank, Price Waterhouse-London, refused to comply with US congressional investigations - claiming that the American Congress does not have jurisdiction in the UK. In addition, Price Waterhouse-London also stated that “it does not do business in jurisdictions in which people have been injured by its handling of audits” (US Congress, 1992). Given the globalisation trend, it will be more difficult for regulators and users of financial statements in the future to establish their jurisdictional rights over ‘global’ audit firms. It will also be very difficult for regulators with limited financial resources to investigate and discipline such firms - especially when regulators in the past were restricted in their attempts over several years to pursue them. A clear example of this can be seen in the way Coopers & Lybrand stalled the attempts of the Joint Disciplinary Scheme to investigate the Mirror Group case in the UK for several years. The difficulties for national regulators in regulating or disciplining global audit firms can also be seen in the way ICAC in Spain was heavily attacked by campaigns headed by the Big Six audit firms. These firms heavily attacked ICAC, claiming that it is not the job of bureaucratic/governmental institution to investigate the role of auditors. They also depicted ICAC’s disciplinary procedures as a personal crusade by the Chairman of ICAC against the Big Six. The Big Six’s publicity machine in Spain seems to have scored some successes as the chairman of ICAC was replaced and ICAC’s right to publish its findings from the sanctioning process were heavily

restricted. The doubts about the ability of national or international bodies to regulate the profession were well expressed in some recent articles:

“For self regulation to work the regulator must surely have the ultimate power to suspend or repeal a firm’s license to audit. But the size of the firms – and their grip on the listed audit market – is such that the use of such a sanction would cause chaos in the markets. In a very real sense, the Big Five are already too big to punish.” (Jim Kelly, FT, 4/2/1999, p. 11).

“The size and scope of the multinational practices of these firms raises the question of whether the disciplinary practices of state, or even national governments and professional institutes are any longer competent to effectively control a multinational practice that transcends all former boundaries.” (Baker and Hayes, 1997, p.335).

10.3.2 Fraud Detection

The KIO scandal and that of others in Kuwait did not lead to debates or doubts in Kuwait about the role of the auditors in detecting of fraud, nor it did lead to public calls for them to detect fraud. Nevertheless, the findings of the questionnaire survey showed that, with the exception of the audit firms, a clear majority of respondents from each group felt that audit firms have a duty to detect all significant fraud. The majority of respondents in all four groups also felt that auditing provides protection against fraud (auditors being the most sceptical but still having a majority support).

However, the findings from the KIO case seems to contradict/undermine the ability of the auditing function to detect and protect against fraud. The KIO case has highlighted three elements that make it difficult for auditors to unravel fraud in any company or organisation. The first element relates to the involvement of a number of senior managers in KIO and GT in the fraud, including the chairman of KIO and deputy general manager (who were both members of the ruling family in Kuwait). Such involvement not only made it easier for them to commit fraud but it also enabled them to block investigations by auditors and inquiries by one of KIO’s managers. The presentation of fake documentation and evidence in the KIO case is also another element undermining the ability of auditors to detect fraud. The auditors were presented with false documents from several members

of GT and a string of shell companies aiming to cover or legitimise transactions related to the funds embezzled from Grupo Torras. Even a bank in one of the transactions, under instructions from GT's managers, presented false information to an auditor of GT's subsidiary. The third element in the case that made detection of fraud even more difficult relates to the role of accounting firms and accountants in constructing complicated offshore schemes. The diversified investments by KIO via different channels around the world seem to make the work of auditors very difficult. This was evident in the way it took several auditors and law firms to figure out what was happening with KIO's investment in GT. The case has shown audit firms, including one of the Big Six, as complicating and contradicting the work of each others. That is the role of audit firms advising on offshore schemes to minimise taxation or to conceal the identity of the shareholders. The main scheme used by KIO to invest in Spain via the Dutch Antilles was devised or proposed by Touche Ross of Spain. The case has demonstrated how an accounting firm in Jersey and a former accountant with Touche Ross played a major role in setting the offshore companies, fronting these companies and designing the transactions in ways to deceive auditors – conclusions arrived at by the Judge in the civil case in London filed by GT, against its former managers. This finding supports the conclusions of Mitchell *et al* (1998) and Robinson (1999) that complicated schemes for moneylaundering require or are conducted with the help of accounting firms. Concerns about the role of accounting firms in relation to the issue of moneylaundering were the focus of recent press commentaries in the UK, indicating that audit firms/accountants are either playing a part in moneylaundering or are turning a blind eye to such practice. Auditing and auditors will no doubt struggle when faced with some or all of the above elements – which, in turn, questions the belief or faith of people in the survey that auditing can provide a significant protection against fraud.

10.3.3 The Role of the Big Six Audit Firms in Setting the Audit Agenda/Influencing the Audit Environment

The case study and the questionnaire analysis have revealed different responses in Spain and Kuwait. The recent string of financial scandals in Spain has created similar concerns and criticisms of the auditing function and the auditor role to those experienced in Anglo-American countries after the breakout of such scandals. Furthermore, the profession response to recent financial scandals in Spain is along the lines of what is established in the Anglo-American context. The profession attributed criticisms of the profession to the audit expectations gap rather than to the performance of auditors. That is, while the profession is in crises it is more often seen to act in its self-interest rather than in the public interest. The Spanish profession denounced any responsibility for the detection of fraud. It also called for self regulation in a time where government regulation seems to be working. The profession was also campaigning to limit liability when there wasn't any legal threat for the audit firms. This self interested response to the crises in the Spanish auditing can be attributed to the involvement of the Big Six audit firms in controlling the debate and setting the agenda. The Big Six in Spain control the biggest Spanish accounting associations and, therefore, represent a major source for change in that country. This domination is vividly evident in the calls for self regulation of the profession – with Big Six representatives rather the public stating that they were not satisfied with governmental regulation and calling for change. This is clearly different from the position in Anglo-American countries where the public is the critic of the regulation of the profession and is calling for change from self regulation to independent or government regulation – calls which the auditing profession seems increasingly willing to accept. The campaign for limiting audit liability in Spain is perhaps the clearest evidence of the Spanish profession following the international strategies of the Big Six firms.

In the Kuwaiti context, the collapse of KIO's Spanish investments and other financial scandals in Kuwait did not create the usual criticisms of auditing and auditors. It might be argued that the collapse of KIO's investments mostly took

part in Spain and could therefore have been expected to more influence the accounting profession in Spain rather than in Kuwait. However, the collapse of GT took place at a time in Kuwait when other major scandals or collapses of Kuwaiti organisations was taking place and such a range of scandals could have been expected to have had an impact on people's perception of auditing and auditors in general. In all of this, it is intriguing that the fines imposed on GT's auditors in Spain for substandard work did not generate a desire on the part of the Kuwaiti government (representing or represented by KIO or KIA) to sue Coopers & Lybrand. There might be several explanations for this attitude in Kuwait. One explanation is that the people seem to feel that management is an important party responsible for such collapses (although in the survey reported in Chapter nine, blame was also attributed to several other parties, including auditors). The Kuwaiti press commentaries and the statements made in the Kuwaiti parliament also mostly seem to blame the management for such actions. The questionnaire survey seems to show that the majority of people also did not know that KIO was externally audited. Further, the issue of C&L being fined by ICAC was either not reported or not prominently reported in Kuwait – all in all meaning that the lack of blame for auditors did not require the accounting profession or the Big Six¹ to move on to the defensive.

However, it would be wrong to say that the Big Six firms play a dominant role in influencing or controlling debates and proposals for change in auditing in Kuwait. The recent change in the commercial law in 1994 requiring two auditors to attest the financial statements of stock holding companies was enacted based on a proposal by the parliament – not by the Big Six firms. The recent attempt to change the audit law was also at one time instigated by the Ministry of Commerce, the profession's regulator, while another attempt was initiated by the KAAA. The Ministry of Commerce's proposal no longer required accountants to

¹ The only time the profession was questioned in a symposium about the Protection of Public Funds law in 1993. In that day a partner in Ernst & Young-Kuwait was questioned about the

pass a professional licensing exam to conduct audit work. Clearly the profession, including the Big Six, were not consulted about such proposed changes and opposed them. Likewise, the KAAA's proposed amendments to the law where auditors will be jointly responsible to their client and others for losses resulting from negligence, comes in contrast to calls in Anglo-American countries for the abolition of Joint and Several Liability (e.g. IFAC, 1996; London Economics, 1998). Accordingly, these recent changes and proposals appear to be initiated by parties other than the Big Six firms, potentially creating some major threats to the profession's standing and status.

Further evidence that the Big Six's influence on auditing debates in Kuwait and the nature of the debate itself is different in Kuwait than in Spain or elsewhere is reinforced by certain results in the questionnaire survey. These showed audit firms in Kuwait accepting specific tasks (such as identifying ways to improve and report on management efficiency) as part of their duties, which are not normally accepted by Big Six audit firms in Anglo-American contexts.

10.3.4 Image of International Audit Firms and their Immunity to Scandals

The questionnaire survey showed that a larger number of financial directors, users of financial statements and audit firms perceived audit firms to be more competent and more successful than the Audit Bureau on most tasks. The survey also showed the Bureau's auditors rating audit firms higher than audit firms rated the Bureau. Such attitudes might be explained by the belief that the Audit Bureau's auditors do not need to acquire a professional qualification to be employed. It also has failed to attract the best qualified/talented accountants in Kuwait given its low salary levels (a position which led the parliament to double the Bureau's salaries to attract a better accountants) – although it has to be said that the performance ratings of auditors from audit firms and the Audit Bureau were generally high (the former just being higher).

failure of the audit firms in detecting fraud in the case of KIO. He response was that detection of fraud is not a duty of auditor (for details see Al- Qabas, 3/2/93).

It also seems that people in Kuwait see the Big Six audit firms in a different light as they are representing international firms. The survey has shown that international audit firms in Kuwait were seen as highly competent and professional – a point emphasised by respondents being in favour of a mandatory regulation requiring all companies with capital above KD5m (£10m) to be audited only by international audit firms. Such perceptions of international audit firms go some way to explaining the trend in Kuwait wherein many local firms are forming some kind of relation with international audit firms (either Big Six or other international firms). More importantly, a large number of respondents from the four groups thought that international audit firms generally have the capacity to understand complex investments and transactions such as those undertaken by KIO while a lesser number of the four groups felt that the Audit Bureau has a similar capacity. However, this strong belief in the ability and capability of the international audit firms seems to be misplaced when one looks at the role of such auditors in the KIO case. Clearly, they had difficulty in understanding and tracking the labyrinth of offshore/shell schemes used by KIO and GT.

The differential influence of the Big Six in Kuwait and Spain might support the claim that these firms are not the same all over the world. The case has shown that KIA probably does not view Big Six firms in Kuwait in the same light as Big Six firms operating abroad in countries such as the UK. In 1987, KIA preferred to hire KPMG-London rather than KPMG-Kuwait to audit both KIA and KIO. This position has some similarity with the recent attempt of a Japanese Bank, Fuji Bank, to have part of its Japanese accounts audited by Ernst & Young-UK rather than Ernst & Young in Japan – in an apparent attempt to improve the credibility of the Bank's accounts (see *Accountancy Age*, 15/10/1998). KPMG's recent attempt to make the firm a global one highlights the view that the offices of these international audit firms are not necessarily uniform throughout the world. The recent Asian crisis has also raised doubts about whether the quality of Big Six/Big Five practice is the same across the world – a question that led the World Bank to call on these firms to refrain from associating their names with accounts

prepared using sub-standard accounting standards (for details see, FT, 19/10/1998).

10.3.5 Comparisons with other Scandals

The KIO case shows some patterns and tendencies that historically have usually been evidenced in other financial scandals with respect to the role of auditing. In many scandals and corporate collapses, a dominant senior management group usually compromises the work and independence of auditors. The dominance of the management in KIO can be seen by the way very few people were undertaking most of the influential decisions that shaped the future of KIO and GT. In Torras it was obvious that Javier de la Rosa took most of the crucial decisions. He was able to make controversial decisions that were in direct conflict with the recommendations of KIO's executive committee in early 1990. A clear example was de la Rosa's decision to buy a paper company called Sarrío in 1991 despite the decision of the executive committee to liquidate the Torras group and the findings of a feasibility study which chose not to recommend such an acquisition. In interview, one of the new Kuwaiti managers of GT appointed before de la Rosa resigned explained that in a board meeting of GT when he opposed one of de la Rosa's decisions, everyone was clearly surprised as this was the first time it had happened. The chairman of KIO, Sheikh Fahad Al-Sabah, was also very dominating and was undertaking very crucial and controversial decisions without much reference to Kuwait or to the auditors. Indeed the resignation letter of KIA's managing director and two members of KIO's executive committee shows the chairman controlling funds of excessive magnitude. The letter also showed the chairman was blocking the implementation of KIA's instruction to KIO's auditor to investigate KIO's Spanish investments. The ability of the chairman of KIO to channel funds to GT to the magnitude of \$1.2bn (when this was against the regulations of KIA) shows the dominant power base of senior management. It is difficult to imagine how audit firms can maintain independence in this type of environment where such dominating managers having the key to lucrative management consulting services for the auditors (on top of their audit fees). The case also questions the auditor's

evidence collection process in practice. ICAC's findings in its sanctioning report on Coopers & Lybrand showed the audit firm relying on evidence that was only available after the date of issuing the audit report. The case also showed KPMG taking the evidence provided by KIO/GT managers at face value without undertaking any further investigation of the accuracy of evidence provided to them.

Comparisons of the KIO case with others like Maxwell, Banesto, Lincoln Savings & Loans has revealed that while prominent figures behind the scandals in these cases had questionable pasts, the auditors were not duly concerned about that and did not appear to take it into account in carrying out their audit. The controversy that surrounded Javier de la Rosa's role in the collapse of Banco Garriga Nogues and the government's concerns about de la Rosa managing GT did not seem to influence GT's auditors in conducting their work. This pattern was similar to the Maxwell scandal where Robert Maxwell illegally channelled funds from the pension funds for the Mirror Group to his private business. Again the auditors did not take into consideration the findings of an investigation of the Department of Trade and Industry in 1975 where it was deemed that Maxwell was unfit to manage a public company. A similar case is the near collapse of the Spanish Bank, Banesto, where Mario Conde the flamboyant chairman was thought to have acquired a stake in the bank using highly deceptive tactics. This management ethos again did not seem unduly to caution the auditor – with Conde embarking on a supposed wide scale process of fraud and mismanagement that eventually led to him being charged and tried by the courts (a case which is still continuing).

It appears that it is more difficult for these audit firms to deal with organisations where a sovereign government or a head of state is closely involved. This problem can be clearly seen in the collapse of KIO as well as in cases like those of BCCI and the failed automotive manufacturer, De Lorean Motor Company. In the GT case, the auditors claimed that they accepted deficiencies in a provision on the understanding that KIO was supporting GT. Similarly, it was reported that

Price Waterhouse's acceptance of the promise by the Ruler of the United Arab Emirates to support BCCI was behind their refraining from a qualified audit report. In a similar vein, Arthur Andersen dismissed the legal charges filed by the British government against the firm for the collapse of De Lorean. Andersen's indicated that the British government's desire to boost the Northern Ireland economy by supporting the factory (despite its difficulties) was the reason behind the collapse. The above would all suggest that the involvement of such sovereign bodies in the organisations being audited is troublesome.

The collapse of KIO's Spanish investments shows the difficulty of obtaining information about what really happened and more importantly, for the purpose of this study, what the auditor did or failed to do. This can be seen in the attitude of KPMG-London, KIO's external auditor, whom refused to discuss any matter related to KIO - including basic issues such as if they were the auditors or not and if so from what period to what period. Rather the London-based audit firm referred me to KIA, who represented by its managing director refused to talk about the role of KIO, sighting a doctrine of secrecy. In a similar fashion, contact with representatives from ICAC, REA and ICJCE, via a Spanish colleague, met with their refusal of an interview to discuss the issue of ICAC's sanctioning of Coopers & Lybrand. All these obstacles in the collection of information about the role of auditors in examining the accounts of GT resembles the difficulties experienced by investigators in examining the role of auditors in other collapsed organisations (and, in many ways, symbolises the problems that auditors can face in politically charged environments). A clear example can be seen in the case of BCCI, where congressional investigators in the USA claimed that they were unable to obtain documents and testimonies from, Price Waterhouse, BCCI's principal auditor (US Congress, 1992) due to disputes over legal remits.

The KIO case, importantly, has revealed something that was not widely seen in other corporate scandals. Most scandals or collapses of corporations seem to take place either immediately or a reasonably short period after the issue of a clean audit report (an 'unqualified' audit report). The collapse of GT does not conform

to this pattern as the groups' accounts were qualified for several years before the collapse of the group. Audit report qualifications were also evident in some of the subsidiaries of KIO such as Ercros. In contrast, cases like those of BCCI saw auditors choosing not to qualify their audit reports – on the grounds that a qualification for a bank could spell the end of that institution. However, this attitude was criticised by Moizer (1995) who was critical of auditors judging qualifications on a rather arbitrary, consequentialist approach. The problem in GT was that auditors had a number of other things on which their reports should have been qualified – a state of affairs which ultimately raises questions as to the real practical significance of audit qualifications in Spain.

The actions of Price Waterhouse in the BCCI case raise questions as to whom the auditors have a duty of care? Price Waterhouse's dilemmas seem somewhat similar to the position of KPMG's first evaluation of Grupo Torras in 1991. KPMG duly responded to the criticism of its evaluation after the collapse of GT by indicating that it had had some reservations about the evaluations but believed that it did not have a duty to communicate such findings to the CNMV, given that GT had been transformed into a private company by KIO. The KIO case also highlights an important point concerning whom KPMG have a duty to in Kuwait. While the money invested by KIO represents public funds, were KPMG hired for the benefit of the public in Kuwait? Is such a claim sustainable if the public is not even allowed to know: what type of services KPMG is providing; what type of reports KPMG is providing; nor anything to do with the role of KPMG. Ironically, in theory, the external auditor's task could be expected to be to make the KIO accounts transparent and its operations more accountable. However, it seems that the role of KIO's auditors is itself not transparent, with no public indication of what they are doing, or what they need to do. For that matter, the auditors do not seem to be accountable themselves, even though the accounts they are investigating are public accounts and the work of KIO is deemed to be in the public interest.

The case also highlights the problem of accounting evaluations - a long-standing dilemma encountered by auditors. This point is seen in the way GT's draft accounts for 1991 showed the group making profits of Pta3.9bn, although this was transformed to losses of Pta44.4bn when the new managers of GT ordered C&L to use market values and remove extraordinary items. A huge difference in valuation was also seen in KPMG's two different valuations of the Spanish group - it first placed it as \$4.5bn in 1991, followed by a significant negative value of \$4bn in 1992. Similar differences in valuations can be seen in other recent Spanish scandals such as those of Grand Tibidabo and Banesto. The cases all show how subjective accounting valuation can be and how crucial these valuations were to the fate of the companies concerned. This finding seems to support the feeling that imprecise accounting standards seriously undermine the auditing process and create what is usually referred to as creative accounting. The majority of respondents from each group in the questionnaire survey seem to share this view in contrast to the 1993 Spanish survey, where the majority of respondents did not view it as problem. The reason behind such view in Spain might be due to the fact that the Spanish survey (see García Benau *et al*, 1993) was conducted before the breakout of the major scandals.

The case clearly shows the role played by family and friends especially in senior positions in complicating the role of the auditors and making them unable to detect fraud. The case shows how the Chairman of KIO allegedly being responsible for channelling KIO funds to his accounts and those of his friend (Fouad Jaffar) and members of his family (Khalid Al-Sabah). This practice does not seem limited to KIO, given the nature of Kuwaiti society and the role of 'Wasta' in Kuwait. The practice of appointing friends and family members (known as *amigoismo*) in Spain seems to have also had some detrimental effect on the work of auditor. In the case of KIO, de la Rosa appointed several friends in different parts of the groups. These friends were playing a crucial role authorising and orchestrating the fraud taking place in the group. This type of co-ordination among senior managers in a corporation makes it very difficult for auditors to detect significant fraud. The involvement of senior management and

family relationships among directors or officers was also evidenced in fraud cases in the USA. The Committee of Sponsoring Organisations of the Treadway Commission (COSO) sponsored study on fraudulent financial reporting between the periods of 1987 and 1997 was based a sample of 200 companies that allegedly had been involved in fraudulent financial reporting (COSO, 1999). The study revealed that top senior executives were involved in the fraud, including the Chief Executive Officer (CEO), in 72% of the cases. The study also found that family relationships among directors and officers were evident in 40% of the fraud cases. All these facts highlight the difficulties that auditors face in conducting their audits.

10.4 The Future of Auditing and Corporate Governance in Kuwait and the Implications for Kuwaiti Democracy

The questionnaire survey in this thesis has clearly shown the satisfaction of people in Kuwait with auditing. The responses also endorsed the recent changes in Kuwaiti law requiring two audit firms to audit companies listed on the stock market. Extending such requirements to government-owned organisations (such as KIO and KPC) was also supported by survey respondents. International audit firms in Kuwait were seen as more competent or professional than the Audit Bureau and other audit firms – a point emphasised by respondents being in favour of a mandatory regulation requiring all companies with capital above KD5m (£10m) to be audited only by international audit firms. Such perceptions of international audit firms goes some way to explaining the trend in Kuwait wherein many local firms are forming some kind of relation with international audit firms (either Big 5 or other international firms). While supporting the greater involvement of international firms, respondents generally seem to want a different form of auditing – something that goes beyond information credibility assessment to an involvement with assessments of value for money and management efficiency. Somewhat surprisingly, respondents from audit firms were clearly willing to provide such services in Kuwait - something that is not seen by audit firms in Anglo-American countries as a normal part of the statutory limited company audit function.

An important issue concerns the basis underlying this apparent demand for more auditing and different kinds of audits. Why is auditing seen as such a desirable part of Kuwaiti approaches to corporate governance, especially in the light of the questionable role of auditing in major corporate collapses like KIO and Grupo Torras? What is auditing capable of achieving in Kuwait? Such issues and questions have to be considered in the wider context of Kuwaiti business and social traditions. A longstanding, significant aspect of Kuwaiti society has been the importance of family and friends in all parts of business and social life. As pointed out in Chapter 4, this is generally referred to in Kuwait as the notion of “Wasta”, wherein social connections and influence are felt to matter more than ability. Thus, it is often stated that people have been employed on the grounds of “Wasta” rather than on who has the best qualifications of prospective candidates. Promotion (and the maintenance) of positions in organisations is also usually influenced by “Wasta” rather than performance. Likewise with business contracts and negotiations. It is also to be expected that the appointment of external auditors is influenced by “Wasta” – a point confirmed by responses to the questionnaire survey discussed in Chapter 9.

This type of social environment seems to create some difficulty for auditing. Employment through “Wasta” usually leads to members of elite families in Kuwait being appointed to the highest positions in government-owned corporations – which effectively means that top-level decision making is unchangeable by others down the organisational hierarchy. This pattern of behaviour was evident in the case of KIO where the chairman of KIO was embarking on investments and decisions that were against the regulations governing KIO’s operations – but it was clearly very difficult for any arguments to be made against such decisions. The resignation of the managing director of KIA and two members of KIO’s executive committee on the cited grounds of serious mismanagement and a string of breaches in regulations was submitted to the prime minister (and Crown Prince) of Kuwait, but even this did not lead to any action against the management of KIO. Given such circumstances, it is hard

to imagine any influential role for auditing in making sure that senior corporate management is held accountable for its decisions.

In considering the likely future effectiveness of a corporate audit function in Kuwait, it is also important to reflect on the dominant role played by government in Kuwait. Most of the major corporations in Kuwait are government owned and the government also has significant stakes in the majority of 'public' companies in Kuwait. This has several implications for the auditing function. First, it means that the government has considerable channels (in addition to the audit function) to find out the 'true' position of any such major corporation. The Audit Bureau will audit all institutions where the government holds investment stakes of more than fifty percent of share capital. The government also has representatives sitting on the boards of these corporations/companies – and, therefore, does not need to rely solely on the report of the external auditor. Secondly, the Kuwaiti government will usually provide significant financial support to Kuwaiti organisations and corporations faced with financial difficulties. This policy makes it very rare for shareholding companies and other government-owned institutions to collapse. It also might explain the lack of blame attached to auditors (in both the business and general media and in the responses to the questionnaire) – with people feeling that they do not need to rely that much on the auditors' report as the corporations will never be allowed to fail. This situation can be compared to the status of auditing in Japan, where auditing does not have the same importance that is attached to auditing in Anglo-American context. The Japanese government's support for the ailing banking sector and western calls for the Japanese government to suspend such support might explain the unpopularity of auditing in Japan. Japanese people's belief, similar to those in Kuwait, that the government's support will not lead to any financial failure might explain the disinterest in auditing in both countries. Thirdly, it leaves government with a significant role in regulating corporate and social affairs in Kuwait. The fact that most regulatory matters (such as regulation of the financial markets, medical practice, law practice etc.) are the responsibility of the government seems to affect the perception of people towards regulatory reform –

in that they are pretty sceptical of any reform process which is not government led. The responses to the questionnaire tend to reflect such a position, with the majority of directors, users and auditors from the Audit Bureau all being opposed to the establishment of self regulation for the audit profession – a view maintained even though the government has failed to discipline even one of the smallest audit firms in Kuwait (who, from interviews conducted in Kuwait – see Chapter 8 - are generally believed to be engaged in questionable auditing practices).

Recent developments after the liberation of Kuwait (following the Iraqi invasion) might change the role and perception of auditing. The government's privatisation of many of its stakes in shareholding companies could play a major role in this change. That is, if the government stake falls below 50% of capital, then it no longer will have a representative on the board of directors and the Audit Bureau will cease to audit the company. Accordingly, there will be more reliance on the role of the external auditor. The government is also studying/considering (in a bid to attract foreign investment in Kuwait) removing restrictions on non-Kuwaitis holding stakes in Kuwaiti shareholding companies. In order to attract such investors, reporting needs to be more transparent and trustworthy. This again places more emphasis on the role of external auditors. In addition, the financial difficulties facing Kuwait in recent years as a result of the Iraqi invasion and the sharp fall in oil prices might make it more difficult for the government to sustain its supports for ailing companies and corporations. This will eventually lead to more attention being directed to the audit report – and, possibly to criticism of auditors (and maybe lawsuits) when corporations or companies fail.

Reliance on informal channels for investment decision in Kuwait might also explain the disinterest in auditing. It has been argued that investors gather informal information about the financial position of corporations via informal channels such as the social gatherings in 'dawaniya' and through 'Wasta' or other social connections. These channels, culturally, might be perceived to be more accurate than financial statements and audit reports.

This study shows that auditing in Kuwait is generally perceived to be a crucial part of any sound economic system and a crucial part of any so-called 'developed' society – although it appears to be a belief held without any genuine sense or awareness of what auditing can achieve. This can be seen especially in the way that problems with the accounting profession in Kuwait are not concerned with what can and cannot be achieved by auditors but rather with deficiencies in the technical skills of auditors and accountants. A requirement for continuing education for certified accountants is being promoted in Kuwait as an essential element to advance the quality of audit services. As such, accounting and auditing education/training are the problem, not any limitations on the part of the audit function. In a developing country like Kuwait, there is little doubt that reaching the education and training level for auditors available in Anglo-American countries is seen to be key in terms of improving the quality of audit work. This assumption, however, clearly assumes that the Anglo-American auditing model is working well – and recent debates over auditing regulation and professional accounting education in the UK, for instance, would suggest that there are still strong concerns over how effectively such a system is working.

Another important factor that can be expected to have a significant impact on the practice and future of auditing in Kuwait, especially with respect to the work of the Audit Bureau, is related to the strength of Kuwaiti democracy. The history of democracy in Kuwait is a very unstable one, with democracy being 'unconstitutionally' dissolved twice (in 1976 and 1986). In recent years, several disputes between the government and the parliament have led to talk of parliament being dissolved - but the government either resigned or a compromise was reached. The function of democracy through parliament plays a crucial role in supporting the work and independence of the Audit Bureau. Dissolving the parliament would place the Bureau under the direct control of government – and it was when it was in such a position that the Audit Bureau was restricted from examining the accounts of organisations like KIO and KIA (between 1986 and 1992). Proper accountability can only be exercised with strong democracy and the strength of democratic traditions will clearly play a crucial role in

determining the strength of the audit function – after all, there is no sense in having auditors report on corporate wrongdoing if their findings (e.g., on illegal acts or mismanagement) are not acted upon.

What are the chances of such a state of affairs being established in Kuwait? And, if they are established, what are the chances of auditing being able to deliver what is expected of it? On the first question, much depends on one's view of the nature of Kuwait society and the forces seeking or resisting change. Those who feel frustrated with the failure of government, parliament and auditors to eradicate or diminish the widespread corruption in the Kuwaiti organisations might be able to become influential voices in the pursuit of change. Such change can be seen in the recent attempt to establish the Kuwaiti Society for the Protection of Public Funds to combat the apparent relentless abuses in managing public funds.

On the second question, one has to look both to the international auditing literature and also to the experiences to date of auditing practice in Kuwait. With respect to the auditing literature researchers have questioned the ability of auditing to deliver (e.g. see Mitchell *et al*, 1993). With respect to the experiences of auditing in Kuwait, there is still very little evidence on which to base any such judgement. The evidence from the KIO case clearly shows the difficulties that auditors face in working in Kuwait. What seems beyond doubt is that the spread of auditing in emerging democracies like Kuwait is not as natural, direct and predictable process as is often portrayed in articles referring to the global auditing profession. It is not clear whether an accountability mechanism rooted in the notion of independence is suitable in a society where dependence seems to be a fundamental way of ordering social behaviour, both at home and in corporations. It may be that auditing in Kuwait is doing little more than placing an artificial gloss on corporate activities – and is a function which, if truth be known, is not highly valued. Alternatively, it may be a function which people genuinely want developing (and developing in a special way in Kuwait) and which they see as a natural companion to, or element of, a democratic society. Whichever

perspective one takes, it is vital to know much more about the day-to-day auditing practices in countries like Kuwait. If the pursuit of democracy is being coupled with the promotion of 'better' auditing, it is essential that the democratic contributions claimed for auditing are properly assessed and examined – especially, given that it is just such claims that are repeatedly coming under criticism in Anglo-American countries with long auditing traditions. It may be that for nations like Kuwait, that the auditing function of the future will look a lot different than it does in the West. Perhaps the answer lies in the promotion of the risk-based management assurance services being advocated in the United States and elsewhere (e.g. see AICPA, 1997). Alternatively, it may be that what Kuwait needs at this stage in its development is a more performance oriented auditing function, which is actively involved in the management process rather than just an assessor of the credibility of financial information. Or, ultimately, it may be that auditing's future rests very much in the hands of those 'non-auditors' seeking constitutional reform and the establishment of some basic democratic rights (such as votes for women, and greater control over the activities of major international corporations and governments seeking to invest or expand in Kuwait and other gulf states). It might just be that the soundest future for auditing will only be secured once the tradition of "Wasta" is broken – which view one takes, will depend on what you know (or maybe 'who you know')! It seems doubtful that 'Wasta' will be eradicated in the near future given the apparent unwillingness of the government and the parliament to tackle such problem. Recently members of the parliament were split in their debates over the use of 'Wasta' in employment. While some members were calling for an end to such practice, others felt it was an inevitable practice given the government's failure to address the problem of unemployment in Kuwait (Al-Qabas, 5/2/1997, p.1). What also makes it difficult to eradicate 'Wasta' is that senior officials in the government tend to deny its existence – in short, it is difficult to solve a problem without admitting that you really have a problem (especially when people in Kuwait believe that they have a duty to help families and friends).

10.5 Research Implications

It has often been argued that financial scandals or collapses are the outcome of economic downturns and do not have any reflection on the general status of the auditing function. The KIO case undermines such claims as it shows the collapse of the group was not due purely to a downturn in the economy but rather was a consequence of a range of factors. The strategy of KIO using external accounts and offshore companies to acquire shares in Spanish companies and then selling them to Grupo Torras at inflated prices paid for with bank loans overburdened the Spanish group with shares at inflated prices and high levels of debt. Other reasons for the collapse of the group included mismanagement and fraud, with the latter being undertaken in schemes designed and participated in by accounting firms and accountants.

The depth of the KIO case study and the range of issues and fundamental questions raised over audit practice shows the value of studying financial scandals – they provide a fairly rare opportunity to explore and enhance understanding of auditing and corporate management/governance mechanisms in action. Overall, the thesis has shown the importance of not just relying on empirical surveys of audit expectations. The contrast in the findings of the two research methods used in this thesis reinforces the need to concentrate more on what is being achieved in practice in the name of auditing – especially given that people in Kuwait have views of auditing performance which do not match well with the fundamental lack of achievements in cases like GT/KIO scandal. This probably shows that views of auditing are very much influenced by more general and less tangible factors such as the profession's image and its claims that it can deliver what the public needs. The benefit of the methodology used in the thesis is being able to come out with different insight about auditing between what is believed to be and what it is in practice. The future research should move beyond opinion surveys that are more concerned with how big a gap to case studies which examine what auditing is delivering in practice – not just in scandals and

high profile cases but also in the routine, everyday audits of private and public organisations in Kuwait and other emerging democracies.

This study has shown that the Kuwaiti environment, with its social, political and economic aspects, has had a strong influence over the way auditing has functioned in Kuwait. The way 'wasta' influenced employment policies, and to some extent auditor appointments showed that the concept of dependence is more widespread than that of independence. Further, the Kuwaiti government domination of the private sector and its financial support for companies in difficulties may well have made people less reliant on auditing in Kuwait. This study has also highlighted that changes in (and attempts to change) Kuwaiti laws relating to the work of auditors were carried out by the government and the parliament without much reference to the profession or users of financial statements. These seem to have been politically motivated rather than based on a clear vision as to what such changes could contribute to audit performance in Kuwait.

Accordingly, this study strongly suggests that future research on auditing in non Anglo-American contexts will be more productive if it gives due consideration to social, religious, political and economical influences on the audit function. The type of auditing being promoted by the large multinational firms and various regulatory bodies and associations was mainly established and designed to work in Anglo-American contexts. Cultural values here can be very different from those in non Anglo-American contexts, as this thesis has clearly illustrated through its analysis of auditing developments in both Spain and Kuwait. These values should be considered when conducting research (e.g. case studies and/or questionnaire surveys) or when interpreting research findings in non-Anglo American contexts. For instance, the questionnaire survey findings in this thesis showed people in Kuwait wanting auditors to provide management advisory services and find ways to improve management efficiency. It is hard for these findings to be attributed purely to an acceptance of the claims of auditors in Anglo-American contexts that providing consulting services improves the quality

of auditing. Rather, it is likely that such findings are a more direct and basic reflection of recent debates and concerns in Kuwait about the poor standing of management in Kuwait – especially in relation to the recent string of financial scandals. The evident degree of mismanagement here has been such that anything which can be held out as offering to improve management will be seen as a good thing, without the validity of its claims being subject to much informed and detailed investigation.

Therefore, in conclusion, it must be stressed that future research in non-Anglo American contexts must be conducted in a way which is both sensitive to the contexts in which it is being conducted. It also must be equally aware of the need to review with care the applicability and relevance of the debates and research studies which have taken place in Anglo American contexts on the subject under investigation.

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Appendix 1

Appendix 1 – Translation of the Resignation Letter of the Managing director of KIA and two members of the Executive committee of KIO in 30/12/1990.

Your Highness Sheikh Sa'ad Al-Abdullah Al-Sabah, the Crown Prince and the Prime Minister.

We were glad to meet you during your visit to London and discuss the working and operational conditions in the KIA - particularly KIO in London. Also our discussion regarding the resignation of Mr Yacoub Yousef Al-Humaidhi from the Executive Committee in London and the content of his resignation letter that included some very serious concerns. A copy of this letter is attached for your attention.

Your Highness the Crown Prince.

The participation in the responsibilities of the KIA was far from easy. On the contrary, it required a great deal of effort and perseverance in addition to a high degree of patience and flexibility without compromising the minimum requirements imposed and necessitated by the great nature of the responsibility entrusted upon us, the members of the board of directors and the Executive Committee, aimed at guarding the funds of the General Reserves and the Reserves of the Future Generations, and achieving growth of these funds within the guidelines and bylaws agreed by KIA's board of directors.

And with regard to the above objectives we would like to raise your attention to the following:

1) Under Management Account.

The account was established in 1979 with \$150 million and is managed by the President and Vice President of the London office and supervised by only one person. The funds in this account have been increased on annual basis and currently stand at \$1,900 million that is kept at Lombard Odier and Volksbank. Further, this account is not subjected to revisions made by KIA's accounting department or the internal auditor. The return on this account did not exceed an annual average of 15.5% between 1979-1987, and an average of 7% between 1988-1990. The annual return on similar assets to those included in this account for the same time periods was estimated at 12-18% according to different market indices and assets.

2) Currency and Indices Speculations.

Until July 1990, the firm specialised in the above activities in the Bahamas was not dissolved in spite of Minister of Finance and the Executive Committee's request to do so due to the very high risks associated with such activities and the Office's previous experiences that led to huge losses in the Future transactions. Such transactions led to huge profits for the foreign partner from currency speculations and very limited returns to the Office in addition to its financial and

legal commitments. The capital of the firm is set at \$500 million. In December 1989, the Executive Committee decided on terminating and dissolving the account.

3) Torras Holdings

\$1 million has been invested in the company and the shareholders were purchased based on recommendations by the Office on the viability of the firm and the restructuring possibilities in case of a complete take-over. However, in May, the Office provided the company with \$450 million due to the latter's low liquidity after the reduction of the credit lines provided to the company by some banks. Neither complete facts truth nor proper justifications were provided for such financing and no approval was obtained from the Executive Committee.

4) Real Estate Project in Arizona.

\$175 million has been invested in this project representing 45% stake in a partnership with an American partner. Recently, the project was declared enviable and it was bought at a much higher price than it actually worth. The American partner has also been investigated and tried by the American authorities and all his relevant ventures, including our partnership, were under scrutiny. It has been disclosed that the partner has paid \$17 million, through a Swiss bank, for facilitating the completion of sale to the Office.

5) Fosterlane Company, USA.

Fosterlane Company participates in real estate projects with the partner Gerald Hines who owns 20% of the value of all the real estate projects that exceed \$1,200 million in value without contributing any assets in the capital of these projects. The agreement with the partner has been modified so that the Office forgoes its priority in income distribution (at 8%) in return for concessions that do not match the return priority which is considered to be indispensable condition with financial and legal importance for investments.

6) London Bridge City Venture.

The management of the Office decided to invest in the second phase of this project that is estimated to cost £500 million. No sufficient information or consulting sources for evaluating this project was available within the decision making channels despite being essential elements of the norms of operation within the Office. The project was presented to the Executive Committee based on demands by the former Finance Minister. The committee rejected it.

7) Participation in DowHeng Bank.

The Office participated with \$50 million in this bank plus transferring deposits worth \$150 million. The Office was asked to get rid of its participation in this bank due to the exposure of many of these deposits and financial transactions

with the bank without proper consideration to financial position or risks involved. The Office also acquired shares in another bank without the Executive Committee's knowledge and approval. And according to the external auditor's report, Mr Fouad Jaffar the former manager, was found to own shares in DowHeng Bank.

8) Dealings and Trading in Financial Securities.

It has been discovered that many trading transactions in financial securities were conducted without following the procedures and documentation requirements needed to register and authenticate these transactions at the time of trading. The internal auditor showed concerns and reservations on the manner of these deals due to the massive size of these dealings that exceeds \$20 billion.

9) General Motors Building, New York.

More than \$200 million has been invested in this building, however, the correspondence and communications between Fosterlane's board member in the US Mr Saleh Al-Zouman and the head of the company's board of directors and the president of the Office show that not all the financial and technical issues needed for investment evaluation of the project were considered.

10) Western Resources.

More than \$300 million was invested in this company that was thought to be over-priced. The company is a petroleum business and is not listed at the stock exchange.

11) Investment in Portugal.

\$40 million was invested in some Portuguese firms through the Spanish partner without the knowledge and approval of the Executive Committee.

12) The decisions and recommendations of the former Finance Minister and the Executive Committee were not implemented with regard to delegation and allocation of roles and specialisation among the Kuwaiti leaders within the Office. The latter were kept away from the actual investment activities.

13) Failing to present the monthly and quarterly accounts and to the Executive Committee and not applying the committee's decision regarding the full and continuous revision of direct investments by the auditor including the Spanish Torras Group in order to clarify ambiguities and cover-ups.

14) Liquidating large portions of the securities portfolio managed by the headquarters and transferring them to the Office's cash portfolios in London in order to manage them without the knowledge of the Executive Committee and board of directors.

15) No meetings of the board of directors and the Executive Committee were held since last July despite the presence of the majority of the members abroad. The role of the Executive Committee and the board was frozen during that period as they were not involved in any decision. The decisions were made by the head of the board of directors, the Minister of Finance.

16) Using the services of people from outside the London office and members of the head office abroad and appointing the former general manager of the London office as a consultant for the London office in defiance of the decisions of the Executive Committee and board of directors. He continues to represent the Office in the board of directors of several companies in spite of the Executive Committee's decisions with regard to this issue.

17) In spite of the Amiri Decree on 21-11-1990 with regard to the renewal of the appointment of the board of directors of KIA for another three months, the head of the board of directors, the finance minister, failed to inform us about such a decision which we just discovered during our meeting with your Highness.

18) The Office failed to follow the standards set out for the selection of the brokerage houses and the size of the dealings with them according to the working bylaws and procedures within the Office aimed at distribution of risk.

19) The Office failed to follow the working procedures and bylaws regarding the membership of the board of directors in different companies and the invitation of the Kuwaiti members to attend the meetings within these companies.

We hope, your Highness, that we have managed to present before you some of the facts and problems that highlight the serious situation in this very important institute. These abuses clearly show the absence of good will and intentions and lack of cooperation on the side of the head of KIA's board of directors, the Minister of Finance, and the board of directors of KIO in London.

As a result, we find ourselves unable to continue to serve as members of the KIA as remaining there will hold us responsible under the current circumstances and these practices for decisions that we have never participated in and we lack full knowledge about.

Your Highness the Crown Prince, we were always and still are ready to serve our dear country.

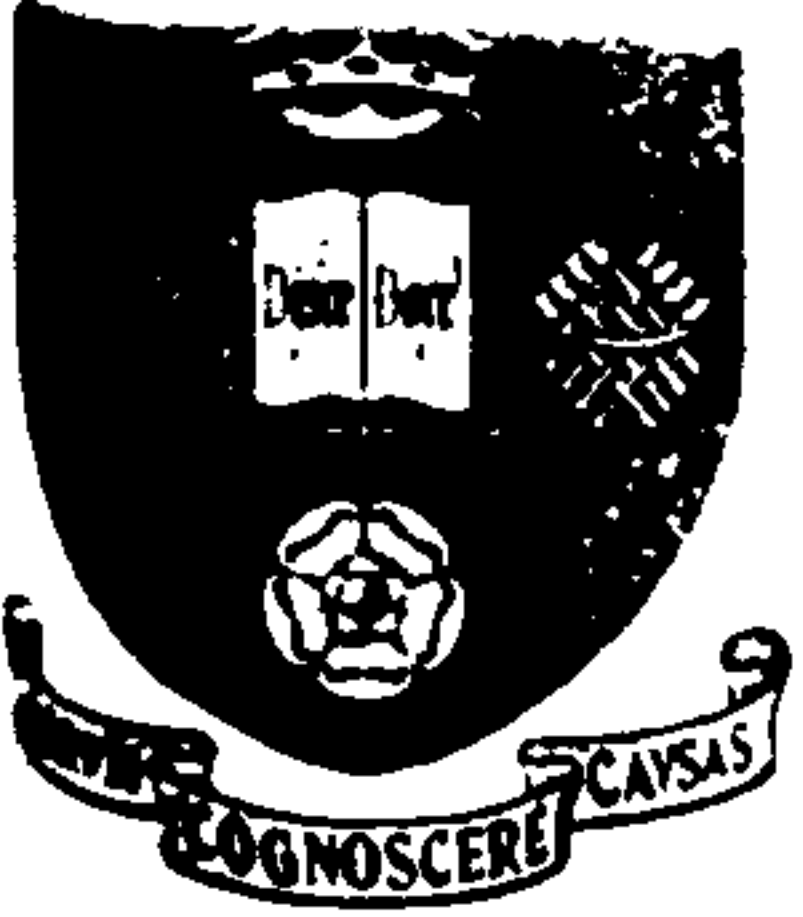
Yacoub Yousef Al-Humaidhi

Fahed Abdul Rahman Al-Baher

Dr. Fahed Mohammed Al-Rashed

Source : Al-Qabas, 6/1/1993, p. 9.

Appendix 2



Department of Accounting & Finance
Department of Business Studies
Department of Economics

Chairman: Dr F A Fretwell-Downing
Director of Teaching: Mr G P Marshall
Head of Department: Professor D I Owen
Head of Department: Professor R I Payne
Head of Department: Professor S Holly

12 April 1996

Head of Audit
KPMG Peat Marwick
8 Salbusry Square
London EC4Y 8BB

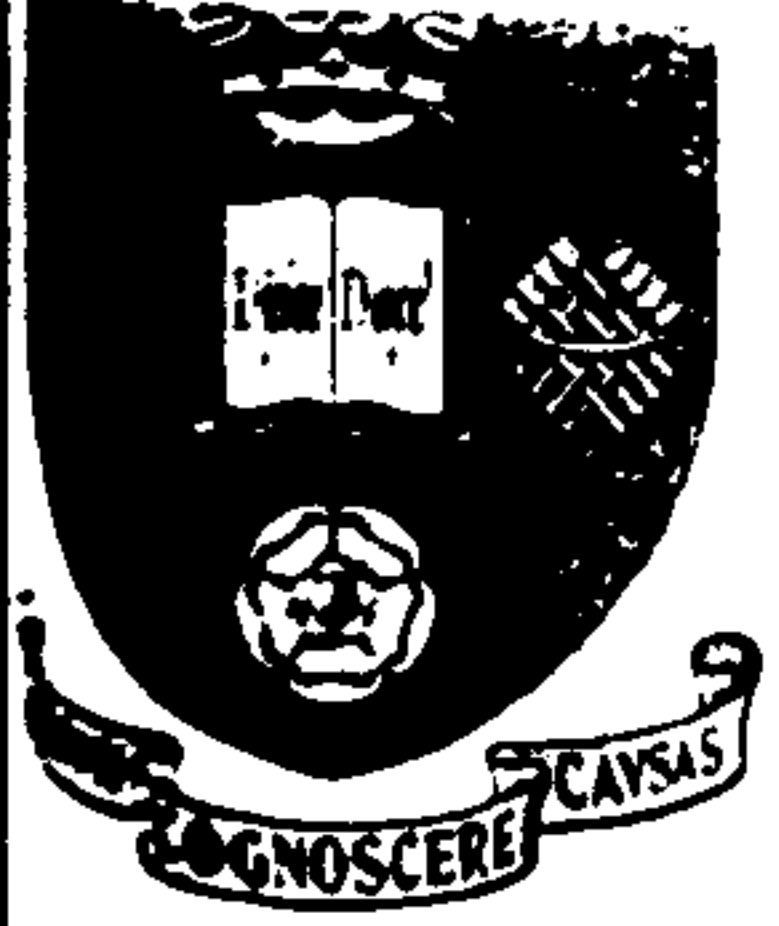
Dear Sir

I am a doctoral student in the Management School at Sheffield University and I am currently conducting research, with Professor Christopher Humphrey, on the role of accounting and auditing in processes of corporate governance in the Kuwait Investment Office (KIO). An important element of my work is concerned with a historical examination of the development of auditing in both KIO (in Kuwait and London) and in KIO's Spanish subsidiary, Grupo Torras.

From my research to date in Kuwait, Spain and Britain, it appears that KPMG was the auditor of KIO between 1952-79 and has been the incumbent auditor since 1986, although this position is disputed in some newspaper articles. It has also been stated that KPMG carried out an examination of Grupo Torras's financial position in 1991 and 1992.

I am writing in this instance to enquire whether it would be possible for me to visit your offices in London to hold a short interview with a relevant member of your staff. I am aware of a number of criticisms in the Kuwaiti and Spanish press of the role of auditors in KIO, but, unfortunately, I have been unable to come across much information which puts the auditors' side of the story. It would be a great help to me, especially in terms of ensuring that I present a balanced and informed view of the case, if I could speak with someone in KPMG who has been involved with KIO.

The issues I am mainly concerned with are largely factual and concern the need to clarify the nature of KPMG's involvement with KIO, in particular its responsibilities with respect to the



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audit of KIO and the extent to which such responsibilities involved KPMG in auditing transactions between KIO and Grupo Torras. I would anticipate any interview lasting no more than 40 minutes and I could provide a list of my questions in advance.

Thank you for your kind attention to this matter and I look forward to hearing from you in the near future.

Yours faithfully,

Walid Ali Husaini



Department of Accounting & Finance
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31 May 1996

Mr David Smith
PO Box 695
8 Salisbury Square
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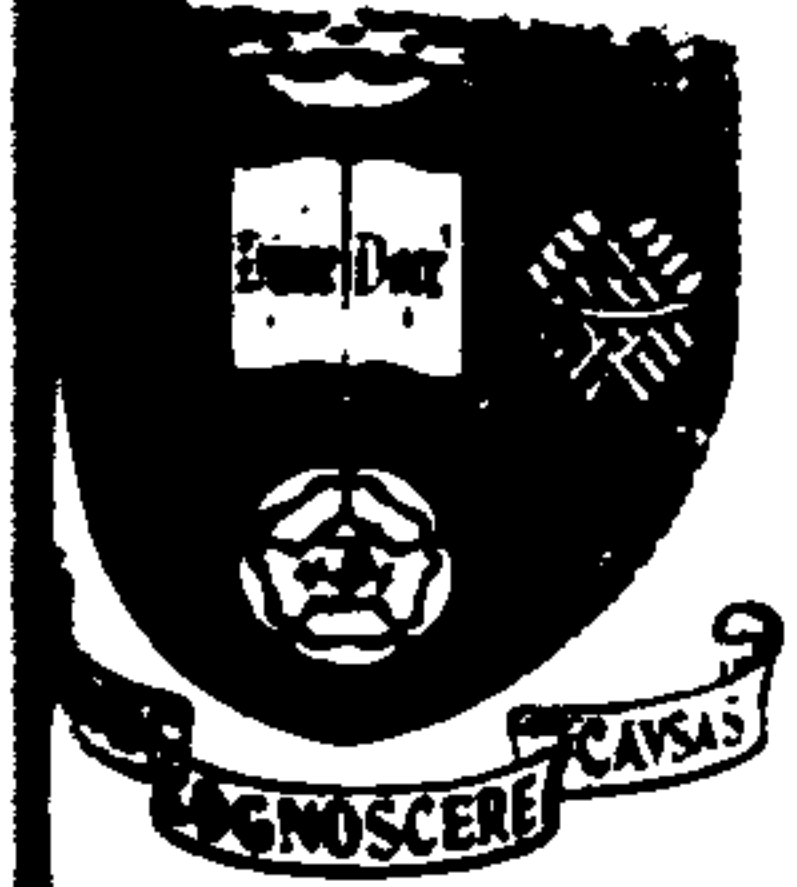
Dear Mr Smith.

I am writing with regard to Mr Gerry Archer's letter (dated 23/4/96) which stated that I could expect to hear from you concerning my request for certain information regarding KPMG's involvement with the Kuwait Investment Office (KIO).

I would like to emphasize that I appreciate the issue of client confidentiality. However, I think that there are a number of factual matters that could be answered without any breach of client confidentiality. These are as follows:

1. From what date and until when were KPMG the external auditors of KIO?
2. From what date and until when were KPMG the external auditors of KIA?
3. Did any audit role involve KPMG commenting on the truth and fairness of KIO/KIA's financial statements?
4. Did KPMG ever assist in the preparation of financial statements for either KIO or KIA?
5. Did KPMG ever had a joint external audit responsibility with Kuwait Audit Bureau for the external audit of KIO/KIA?
6. Has KPMG ever had any responsibility for auditing Grupo Torras in Spain?
7. Why did the Spanish government demand the removal of KPMG as the receiver for Grupo Torras?
8. The Kuwaiti parliamentary committee investigating the Grupo Torras affair claimed that KPMG did not present their audit report of KIO for the years 1990 and 1991? Is this true? and, if so, why were KPMG's reports were not presented?
9. Does KPMG offer consulting services to KIO (Taxation, Management Advisory Services)?

I am sure you will agree that answering the above factual questions is not damaging to any client confidentiality. Your answers will help to ensure that my thesis on KIO is accurate and not misleading. I would be very willing to visit you in London if it easier for you to discuss these matters fact to face. I also have some questions relating to the



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establishment and development of KPMG's audit practice in Kuwait. These are as follows:

- ◆ What was the role of KPMG in relation to foreign oil companies (e.g. Shell; BP and Gulf Oil) working in the 1950's in Kuwait?
- ◆ What motivated KPMG to establish an office in Kuwait in 1975?
- ◆ Why did KPMG close their office in Kuwait in 1981 and then re-establish another one in 1986?

I would really like to hear from you soon with regard to the above matter. Thank you, in advance, for your kind attention and effort.

Yours sincerely,

Wahid AlHusaini



Department of Accounting & Finance
Department of Business Studies
Department of Economics

Chairman: Dr F A Fretwell-Downing
Director of Teaching: Mr G P Marshall
Head of Department: Professor D I Owen
Head of Department: Professor R L Payne
Head of Department: Professor S Holly

25 June 1996

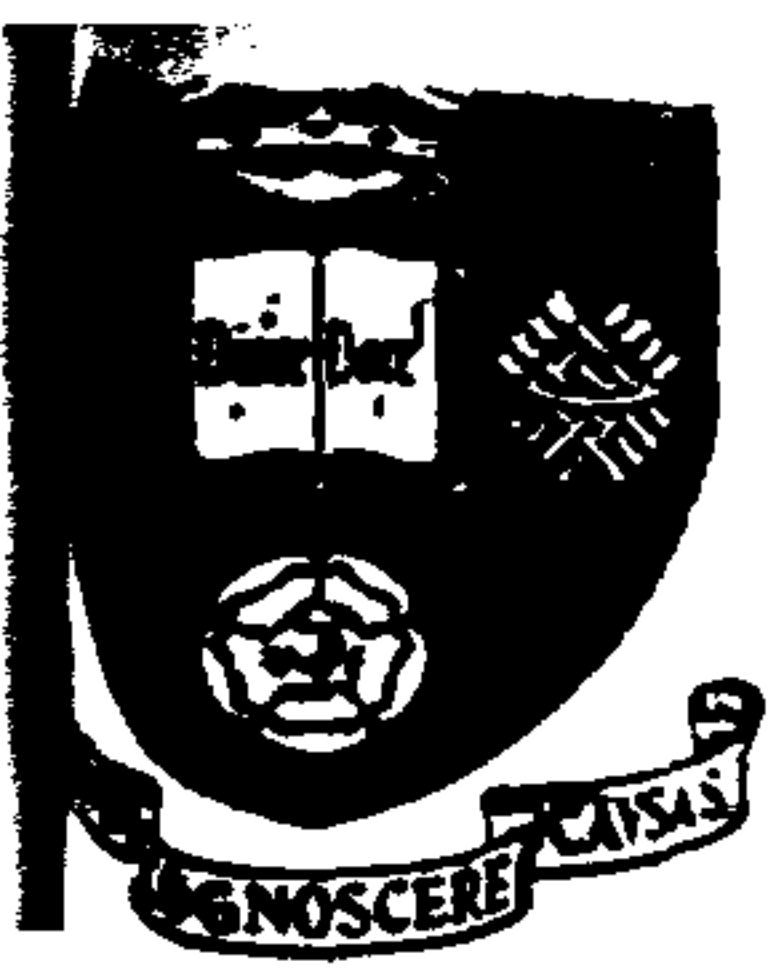
Mr Ali A Al-Bader
Managing Director
Kuwait Investment Authority
P.O.Box 64
Safat, 13001
Kuwait

Dear Mr AlBader,

I am a Kuwaiti doctoral student at Sheffield University Management School conducting a research project with Professor Christopher Humphrey on the role of accounting and auditing in processes of corporate governance and accountability at the Kuwait Investment Office (KIO). A major part of my research is concerned with examining the history of auditing in both KIO (in Kuwait and London) and in KIO's Spanish subsidiary, Grupo Torras.

I have contacted KPMG in London to clarify the nature of their involvement with KIO in order to present a balanced view of the case. However, KPMG suggested that I should be in a direct contact with KIA to acquire such information. Therefore, I am enclosing a list of questions that I have presented to KPMG which I think are related to factual matters and do not breach KPMG's client confidentiality. These are as follows:

1. From what date and until when were KPMG the external auditors of KIO?
2. From what date and until when were KPMG the external auditors of KIA?
3. Did any audit role involve KPMG commenting on the truth and fairness of KIO/KIA's financial statements?
4. Did KPMG ever assist in the preparation of financial statements for either KIO or KIA?
5. Did KPMG ever had a joint external audit responsibility with Kuwait Audit Bureau for the external audit of KIO/KIA?
6. Has KPMG ever had any responsibility for auditing Grupo Torras in Spain?
7. Why did the Spanish government demand the removal of KPMG as the receiver for Grupo Torras?
8. The Kuwaiti parliamentary committee investigating the Grupo Torras affair claimed that KPMG did not present their audit report of KIO for the years 1990 and 1991? Is this true? and, if so, why were KPMG's reports were not presented?
9. Does KPMG offer consulting services to KIO (Taxation, Management Advisory Services)?



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I am confident that you will agree that addressing these factual questions in no way breaches KIA regulations. I would be very willing to visit you in Kuwait or London if it is easier for you to discuss these matters personally.

I would really like to hear from you soon with regard to the above matter. Thank you, in advance, for your kind attention and effort.

Yours sincerely,

W. ALHUSAINI

Walid AlHusaini.

Appendix 3

Appendix 3 - Chronology of ICAC's Process for Sanctioning Coopers & Lybrand

Date	Action
9 March 1993	The presidency of ICAC informed C&L that it was starting a technical investigation relating to C&L's 1990 & 1991 audits of GT
8 June 1993	C&L wrote to ICAC formulating their response to the charges
11 June 1993	ICAC wrote to C&L informing the firm that an agreement had been reached to file for sanctioning after the technical control process relating to the 1990 audit had been concluded Findings of the technical control and the corresponding response were presented in six charges that were potentially constitutive of a breach in some of the articles of Audit Law 1988
27 August 1993	ICAC requested an opinion from CNMV concerning the sixth charge
7 September 1993	ICAC received CNMV's response and sent a copy of that response to C&L
3 September 1993	C&L respond to ICAC formulating the same response to the charges (expressed previously on 8 June 1993) and requesting the dismissal of all charges
22 October 1993	The instructor at ICAC formulated a proposed resolution, retaining all the charges except the fifth one
12 November 1993	C&L made another response after being informed by ICAC of the proposed resolution, requesting a technical opinion on the charges from one of the professional bodies in Spain
9 December 1993	C&L present to ICAC a report prepared by REA concerning the charges
9 December 1993	The proposed resolution and the corresponding allegations and other documentation were submitted to the Advisory Committee of ICAC for consideration
21 December 1993	C&L submitted to ICAC a report by ICJCE relating to the charges
7 January 1994	ICAC sanctioned C&L for their 1990 audit of Grupo Torras

Appendix 4

Appendix 4 - Main Findings of ICAC's Investigation of Coopers & Lybrand

While the auditors specifically claim that article 16.2.c of Law 19/1998 might be unconstitutional, ICAC responded that even though the question of constitutionality was not relevant in these proceedings, the issue was resolved by the constitutional court in 1989. The auditors alleged that "the guilt principle requires the existence of fraudulent conduct or culpability in performing the violation" and the "conviction principle" requires the presumption of innocence. ICAC responded that the Law 19/1988 does not propagate a special requirement of deceit, blame or other circumstances for establishing the non-fulfilment of the auditor procedures that could cause economic prejudice to third parties or to the company being audited.

The first charge:

The first charge was related to £100m convertible bond into Torras Hostench shares issued in July 1988 by Phoneix Finance International Ltd and due in 1998. ICAC claimed that the Pts3bn provision prepared by GT to meet the potential losses that it might incur as result of the guarantees it offered for the convertible bond was underestimated. The auditors in their response to ICAC's charges indicated that the provision for the guarantees was established as follows:

Provision =	The total risk	-	Projected shareholders'	Pts6bn guarantee by
	(bonds and interest)		equity value of Phoenix to the date of redemption	- companies holding shares in GT

ICAC attributed the deficit in the provision to two factors. The first factor was related to the financial capacity of Phoenix that was based on the value of its shares in a Prima Inmobiliaria portfolio, which was estimated on the basis of a projection of value of the real-estate assets of Prima to the date of redemption of the bonds in 1998. ICAC indicated that such projection presumably recognised probable future benefits to the value of those assets in 1990. This consequently affected GT's financial statements of 31/12/1990 as it led to a decrease in the above provision, which constituted a clear non-compliance with the "prudence" concept. C&L responded that there is more than one method for calculating the provision, while ICAC countered that the method adopted by GT was in no way acceptable because it did not comply with the prudence principle.

ICAC had another problem with the way C&L accepted the validity of the guarantees of Pts6bn granted by two companies (PHILIBY and CAOS) that held shares in GT. C&L based its decision on the evaluation of the payment capacity of these two companies and the support of KIO, which C&L considered as fundamental. ICAC's examination revealed that the evaluation study in C&L's working papers of the capacity of these two companies only showed the following:

Assets	Liabilities
Grupo Torras Shares	Loans from Grupo Torras to finance the acquisition of GT shares

Moreover, the technical control report issued by ICAC indicated that both companies did not have the ability to meet the guarantees. In addition, ICAC concluded that the guarantees did not exist given that four companies owned by de la Rosa, Philiby, CAOS, Mira and Folma, were under contract with GT to buy the group's shares and then sell them to GT. C&L's claim that the support of KIO was prominent in accepting the reduction in the provision did not seem credible. Although, ICAC claimed that it did not find evidence of that support in the auditors work papers, C&L referred to a letter from KIO dated 3/3/1992. ICAC dismissed this letter pointing out that GT's financial statements were issued in 20/6/1991 and therefore there was no way that C&L would have used this letter as evidence in their audit.

Accordingly, ICAC found C&L's failure to include a qualification in its report given the different problems with provisions as representing non-compliance with the Technical Procedures on Reports, issued by ICAC's resolution of 19 January, 1991, especially in relation to points 3.6.3 and 3.6.4 on opinions with qualifications and to points 3.7.5 and 3.7.6 that regulate the "mistakes or non-compliance with generally accepted accounting principles and standards" as circumstances with possible effect on the opinion of the auditor.

The Second Charge

This charge related to the transfer of some of GT's loans so that they appeared as capital increases. GT received from its principal shareholder, KIO, loans for a total amount of Pts167,499,643,664 in 1990 (as detailed in Table 1). The notes of GT's 1990 accounts revealed that the principal shareholder intended to seek approval from the Extraordinary General Board of GT (to be held in July 1991) to transfer a large amount (Pts162,912,190,000) of these loans to capital. Accordingly, an amount of Pts115,413,549,589¹ was capitalised through a charge to reserves in the balance sheet of the 1990 accounts. Then out of this amount, which was set for future capital increases, GT deducted Pts14,472,629,000 from the share premium account and transferred this to THL to settle obligations towards third parties.

Table 1 - Calculation of How Loans were Transferred to Capital Increase

¹ Even though the principle shareholder sought approval for transfer of Pts162,912,190,000 into capital. The only capitalised amount in the financial statements of 1990 was Pts115,413,549,589 (80,000,000,000 + 35,412,549,589) as these loans were expired in 31 December 1990, while the Pts47,499,640,411 was not expired during that year.

	Loans Received by GT	To be Converted to Capital
Loan in September 1990	80,000,000,000	80,000,000,000
Loan in October 1990	40,000,000,000	35,412,549,589
Operation of Letters transfer by the Spanish Public Exchequer	47,499,643,664	47,499,640,411
Total	167,499,643,664	162,912,190,000
Charged to 1990 reserves as contributions for future capital increases		115,413,549,589
Transferred to Torras Hostench London		14,472,629,000

C&L explained that during the drafting of documentation for transferring liabilities to capital, the whole debt was capitalised then an amendment were made to the share premium account. In other words, initially capitalisation was for the whole amount and then an amount was transferred to the account of THL with the balance being charged to reserves. ICAC claimed that this treatment was right when priority were given to substance over form. However, rectifying the credit to the reserve account through the profit and loss account might not been the right treatment given that the company at all times acted as an intermediary.

ICAC saw the auditor's failure to make an exception in their report as a non-compliance with the technical procedures on reports published by ICAC, especially points 3.6.3, 3.6.4, 3.7.5, 3.7.6.

The Third Charge

The issue involved here was that GT made an adjustment in the annual accounts of 1990 which showed a 35% reduction in its own funds as of 31 December 1989 in comparison to what was reported in the annual accounts of 1989. Consequently, the Balance Sheet and the Profit and Loss accounts of 1989 (reproduced in the 1990 accounts for comparison purposes) differed from the ones originally issued in the annual accounts of 1989.

	1989 Figures as published in 1989 accounts	1989 Figures as published in 1990 accounts
Share Premium Account	Pts 67,573	Pts 35,072
Profit for the year	Pts 5,665m	Pts 7,477

C&L's response opposed ICAC's resolution proposal and supported their position by making reference to the EU VII Directive's guidelines and to the International Accounting Standard, No.22. ICAC dismissed C&L's claim indicating that such standards can not be adopted when there are local standards that can be applied. Moreover, ICAC claimed that these standards dealt with consolidated accounts and could not be applied to what was under examination as these were "individual accounts". Even though, C&L claimed that the

adjustment did not affect the 1990 accounts, ICAC indicated that, since GT did not issue new financial statements for 1989 to introduce such adjustments, there was no other understanding other than that the adjustment affected the 1990 financial statements.

Accordingly, ICAC concluded that the adjustment did not comply with GAAP and that it would have affected the accounts of 1990. Furthermore, the failure by C&L to make an exception in their report with regard to this issue resulted in their non-compliance with ICAC's technical procedures on reports, especially points 3.6.3, 3.6.4, 3.7.5, 3.7.6.

Fourth Charge

The focus of this charge related to the contract between Grupo Torras and four companies owned by de la Rosa to buy and sell GT's shares. Under this agreement GT had a commitment with four companies (Philiby, CAOS, Mira and Folma) to buy all the 21,960,553 GT shares they held at the date of signing the contract. In addition, GT were also obliged to buy all the shares acquired by these companies at the date of execution (between 1 and 10 December 1992).

ICAC did not consider the contractual relationship between GT and the four companies as a merely "unilateral promise", as has been claimed by the auditors.

The purchase price for the 21,960,553 shares was Pts47bn. These companies were also indebted to GT by the same amount of Pts47bn.

C&L working papers incorporated a legal report in which an attorney argued that the funds intended for the acquisition of GT shares did not leave GT, meaning that the transaction was not prohibited by article 81 in the Formulated Text on Company Law. ICAC said that it was not possible to accept this legal report as evidence to support the auditor's acceptance of the validity of the transaction.

ICAC's investigation of the contract and the operation that surrounded it led ICAC to conclude that GT had given financial assistance for the purchase of its own shares through these companies. ICAC attributed the motivation behind these operations as being to avoid the limits with respect to companies acquiring their own shares as established by articles 74 of the reformulated text on company law. The investigation also revealed that a memorandum in the auditor's working papers showed that there was as many shares in GT's hands as in the hands of the four companies. Accordingly, ICAC indicated that given that the auditors did not make reference to the non-compliance with section 4 chapter 4 of the reformulated text on company law, there was a non-compliance with article 209.1 of this law.

The price of acquiring GT's shares conveyed in the contract between GT and the four companies was higher than the accounting net value that corresponded to them. However, when considering the capital increase to take place in the year 1991, this situation was indicative of a loss of shareholder's equity for Grupo

Torras, S.A. – a loss that the auditors should have declared in their report, unless they had obtained evidence that shares could be sold at an equal price or higher to that of acquisition. However, such evidence did not exist in the auditor's working papers. Nevertheless, the auditors did not include in their exception report in this regard, which constituted a non-compliance with ICAC's Technical Procedures on reports (published on 19th of January 1991), especially in relation to points 3.6.3, 3.6.4, 3.7.5 and 3.7.6.

The Sixth Charge:

ICAC claimed that the working papers of C&L revealed that they had detected an undervaluation of Pts4.5bn in the portfolio provisions of the annual accounts of Grupo Torras for 1990. However, C&L made no reference to this in their audit report. The failure of C&L to make an exception in their report concerning this issue meant that the firm did not comply with ICAC's technical procedures, especially 3.6.3, 3.6.4, 3.7.5. and 3.7.6.

REA's response to ICAC report

1st Charge

REA stated that the consolidated accounts of the final shareholder are only representative in the case of interrelated groups. ICAC responded that it might be theoretically valid but it is the not position of the regulations to distinguish between the consolidated and individual accounts. Moreover, ICAC indicated that other aspects should have to be taken into account in the case of consolidated financial statements, aspects that REA had failed to highlight.

2nd Charge

REA asserted that even if the right accounting procedures had been followed it would not changed the results for the year. ICAC disagreed with this statement indicating that the payment of Pts14,472,629,000 represented lost funds and should have been recognised in the profit and loss account. The way the transaction was reported was seen by ICAC as absurd, giving two outcomes for the transaction – an increase in capital, then a transfer to meet obligations

3rd Charge

ICAC thought that REA had used a limited basis in reaching the conclusions in its report. REA claimed that the loss in value of the financial investments was reported before the 1990 accounts – but ICAC said it did not find any supporting evidence for such a claim.

4th Charge

ICAC refused to comment on REA's claim that there does not seem to exist non-compliance in the accounting or in the annual accounts of the Company as of 31st December 1990 with legislation on a company's own shares and the provision of financial assistance for the acquisition of such shares - given that REA did not provide any reason for such a claim. ICAC also thought that REA provided little justification with respect to the possibility that shareholder's equity will decrease as a result of the financial assistant given by GT to acquire its own shares.

6th Charge

REA denied the existence of an overvaluation of shares in Prima Inmobiliaria citing as an evidence that C&L-London, THL's auditor, did not mention such an overvaluation and the existence of an agreement between the related parties. ICAC responded that acceptance of the first argument indicates admission that an auditor knowing a situation affects the financial statements had not taken any action in this regard, in order to protect the report of another auditor. With respect to the existence of a private agreement, the working papers of the auditor at no time mentioned such a point. On the other hand, communications sent to the CNMV and the commentaries collected in the working papers seem to infer that the shares in Prima Inmobiliaria were overvalued.

ICJCE's Response to ICAC

ICJCE did not disapprove of the charges laid down by ICAC but rather made reference to alternative accounting criteria that could have been employed by GT. They also refrained from commenting on the performance of auditors in reference to the criteria adopted by GT. Their response to the fourth charge was to emphasise its strictly legal aspect and to refer, as evidence, to documentation showing the subsequent date of the issue of the audit report.

Appendix 5

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January 15, 1997

To whom it may concern:

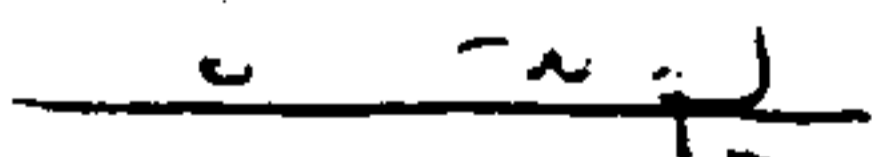
Mr Walid Abdullah AlHusaini holds a scholarship from Kuwait University to study for the Ph.D. degree of accounting at University of Sheffield in Britain. He is going to examine the role of auditing in processes of corporate governance and control in Kuwait's companies and financial institutions. His study will partly focus on the involvement of auditors, from the auditing firms and the audit bureau, in the activities of Kuwait Investment Office (KIO).

Mr walid will distribute questionnaire to users of financial statements, directors, and auditors, from both the auditing firms and the audit bureau, to elicit the perceptions and expectations of these groups towards the work of the external auditor in Kuwait. In addition, the survey will seek the views of these groups on KIO's investments in Spain.

I would really appreciate if you can help Mr. Walid distribute and fill the questionnaire as his study is vital for the development of accounting profession in Kuwait and the protection of the public funds.

Thank you for your cooperation

Best regards,


Dr. Yousef Al-Ebraheem
Dean
College of Administrative Sciences



EXPECTATION OF AUDITORS IN KUWAIT AND THE ROLE OF AUDITING IN THE KUWAIT INVESTMENT OFFICE INVESTMENTS IN SPAIN

We are conducting research at the University of Sheffield in England on the role of auditing in processes of corporate governance and control in Kuwait's companies and financial institutions. A part of this study is focusing on the involvement of auditors from audit firms and the Audit Bureau in the activities of the Kuwait Investment Office (KIO).

This questionnaire seeks to examine your general perceptions and expectations of external auditors in Kuwait and to elicit your specific views regarding KIO's operations in Spain through its involvement in the Spanish holding company, Grupo Torras (GT). In some parts of the questionnaire, you are required to express opinions on the respective work of external audit firms and the Audit Bureau. The questionnaire is also being sent to financial directors and users of financial statements and auditors from the Audit Bureau and the study will seek to draw comparisons between the views of different respondents.

Responses to the questionnaire will be treated with complete confidentiality and will be reported in the form of general statistical summaries. These will not attribute responses to any named individual.

We estimate that filling in the questionnaire will take less than 25 minutes of your time. The questionnaire will be collected by Walid AlHusaini within a week. (After completing the questionnaire, please return to Walid AlHusaini in the stamped addressed envelope provided-*this only for the ones that I will send by mail*)

If you need more information on completing the questionnaire or have comments on it, please contact Walid AlHusaini at the following address:

Accounting Dept., Kuwait University,

P. O. Box 5486, Safat 13055, Kuwait.

Tel. 2543618 - Fax. 2533382.

Your contribution is vital to the success of this study and is greatly appreciated. Thank you very much for your valuable time.

WALID A. ALHUSAINI
RESEARCH STUDENT
MANAGEMENT SCHOOL
UNIVERSITY OF SHEFFIELD
UNITED KINGDOM

PROFESSOR CHRISTOPHER HUMPHREY
SUPERVISOR
MANAGEMENT SCHOOL
UNIVERSITY OF SHEFFIELD
UNITED KINGDOM

DISTRIBUTION OF THE RESULTS OF THE SURVEY

We would be very happy to make results of the survey available to you. Should you require a copy of such results, please fill in your name and address below.

This form will be detached as soon as it received and will be filed separately. You can also send it separately if you like.

Name

Address.....

.....

.....

General Directions for completing the questionnaire: Throughout the questionnaire, you will be required to **circle** numbers to indicate your opinion concerning particular statements and questions. For example, in the **first set** of questions below you are required to indicate the extent of your agreement with certain statements **about** auditing. If you strongly disagree with the statement circle 1, while if you disagree with it to a lesser extent circle 2 or 3. If you strongly agree with the statement circle 7, while if you agree to a lesser extent circle 5 or 6. If you neither agree nor disagree circle 4 and if you don't know circle 8.

A. QUESTIONS RELATING TO AUDIT FIRMS IN KUWAIT

1. The following statements have been made about external auditors and the auditing process. Please circle a number for each statement to indicate the extent of your agreement.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
1. The quality of company audits has increased since the Manakh crises of 1982	1	2	3	4	5	6	7	8
2. Too much is expected of auditors by the investing community	1	2	3	4	5	6	7	8
3. Auditors are too concerned with keeping company management happy	1	2	3	4	5	6	7	8
4. The auditing process is seriously weakened by imprecise accounting standards	1	2	3	4	5	6	7	8
5. An audit is of very little benefit to a company	1	2	3	4	5	6	7	8
6. Audits generally take too long to complete	1	2	3	4	5	6	7	8
7. Auditors do not understand the problems of business	1	2	3	4	5	6	7	8
8. Audits provide significant protection against fraud	1	2	3	4	5	6	7	8
9. Auditors should be identifying ways to improve management efficiency	1	2	3	4	5	6	7	8
10. Auditors should report to shareholders on management efficiency	1	2	3	4	5	6	7	8
11. Auditors are not made adequately accountable for their work	1	2	3	4	5	6	7	8
12. Friendships and relationships with senior corporate management usually govern the appointment of external auditors	1	2	3	4	5	6	7	8

2. Please indicate the extent to which you agree that the company's external auditors should have a legal responsibility to the following groups for any loss arising from their reliance on the audited financial statements.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
1. Existing shareholders?	1	2	3	4	5	6	7	8
2. Potential shareholders?	1	2	3	4	5	6	7	8

3. Please indicate what you think of the following propositions concerning the role that should be played by the external auditor.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
The auditors' role with respect to the audited company should be to ensure that:								
1. all significant fraud is detected	1	2	3	4	5	6	7	8
2. company financial statements contain no significant deliberate distortions	1	2	3	4	5	6	7	8
3. a satisfactory system of internal control is being operated	1	2	3	4	5	6	7	8
4. the future viability of the company is not in doubt	1	2	3	4	5	6	7	8
5. the company is being run efficiently	1	2	3	4	5	6	7	8
6. the appropriate regulatory authorities have been informed of any significant malpractice	1	2	3	4	5	6	7	8
7. the company's accounts give a reliable indication of its market value	1	2	3	4	5	6	7	8

4. A 1994 amendment to the Kuwait Commercial Companies Law (Article No. 161) requires that companies listed on the Kuwait Stock Market must be audited by two independent audit firms (instead of one as under the previous law). Please indicate to what extent you agree or disagree with the following related statements.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
1. Having two external auditors will make the detection of material fraud and errors much easier	1	2	3	4	5	6	7	8
2. The appointment of two external auditors will enhance the overall independence of audit work	1	2	3	4	5	6	7	8
3. The use of two external auditors will limit either auditors' ability to obtain a clear picture of the financial position of the company.	1	2	3	4	5	6	7	8
4. The appointment of two external auditors will lead to unnecessary duplication of audit work	1	2	3	4	5	6	7	8
5. The requirement to appoint two external auditors will increase the share of the audit market held by large accounting firms in Kuwait	1	2	3	4	5	6	7	8
6. The appointment of two external auditors will generate no significant benefits for shareholders	1	2	3	4	5	6	7	8

5. The following propositions relate to the regulation of external audit firms. Please indicate to what extent you agree or disagree with each proposition.

	Strongly Disagree		Neutral		Strongly Agree		Don't know	
	1	2	3	4	5	6	7	8
Audit firms in Kuwait should:								
1. be able to provide management advisory services to their audit clients	1	2	3	4	5	6	7	8
2. be allowed to own shares in their audit clients	1	2	3	4	5	6	7	8
3. not be able to earn more than 10% of total income from any one audit client	1	2	3	4	5	6	7	8
4. have a specific time limit to act as an external auditor of any client (e.g. no more than 5 consecutive years)	1	2	3	4	5	6	7	8
5. be self-regulated instead of being regulated by the Ministry of Commerce	1	2	3	4	5	6	7	8
6. not act primarily to make a profit	1	2	3	4	5	6	7	8
7. have their appointment and fee determined by a body independent of the client company	1	2	3	4	5	6	7	8
8. have limited liability determined by statute	1	2	3	4	5	6	7	8
9. have their audit methods checked by a professional standards body	1	2	3	4	5	6	7	8
10. be required to be associated with a major international audit firm	1	2	3	4	5	6	7	8
11. not have close personal friendships with their audit clients	1	2	3	4	5	6	7	8

6. In relation to their external audit work, please indicate how successful you think audit firms in general at the following:

	Extremely unsuccessful		Neither successful nor unsuccessful			Extremely Successful		Not applicable
	1	2	3	4	5	6	7	8
1. Diagnosing problems	1	2	3	4	5	6	7	8
2. Prescribing remedies to problems	1	2	3	4	5	6	7	8
3. Acquiring information	1	2	3	4	5	6	7	8
4. Coping with risk and uncertainty	1	2	3	4	5	6	7	8
5. Predicting the future	1	2	3	4	5	6	7	8
6. Making a profit	1	2	3	4	5	6	7	8
7. Detecting errors and irregularities	1	2	3	4	5	6	7	8
8. Preventing errors and irregularities	1	2	3	4	5	6	7	8
9. Complying with professional rules	1	2	3	4	5	6	7	8
10. Enforcing legal requirements	1	2	3	4	5	6	7	8
11. Forming correct judgements	1	2	3	4	5	6	7	8
12. Acting independently without regard to self-interest	1	2	3	4	5	6	7	8
13. Communicating effectively	1	2	3	4	5	6	7	8
14. Reporting truthfully	1	2	3	4	5	6	7	8
15. Providing cost-effective audit investigations	1	2	3	4	5	6	7	8
16. Being even-handed with the interests of others	1	2	3	4	5	6	7	8
17. Limiting their own legal responsibility	1	2	3	4	5	6	7	8
18. Providing a useful service to corporate management	1	2	3	4	5	6	7	8
19. Providing a useful service to society	1	2	3	4	5	6	7	8
20. Providing protection for Kuwait's public funds	1	2	3	4	5	6	7	8

B-QUESTIONS RELATING TO THE AUDIT BUREAU IN KUWAIT

Directions: Questions in this section relate to the corporate audit work of the Audit Bureau in government owned companies (whether listed or unlisted on the Kuwait Stock Exchange) and other government profit seeking organisations (e.g. Kuwait Investment Authority (KIA), KIO).

1. In relation to its corporate audit work, please indicate how successful you think the Audit Bureau generally is at the following:

	Extremely unsuccessful		Neither successful nor unsuccessful			Extremely Successful		Not applicable
	1	2	3	4	5	6	7	8
1. Diagnosing problems	1	2	3	4	5	6	7	8
2. Prescribing remedies to problems	1	2	3	4	5	6	7	8
3. Acquiring information	1	2	3	4	5	6	7	8
4. Coping with risk and uncertainty	1	2	3	4	5	6	7	8
5. Predicting the future	1	2	3	4	5	6	7	8
6. Detecting errors and irregularities	1	2	3	4	5	6	7	8
7. Preventing errors and irregularities	1	2	3	4	5	6	7	8
8. Complying with professional rules	1	2	3	4	5	6	7	8
9. Enforcing legal requirements	1	2	3	4	5	6	7	8
10. Forming correct judgements	1	2	3	4	5	6	7	8
11. Acting independently without regard to self interest	1	2	3	4	5	6	7	8
12. Communicating effectively	1	2	3	4	5	6	7	8
13. Reporting truthfully	1	2	3	4	5	6	7	8
14. Providing cost-effective audit investigations	1	2	3	4	5	6	7	8
15. Being even-handed with the interests of others	1	2	3	4	5	6	7	8
16. Limiting their own organisational responsibility	1	2	3	4	5	6	7	8
17. Providing a useful service to corporate management	1	2	3	4	5	6	7	8
18. Providing a useful service to society	1	2	3	4	5	6	7	8
19. Providing protection for Kuwait's public funds	1	2	3	4	5	6	7	8

2. What do you think of the following propositions about the role that should be played by the Audit Bureau.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
The Audit Bureau's role with respect to its audits of government owned corporations and organisations should be to ensure that:								
1. all significant fraud is detected	1	2	3	4	5	6	7	8
2. Company financial statements contain no significant deliberate distortions	1	2	3	4	5	6	7	8
3. a satisfactory system of internal control is being operated	1	2	3	4	5	6	7	8
4. the company is being run efficiently	1	2	3	4	5	6	7	8
5. the appropriate regulatory authorities have been informed of any significant malpractice	1	2	3	4	5	6	7	8

5. From your understanding of KIO's involvement with GT in Spain, Please indicate the extent to which you agree or disagree with each of the following statements.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
1. In the "GT" affair, auditors generally placed too much reliance on the assurances of corporate management	1	2	3	4	5	6	7	8
2. Auditors should be legally liable for the collapse of KIO's investments in "GT" if their work was substandard	1	2	3	4	5	6	7	8
3. People responsible for the collapse of KIO's investments have not yet been held adequately to account	1	2	3	4	5	6	7	8
4. People responsible for the collapse of KIO's investments will never be held accountable.	1	2	3	4	5	6	7	8
5. Traditions of secrecy at KIO prevented auditors from detecting breaches in corporate law	1	2	3	4	5	6	7	8
6. Traditions of secrecy at KIO prevented auditors from reporting discovered breaches in corporate law to the appropriate authorities	1	2	3	4	5	6	7	8
7. International audit firms generally have the capacity to understand fully the type of complex investments and transactions undertaken by KIO	1	2	3	4	5	6	7	8
8. The Audit Bureau generally has the capacity to understand fully the type of complex investments and transactions undertaken by KIO	1	2	3	4	5	6	7	8
9. KIO's Spanish investment problems are an isolated incident, not reflective of the general way in which Kuwaiti institutions manage their investment portfolios	1	2	3	4	5	6	7	8
10. In Kuwait, power and good connections make it easy to get away with corporate fraud.	1	2	3	4	5	6	7	8
11. Scandals on the scale of "GT" and "Kuwait Oil Tankers Company" are likely to re-occur in Kuwait in the future	1	2	3	4	5	6	7	8

6. From your understanding of the KIO case, what degree of blame would you attach to the following bodies for the collapse of Grupo Torras (GT).

	No Blame			Some Blame			Total Blame	Don't know
	1	2	3	4	5	6	7	8
1. KIO's External auditors	1	2	3	4	5	6	7	8
2. GT's External auditors	1	2	3	4	5	6	7	8
3. Audit Bureau	1	2	3	4	5	6	7	8
4. Managers at Kuwait Investment Office	1	2	3	4	5	6	7	8
5. Managers at Grupo Torras	1	2	3	4	5	6	7	8
6. Managers at Kuwait Investment Authority	1	2	3	4	5	6	7	8
7. The Spanish government	1	2	3	4	5	6	7	8
8. The Kuwaiti government	1	2	3	4	5	6	7	8

7. After the liberation of Kuwait in 1991 several financial scandals occurred. Please indicate to what extent you think the following factors were common causes of such scandals.

	Strongly Disagree			Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8	
1. Excessive secrecy in Kuwait's government institutions	1	2	3	4	5	6	7	8	
2. Absence of adequate accountability	1	2	3	4	5	6	7	8	
3. Absence of the Kuwait National Assembly (1986-1992)	1	2	3	4	5	6	7	8	
4. Poor management	1	2	3	4	5	6	7	8	
5. Failure to maintain adequate accounting records	1	2	3	4	5	6	7	8	
6. Sub-standard external audits	1	2	3	4	5	6	7	8	
7. Failure to enforce existing Kuwaiti corporate laws and regulations	1	2	3	4	5	6	7	8	

D. QUESTIONS RELATING TO THE FUTURE OF CORPORATE GOVERNANCE IN KUWAIT

The following suggestions have been made as ways of improving the future of corporate governance and regulation of organisations in Kuwait. Please indicate the extent to which you agree or disagree with each suggestion.

	Strongly Disagree		Neutral			Strongly Agree		Don't know
	1	2	3	4	5	6	7	8
1. Legally require that external audits of companies and organisations with a capital above KD 5 million are audited by internationally affiliated audit firms	1	2	3	4	5	6	7	8
2. Increase audit fees to enable more extensive audits to be performed	1	2	3	4	5	6	7	8
3. Change the law to allow companies listed on the stock exchange to be audited by just one Audit firm	1	2	3	4	5	6	7	8
4. Require that government owned corporations and organisations not listed on the stock market (such as Kuwait Petroleum Corporation (KPC) KIO, and KIA,) are audited by two different external audit firms	1	2	3	4	5	6	7	8
5. Place directors of Kuwaiti corporations on performance-related contracts	1	2	3	4	5	6	7	8
6. Allow the Audit Bureau a greater role in evaluating the efficiency of corporate management	1	2	3	4	5	6	7	8
7. Allow the Audit Bureau a greater role in the regulation to appoint audit firms and set their fees for their work in government owned companies and organisations as a measure to enhance the auditor independence	1	2	3	4	5	6	7	8
8. Require that all stockholding companies, listed at the Kuwaiti stock exchange, in which the government hold 50% or more of the equity capital are exempted from any Audit Bureau attestation	1	2	3	4	5	6	7	8
9. External audit is abolished as a mandatory legal requirement for Kuwaiti companies	1	2	3	4	5	6	7	8
10. Require that all reports prepared by the Audit Bureau on government owned organisations and corporations are publicly available	1	2	3	4	5	6	7	8

E. QUESTIONS RELATING TO YOURSELF

Directions : Please circle the appropriate number that represents your answer

1. What is your position in your firm?

1. Partner	4. Assistant Audit Manager
2. Managing Partner	5. Auditor
3. Audit Manager	6. Other - please specify

2. What is the area of activity on which you spend the largest proportion of your working week?

1. Audit and Accountancy	5. Insolvency
2. Taxation	6. Technical
3. Corporate Finance	7. Administrative/Personnel
4. Management consultancy	8. Other - please specify

3. What type of accounting firm do you currently work in?
 1. Large audit firm
 2. Medium size audit firm
 3. Small audit firm

4. Does your firm have an association with any of the following firms:
 1. Big Six accounting firms(Arthur Andersen, Coopers & Lybrand, Deloitte & Touche, Ernst & Young, KPMG, Price Waterhouse)
 2. Non - Big Six international accounting firms

5. Please specify the approximate number of accountants in your firm?

1. Less than 5	5. 31 - 40
2. 5 - 10	6. 41 - 50
3. 11 - 20	7. 51 - 60
4. 21 - 30	8. Over 60

6. What is length of time that you have spent working in a firm of professional accountants?

1. 1 - 2 years	4. 11 - 15 years
2. 3 - 4 years	5. 16 - 25 years
3. 5 - 10 years	6. Over 25 years

7. How familiar are you with

	Not Familiar at all		familiar		Very familiar	
1. The activities of KIA	1	2	3	4	5	6 7
2. The activities of KIO	1	2	3	4	5	6 7
3. The involvement of KIO in Spain through Grupo Torras	1	2	3	4	5	6 7
4. the activities of external audit firms in Kuwait	1	2	3	4	5	6 7

**PAGE
NUMBERING
AS ORIGINAL**

E. QUESTIONS RELATING TO YOURSELF

Directions : Please circle the appropriate number that represents your answer

1. Please indicate your position in the Audit Bureau?
.....

2. Which type of organisations do you most frequently audit?

1. Shareholding companies
2. Ministries
3. Government owned corporations (Kuwait Airways, KPC)
4. Government owned organisations (KIO, KIA)
5. Other- Please specify
.....

3. What is the length of time that you have spent working in the Audit Bureau?

- | | |
|-----------------|------------------|
| 1. 1 - 2 years | 4. 11 - 15 years |
| 2. 3 - 4 years | 5. 16 - 25 years |
| 3. 5 - 10 years | 6. Over 25 years |

4. Have you ever worked for an external auditing firm?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

and if your answer is "Yes", please specify for how long

5. How familiar are you with

	Not Familiar at all	1	2	3	4	5	6	7
1. The activities of KIA		1	2	3	4	5	6	7
2. The activities of KIO		1	2	3	4	5	6	7
3. The involvement of KIO in Spain through Grupo Torras		1	2	3	4	5	6	7
4. the activities of external audit firms in Kuwait		1	2	3	4	5	6	7

6. What is your age?

- | | |
|------------|------------|
| 1. 21 - 24 | 5. 40 - 45 |
| 2. 25 - 29 | 6. 46 - 50 |
| 3. 30 - 34 | 7. 51 - 60 |
| 4. 35 - 39 | 8. 61 - 70 |

7. What is your sex?

- | | |
|---------|-----------|
| 1. Male | 2. Female |
|---------|-----------|

8. What is your nationality?

- | | |
|--------------|----------------------------|
| 1. Kuwaiti | 6. Egyptian |
| 2. Indian | 7. Pakistani |
| 3. Lebanese | 8. Syrian |
| 4. Jordanian | 9. British |
| 5. American | 10. Other - Please specify |

.....

9. What educational level have you achieved?

- | | |
|----------------|--------------------------|
| 1. High School | 4. Master |
| 2. Diploma | 5. Doctoral |
| 3. Bachelor | 6. Other- Please specify |

.....

10. Do you have any professional qualifications?

1. None
2. CPA
3. ACCA
4. Member of one of the British professional accountancy bodies (e.g. CIMA or ICAEW)
5. Certification according to the Kuwaiti Law
6. Other- Please specify

11. Have you studied abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

12. Have you worked abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

13. If your answer was "yes" in either question 11 or 12, please indicate when you studied or worked abroad by ticking the appropriate box.

	Studied	Worked
1960's		
1970's		
1980's		
1990's		

Thank you for completing this questionnaire.

E. QUESTIONS RELATING TO YOURSELF

Directions : Please circle the appropriate number that represents your answer

1. What type of organisation do you work in?

- | | |
|------------------------|----------------------------|
| 1. Commercial Bank | 6. Industrial Company |
| 2. Insurance Company | 7. Service company |
| 3. Investment Company | 8. Food company |
| 4. Oil Company | 9. Government agency |
| 5. Real Estate Company | 10. Other - please specify |
-

2. Please indicate your job title?

.....

3. Please indicate the degree of government ownership of your organisation's equity capital?

1. 100% privately owned
2. Less than 25% owned by the government
3. Government ownership is between 25% and 50%
4. Government ownership is more than 50%

4. How familiar are you with

	Not Familiar at all				familiar			Very familiar
	1	2	3	4	5	6	7	
1. The activities of KIA	1	2	3	4	5	6	7	
2. The activities of KIO	1	2	3	4	5	6	7	
3. The involvement of KIO in Spain through Grupo Torras	1	2	3	4	5	6	7	
4. the activities of external audit firms in Kuwait	1	2	3	4	5	6	7	

5. What is your age?

- | | |
|------------|------------|
| 1. 21 - 24 | 5. 40 - 45 |
| 2. 25 - 29 | 6. 46 - 50 |
| 3. 30 - 34 | 7. 51 - 60 |
| 4. 35 - 39 | 8. 61 - 70 |

6. What is your sex?

- | | |
|---------|-----------|
| 1. Male | 2. Female |
|---------|-----------|

7. What is your nationality?

- | | |
|--------------|----------------------------|
| 1. Kuwaiti | 6. Egyptian |
| 2. Indian | 7. Pakistani |
| 3. Lebanese | 8. Syrian |
| 4. Jordanian | 9. British |
| 5. American | 10. Other - Please specify |
| | |

8. What educational level have you achieved?

- | | |
|----------------|--------------------------|
| 1. High School | 4. Master |
| 2. Diploma | 5. Doctoral |
| 3. Bachelor | 6. Other- Please specify |
| | |

9. Was your subject of study related to business studies?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

and if your answer is "Yes", please give degree subject

10. Have you studied abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

11. Have you worked abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

12. If your answer was "yes" in either question 10 or 11, please indicate when you studied or worked abroad by ticking the appropriate box.

	Studied	Worked
1960's		
1970's		
1980's		
1990's		

13. Do you have any professional qualifications?

1. None
2. CPA
3. ACCA
4. Member of one of the British professional accountancy bodies (e.g. CIMA or ICAEW)
5. Certification according to the Kuwaiti Law
6. Other- Please specify

Thank you for completing this questionnaire.

E. QUESTIONS RELATING TO YOURSELF

Directions : Please circle the appropriate number that represents your answer

1. What type of organisation do you work in?

1. Commercial Bank	5. Government Agency
2. Insurance Company	6. University
3. Investment Company	7. Other - please specify
4. Stockbroking firm	-----

2. Please indicate your job title?
.....

3. Please indicate the degree of government ownership of your organisation's equity capital?
 1. 100% privately owned
 2. Less than 25% owned by the government
 3. Government ownership is between 25% and 50%
 4. Government ownership is more than 50%

4. How familiar are you with

	Not Familiar at all	1	2	3	4	5	6	7
1. The activities of KIA		1	2	3	4	5	6	7
2. The activities of KIO		1	2	3	4	5	6	7
3. The involvement of KIO in Spain through Grupo Torras		1	2	3	4	5	6	7
4. the activities of external audit firms in Kuwait		1	2	3	4	5	6	7

5. Do you rate yourself as
 1. an informed reader of annual corporate financial statements
 2. an average reader of annual corporate financial statements
 3. a novice reader of annual corporate financial statements

6. In your opinion are external audit reports based on evidence collected from an investigation of a sample of client's accounts and records.

1. Yes	2. No	3. Don't know
--------	-------	---------------

7. What is your age?

1. 21 - 24	5. 40 - 45
2. 25 - 29	6. 46 - 50
3. 30 - 34	7. 51 - 60
4. 35 - 39	8. 61 - 70

8. What is your sex?

1. Male	2. Female
---------	-----------

9. What is your nationality?

- | | |
|--------------|----------------------------|
| 1. Kuwaiti | 6. Egyptian |
| 2. Indian | 7. Pakistani |
| 3. Lebanese | 8. Syrian |
| 4. Jordanian | 9. British |
| 5. American | 10. Other - Please specify |

.....

10. What educational level have you achieved?

- | | |
|----------------|--------------------------|
| 1. High School | 4. Master |
| 2. Diploma | 5. Doctoral |
| 3. Bachelor | 6. Other- Please specify |

.....

11. Was your subject of study related to business studies?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

and if your answer is "Yes", please give degree subject

12. Have you studied abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

13. Have you worked abroad for more than one year?

- | | |
|--------|-------|
| 1. Yes | 2. No |
|--------|-------|

14. If your answer was "yes" in either question 12 or 13, please indicate when you studied or worked abroad by ticking the appropriate box.

	Studied	Worked
1960's		
1970's		
1980's		
1990's		

15. Do you have any professional qualifications?

1. None
2. CPA
3. ACCA
4. Member of one of the British professional accountancy bodies (e.g. CIMA or ICAEW)
5. Certification according to the Kuwaiti Law
6. Other- Please specify

Thank you for completing this questionnaire.



لمن يهمه الأمر

السيد وليد عبد الله الحسيني مبعوث من قبل جامعة الكويت لدراسة الدكتوراه في المحاسبة في جامعة شفيلد ببريطانيا. وسوف يقوم بدراسة عن دور مهنة التدقيق في عملية إدارة الشركات والسيطرة على الشركات والمؤسسات المالية الكويتية. حيث سيركز جزء من هذه الدراسة على دور المدققين، من مكاتب التدقيق وديوان المحاسبة، في الأعمال التي يقوم بها مكتب الاستثمار الكويتي (KIO).

لذا سوف يقوم السيد وليد بتوزيع استبيان على كل من مستخدمي التقارير المالية والمدراء الماليين والمدققين، من مكاتب التدقيق وديوان المحاسبة، وذلك لدراسة أنطباعات وتوقعات هذه المجموعات اتجاه عمل مدقق الحسابات الخارجي في الكويت. كذلك سوف يقوم هذا الاستبيان باستطلاع آراء هذه المجموعات بخصوص استثمارات مكتب الاستثمار الكويتي في أسبانيا. نظراً لأهمية هذه الدراسة في المساهمة تطوير مهنة المحاسبة والحفاظ على الأموال العامة في الكويت، نرجو التكرم بمساعدة السيد وليد في توزيع استبيانته والرد عليه.

و أشكركم على حسن تعاونكم

ليلى
عميد كلية العلوم الإدارية
د. يوسف الأبراهيم



توقعات مهنة التدقيق بالكويت ودور مهنة التدقيق في استثمارات مكتب الاستثمار الكويتي في أسبانيا

نحن نقوم بدراسة في جامعة شفيلد-إنكلترا عن دور مهنة التدقيق في عملية إدارة الشركات وانمؤسسات المالية الكويتية والسيطرة عليها. وسيركز جزء من هذه الدراسة علي دور المدققين، من مكاتب التدقيق وديوان المحاسبة، في الأعمال التي يقوم بها مكتب الاستثمار الكويتي (KIO).

وهذا الاستبيان يوضح لدراسة انطباعتك وتوقعاتك بشكل عام عن مدقق الحسابات الخارجي في انكويت ومعرفة أرائك بشكل خاص عن عمليات مكتب الاستثمار الكويتي (KIO) في أسبانيا والتي تمت عن طريق الشركة نقابضة غروبو تورس (Grupo Torras) GT. وفي أجزاء من هذا الاستبيان، سوف تطالب بإبداء رأيك حول عمل كل من مكاتب التدقيق الخارجي وديوان المحاسبة. وهذا الاستبيان أيضا مرسل إلى مدراء ماليين ومستخدمي القوائم المتية ومدققي الحسابات من ديوان المحاسبة وذلك للمقارنة بين آراءهم.

وسوف تعامل الإجابة على هذا الاستبيان بأقصى سرية؛ حيث أن النتائج لن تظهر إلا من خلال جدول وإحصائيات عامة دون أن تدل على اسم أي شخص.

ونتوقع أن تستغرق عملية تعبئة الاستبيان أقل من ٢٥ دقيقة من وقتكم. وسيتم تجميع الاستبيان من قبل وليد الحسيني في خلال أسبوع من استلامكم له.

وإذا رغبتكم في مزيد من المعلومات عن تعبئة الاستبيان أو كان لديكم أية تعليقات على الاستبيان فيمكنكم الاتصال على وليد الحسيني بالعنوان التالي:

قسم المحاسبة، جامعة الكويت

ص ب: ٥٤٨٦ الصفاة ، الكويت ١٣٠٥٥

هاتف : ٢٥٤٣٦١٨ ، فاكس ٢٥٣٣٣٨٢

إن مساهمتك في إنجاح هذه اندراسة ضرورية ونحن نقدرها و ننتقدم إليك بالشكر الجزيل علي منحنا جزءاً ثميناً من وقتك.

بروفيسور كريستفور همبفري

المشرف

كلية الإدارة

جامعة شفيلد

المملكة المتحدة

وليد عبد الله الحسيني

طالب دكتوراه

كلية الإدارة

جامعة شفيلد

المملكة المتحدة

توزيع نتائج الاستبيان

بسعدنا توفير نتائج هذه الدراسة لكم. لذا إن رغبتكم في الحصول علي نتائج هذه الدراسة ، يرجى كتابة الاسم والعنوان في المساحة الموجودة في الأسفل.

هذا الجزء سوف يقطع حالما يتم استلام الاستبيان ويحفظ في مكان آخر. كذلك يمكنك إرسال هذا الجزء منفصلاً إذا رغبتكم.

الاسم.....

العنوان.....

.....

.....

٣- الرجاء تحديد رأيك بالافتراضات التالية التي تتعلق بالدور الذي يجب أن يقوم به مدقق الحسابات الخارجي.

لا أعرف	أوافق بشدة	محايد	لا أوافق بشدة	دور المدقق الخارجي تجاه الشركة التي يقوم بتدقيق حساباتها يجب أن يؤكد على:				
٨	٧	٦	٥	٤	٣	٢	١	١- الكشف عن جميع الاختلاسات المالية
٨	٧	٦	٥	٤	٣	٢	١	٢- أن القوائم المالية للشركة لا تحتوي على تضليل مادي متعمد
٨	٧	٦	٥	٤	٣	٢	١	٣- وجوب استخدام نظام رقابة داخلي مناسب
٨	٧	٦	٥	٤	٣	٢	١	٤- أن استمرارية عمل الشركة غير مشكوك به
٨	٧	٦	٥	٤	٣	٢	١	٥- أن الشركة تدار بكفاءة
٨	٧	٦	٥	٤	٣	٢	١	٦- أن الجهات الرقابية على معرفة بأي تقصير مهني بارز
٨	٧	٦	٥	٤	٣	٢	١	٧- أن حسابات الشركة تعطي مؤشراً يعتمد عليه عن القيمة السوقية للشركة

٤. في عام ١٩٩٤، تم إضفاء تعديل على القانون الكويتي للشركات التجارية (المادة رقم ١٦١) يلزم الشركات المدرجة بسوق الكويت لأوراق المالية بتعيين اثنين من مكاتب تدقيق الحسابات للقيام بتدقيق حساباتهم (بدلاً من مكتب واحد حسب القانون القديم) الرجاء تحديد مدى موافقتك أو عدم موافقتك مع العبارات التالية المتعقبة بهذا التعديل.

لا أعرف	أوافق بشدة	محايد	لا أوافق بشدة	١- وجود اثنين من المدققين الخارجيين سوف يجعل اكتشاف الاختلاسات والأخطاء المالية أسهل بكثير				
٨	٧	٦	٥	٤	٣	٢	١	٢- تعيين اثنين من منققي الحسابات الخارجيين سوف يعزز بشكل عام من استقلالية عملية التدقيق
٨	٧	٦	٥	٤	٣	٢	١	٣- الحاجة إلى اثنين من المدققين الخارجيين سوف يحد من قدرة كل من المدققين على الحصول على صورة واضحة توضع المالي للشركة
٨	٧	٦	٥	٤	٣	٢	١	٤- تعيين اثنين من منققي الحسابات سوف يؤدي إلى ازدواجية غير ضرورية في عملية التدقيق
٨	٧	٦	٥	٤	٣	٢	١	٥- شرط تعيين اثنين من منققي الحسابات الخارجيين سوف يؤدي إلى زيادة حصة مكاتب التدقيق الكبيرة في سوق التدقيق في الكويت
٨	٧	٦	٥	٤	٣	٢	١	٦- تعيين اثنين من منققي الحسابات الخارجيين لن يؤدي إلى وجود فائدة مهمة تعود على المساهمين

٥. الاقتراحات التالية تتعلق بتنظيم مكاتب التدقيق الخارجي. الرجاء تحديد ما مدى موافقتك أو عدم موافقتك على كل اقتراح.

لا أعرف	أوافق بشدة	محايد	لا أوافق بشدة	لا أوافق بشدة				
٨	٧	٦	٥	٤	٣	٢	١	يجب على مكاتب تدقيق الحسابات أن:
٨	٧	٦	٥	٤	٣	٢	١	١. يكونوا قادرين على تقديم خدمة استشارات إدارية إلى العملاء الذين يقومون بتدقيق حساباتهم
٨	٧	٦	٥	٤	٣	٢	١	٢. يكون مسموحاً لهم استملاك أسهم في اشركات أو المؤسسات التي يدققون حساباتها
٨	٧	٦	٥	٤	٣	٢	١	٣. لا يتمكنوا من الحصول على أكثر من ١٠٪ من إجمالي دخلهم من تدقيق حسابات عميل واحد
٨	٧	٦	٥	٤	٣	٢	١	٤. يكونوا مقيدين بفترة محددة لنقيام بدور مدقق الحسابات الخارجي لأي عميل (على سبيل المثال: ليس أكثر من خمس سنوات متتالية)
٨	٧	٦	٥	٤	٣	٢	١	٥. يكونوا منظمين ذاتياً (Self regulated) بدلاً من تنظيمهم من قبل وزارة التجارة
٨	٧	٦	٥	٤	٣	٢	١	٦. لا يعملوا بشكل أساسي لتحقيق الربح
٨	٧	٦	٥	٤	٣	٢	١	٧. يجعلوا طرق التدقيق التي يتبعوها خاضعة للفحص من قبل هيئة مبادئ مهنية
٨	٧	٦	٥	٤	٣	٢	١	٨. يجعلوا هيئة مستقلة عن شركة العميل تقوم بعملية تعيينهم وتحديد أتعابهم
٨	٧	٦	٥	٤	٣	٢	١	٩. يجعلوا مسئوليتهم محددة طبقاً لنص قانوني
٨	٧	٦	٥	٤	٣	٢	١	١٠. يرتبطوا مع مكاتب تدقيق كبيرة عالمياً
٨	٧	٦	٥	٤	٣	٢	١	١١. لا يكونوا على علاقة صداقة وثيقة مع العميل الذي يدققون حساباته

٦. فيما يتعلق بعملهم كمدققين خارجيين، الرجاء تحديد اعتقادك بمدى نجاح مكاتب التدقيق عادة في الأعمال التالية:

فشل جدا	١	٢	٣	٤	٥	٦	٧	٨	فشل جدا
١	٢	٣	٤	٥	٦	٧	٨	٨	١. تحديد المشاكل
١	٢	٣	٤	٥	٦	٧	٨	٨	٢. إيجاد حلول للمشاكل
١	٢	٣	٤	٥	٦	٧	٨	٨	٣. الحصول على المعلومات
١	٢	٣	٤	٥	٦	٧	٨	٨	٤. التأقلم مع الأخطار والمجهول
١	٢	٣	٤	٥	٦	٧	٨	٨	٥. التنبؤ بالمستقبل
١	٢	٣	٤	٥	٦	٧	٨	٨	٦. تحقيق ربح
١	٢	٣	٤	٥	٦	٧	٨	٨	٧. اكتشاف الأخطاء والتلاعب
١	٢	٣	٤	٥	٦	٧	٨	٨	٨. منع الأخطاء والتلاعب
١	٢	٣	٤	٥	٦	٧	٨	٨	٩. الالتزام بالقواعد المهنية
١	٢	٣	٤	٥	٦	٧	٨	٨	١٠. تنفيذ المتطلبات القانونية
١	٢	٣	٤	٥	٦	٧	٨	٨	١١. تكوين أنطباعات صحيحة
١	٢	٣	٤	٥	٦	٧	٨	٨	١٢. التصرف باستقلالية بدون اعتبار للمصلحة الشخصية
١	٢	٣	٤	٥	٦	٧	٨	٨	١٣. توصيل المعلومات بفعالية
١	٢	٣	٤	٥	٦	٧	٨	٨	١٤. تقديم تقارير صادقة
١	٢	٣	٤	٥	٦	٧	٨	٨	١٥. توفير خدمة تدقيق بتكلفة فعالة (Cost Effective Audit)
١	٢	٣	٤	٥	٦	٧	٨	٨	١٦. يكون عادلا مع مصالح الآخرين
١	٢	٣	٤	٥	٦	٧	٨	٨	١٧. التقليل من مسئوليتهم القانونية
١	٢	٣	٤	٥	٦	٧	٨	٨	١٨. توفير خدمة مفيدة لإدارة الشركة
١	٢	٣	٤	٥	٦	٧	٨	٨	١٩. توفير خدمة مفيدة للمجتمع
١	٢	٣	٤	٥	٦	٧	٨	٨	٢٠. توفير حماية للمال العام في الكويت

ج - جميع الأسئلة في هذا الجزء تتعلق بعمليات مكتب الاستثمار الكويتي (KIO) واستثماراته في أسبانيا

١. هل كنت تعلم أن مكتب الاستثمار الكويتي (KIO) كانت تدقق حساباته من قبل مكتب تدقيق خارجي قبل انهيار استثماراته في أسبانيا في عام ١٩٩٢؟

١. نعم
٢. لا

٢. بينما يتم حالياً تدقيق حسابات مكتب الاستثمار الكويتي من قبل مدقق خارجي، لا يقوم هذا المكتب بنشر أي معلومات مالية مدققة للجمهور. الرجاء تحديد مستوى المعلومات التي تعتقد بوجود توفيرها للجمهور من قبل KIO (وذلك باختيار واحد فقط من الاختيارات التالية).

٣. KIO يجب أن تشر جميع القوائم المالية المدققة

٤. KIO يجب أن تشر تقرير مدقق الحسابات وملخص للقوائم المالية

٥. KIO يجب أن لا تشر أية معلومات مالية

٦. ليس لدي رأي بخصوص هذا الموضوع

٣. من خلال فهمك لاستثمارات (KIO) في أسبانيا وعدم قيام KIO بنشر أي معلومات مالية، نرجو تحديد ما مدى اعتقادك أن النقاط التالية تمثل أهدافاً رئيسية لتدقيق الخارج لمكتب الاستثمار الكويتي.

لا أعرف	هدف رئيسي	محايد	ليس هدف					
٨	٧	٦	٥	٤	٣	٢	١	١. اكتشاف جميع الاختلاسات المالية
٨	٧	٦	٥	٤	٣	٢	١	٢. اكتشاف أي مخالفة كبيرة للقوانين المنظمة لعمليات KIO
٨	٧	٦	٥	٤	٣	٢	١	٣. إبلاغ الجهات الرقابية المعنية عن أي تقصير مهني بارز
٨	٧	٦	٥	٤	٣	٢	١	٤. المساعدة في أعداد القوائم المالية
٨	٧	٦	٥	٤	٣	٢	١	٥. تقييم أداء الإدارة
٨	٧	٦	٥	٤	٣	٢	١	٦. التأكد من أن القوائم المالية لـ KIO قد أعدت طبقاً للمبادئ المحاسبية المتعارف عليها
٨	٧	٦	٥	٤	٣	٢	١	٧. المساعدة في خفض الالتزامات الضريبية الخاصة بـ KIO في دول العالم
٨	٧	٦	٥	٤	٣	٢	١	٨. التأكد من أن الأموال العامة المستثمرة من قبل KIO تتوفر لها الحماية الملائمة

٤. من يكون في اعتقادك أكثر استقلالية عند تدقيق الشركات والمؤسسات التي تملكها أو تستثمر بها الحكومة الكويتية؟ الرجاء ترتيبهم حسب الأهمية، بأعطاء رقم ١ إلى الأكثر استقلالية، وأعطاء ٢ إلى التالي و إعطاء ٣ إلى الأقل استقلالية:

١. ديوان المحاسبة

٢. مكاتب تدقيق كويتية ترتبط مع مكاتب تدقيق عالمية كبيرة

٣. مكاتب تدقيق كويتية لا ترتبط مع مكاتب تدقيق عالمية

٤. من خلال فهمك لاستثمارات KIO في GT بأسبانيا، الرجاء تحديد مدى موافقتك أو معارضتك لكل من العبارات التالية.

لا أعرف	أوافق بشدة	محايد	لا أوافق بشدة					
٨	٧	٦	٥	٤	٣	٢	١	١. في مشكلة GT، عادة وضع مدققي الحسابات ثقة كبيرة في تأكيدات الشركة.
٨	٧	٦	٥	٤	٣	٢	١	٢. يجب أن يكون المدققين مسئولين مسئولية قانونية عن انهيار استثمارات KIO في GT إذا كان عملهم دون المستوى
٨	٧	٦	٥	٤	٣	٢	١	٣. الأشخاص المسنونون عن انهيار استثمارات KIO لم يحاسبوا بطريقة ملائمة إلى الآن
٨	٧	٦	٥	٤	٣	٢	١	٤. الأشخاص المسنونون عن انهيار استثمارات KIO لن يحاسبوا أبدا
٨	٧	٦	٥	٤	٣	٢	١	٥. منعت تقاليد السرية في KIO مدققي الحسابات من اكتشاف تجاوزات القوانين واللوائح
٨	٧	٦	٥	٤	٣	٢	١	٦. منعت تقاليد السرية في KIO مدققي الحسابات من إبلاغ السلطات المختصة عن اكتشافهم تجاوزات تقوانين واللوائح
٨	٧	٦	٥	٤	٣	٢	١	٧. مكاتب التدقيق العالمية عادة لديها القدرة الكاملة على فهم نوعية العمليات المعقدة التي تقوم بها KIO
٨	٧	٦	٥	٤	٣	٢	١	٨. ديوان المحاسبة عادة لديه القدرة الكاملة على فهم نوعية العمليات المعقدة التي تقوم بها KIO
٨	٧	٦	٥	٤	٣	٢	١	٩. تمثل مشاكل KIO الخاصة باستثمارات أسبانيا حالة منفردة ولا تمثل المنهج العام الذي تتخذه المؤسسات الكويتية لإدارة محافظها المالية
٨	٧	٦	٥	٤	٣	٢	١	١٠. في الكويت، النفوذ والعلاقات الجيدة تجعل من السهل النفاذ من أي مسألة عند ارتكاب اختلاسات في الشركات أو المؤسسات
٨	٧	٦	٥	٤	٣	٢	١	١١. فضائح بحجم تلك الخاصة بغروبوتورس وشركة ناقلات النفط الكويتية من المرجح أن تتكرر في الكويت في المستقبل

٥. من خلال فهمك لقضية KIO ، إلى أي درجة تلقي اللوم على الجهات التالية لانتهيار غروبوتورس (GT).

لا أعرف	لوم كامل	لوم محدود	لا لوم		
٨	٧	٦	٥	٤ ٣ ٢ ١	١. مدقق KIO الخارجي
٨	٧	٦	٥	٤ ٣ ٢ ١	٢. مدقق GT الخارجي
٨	٧	٦	٥	٤ ٣ ٢ ١	٣. ديوان المحاسبة
٨	٧	٦	٥	٤ ٣ ٢ ١	٤. مدراء مكتب الاستثمار الكويتي KIO
٨	٧	٦	٥	٤ ٣ ٢ ١	٥. مدراء غروبوتورس GT
٨	٧	٦	٥	٤ ٣ ٢ ١	٦. مدراء الهيئة العامة للاستثمار KIA
٨	٧	٦	٥	٤ ٣ ٢ ١	٧. الحكومة الأسبانية
٨	٧	٦	٥	٤ ٣ ٢ ١	٨. الحكومة الكويتية

٦. عدة فضائح ماثية حدثت بعد تحرير الكويت في عام ١٩٩١. الرجاء تحديد إلى أي مدى تعتقد أن العوامل التالية كانت أسباب مشتركة لحدوث هذه الفضائح ؟

لا أعرف	أوافق بشدة	محايد	لا أوافق بشدة		
٨	٧	٦	٥	٤ ٣ ٢ ١	١. السرية المفرطة في المؤسسات الحكومية الكويتية
٨	٧	٦	٥	٤ ٣ ٢ ١	٢. غياب المساءلة العلنية
٨	٧	٦	٥	٤ ٣ ٢ ١	٣. غياب مجلس الأمة الكويتي (١٩٨٦-١٩٩٢)
٨	٧	٦	٥	٤ ٣ ٢ ١	٤. ضعف الإدارة
٨	٧	٦	٥	٤ ٣ ٢ ١	٥. الفشل في مسك سجلات محاسبية ملانمة
٨	٧	٦	٥	٤ ٣ ٢ ١	٦. تدقيق خارجي دون المستوى
٨	٧	٦	٥	٤ ٣ ٢ ١	٧. الفشل في تطبيق القوانين واللوائح التجارية الموجودة في الكويت

هـ - أسئلة تتعلق بمعلومات عنك

تعليمات : الرجاء وضع دائرة حول الرقم الذي يمثل أجابتك

١. ما هو منصبك في المكتب؟
١. شريك
٢. شريك مدير
٣. مدير تدقيق
٤. مساعد مدير التدقيق
٥. منسق
٦. آخر - الرجاء تحديده

٢. ما هو نوع النشاط الذي تغطي به معظم وقتك خلال الأسبوع؟
١. التدقيق وأعمال المحاسبة
٢. الضرائب
٣. تمويل الشركات
٤. استشارات إدارية
٥. اتصافية
٦. اتقنية
٧. إداري/شئون الموظفين
٨. أخرى - الرجاء تحديده

٣. ما هو نوع مكتب التدقيق الذي تعمل لديه؟
١. مكتب تدقيق كبير الحجم
٢. مكتب تدقيق متوسط الحجم
٣. مكتب تدقيق صغير الحجم
٤. هل مكتبكم على صلة مع أحد المكاتب التالية:

١. مكاتب المحاسبة الستة الكبار (Arthur Andersen, Coopers & Lybrand, Deloitte & Touche, Ernst & Young, KPMG, Price Waterhouse)

٢. مكاتب محاسبة عالمية غير الستة الكبار
٥. الرجاء تحديد العدد التقريبي للمحاسبين في مكتبكم؟
١. أقل من ٥
٢. ٥-١٠
٣. ١١-٢٠
٤. ٢١-٣٠
٥. ٣١-٤٠
٦. ٤١-٥٠
٧. ٥١-٦٠
٨. أكثر من ٦٠
٦. ما هي مدة عملك لدى مكاتب المحاسبة المهنية؟
١. ١-٢ سنوات
٢. ٣-٤ سنوات
٣. ٥-١٠ سنوات
٤. ١١-١٥ سنة
٥. ١٦-٢٥ سنة
٦. أكثر من ٢٥ سنة
٧. ما مدى معرفتك بالآتي:

معروف جداً	معروف	لا أعرف شيئاً	معروف	لا أعرف شيئاً	معروف	لا أعرف شيئاً	معروف
٧	٦	٥	٤	٣	٢	١	١. أعمال الهيئة العامة للاستثمار (KIA)
٧	٦	٥	٤	٣	٢	١	٢. أعمال مكتب الاستثمار الكويتي (KIO)
٧	٦	٥	٤	٣	٢	١	٣. استثمارات (KIO) في أسبانيا من خلال غروبوتورس (GT)
٧	٦	٥	٤	٣	٢	١	٤. أعمال مكاتب التدقيق في الكويت

٨. هل قمت لأي فترة بالعمل لدى ديوان المحاسبة؟
١. نعم
٢. لا
- وإذا كانت أجبائك "نعم"، الرجاء تحديد كم كنت الفترة

٩. ما هو سنك؟
١. ٢٤-٢١
٢. ٢٩-٢٥
٣. ٣٤-٣٠
٤. ٣٩-٣٥

١٠. ما هو نوع جنسك؟
١. ذكر
٢. أنثى

١١. ما هي جنسيتك؟
١. كويتي
٢. هندي
٣. لبناني
٤. أردني
٥. أمريكي
٦. مصري
٧. باكستاني
٨. سوري
٩. بريطاني
١٠. أخرى - الرجاء تحديده

١٢. ما هو مستواك التعليمي؟
١. ثانوية عامة
٢. دبلوم
٣. بكالوريوس
٤. ماجستير
٥. دكتوراه
٦. آخر - الرجاء تحديده

١٣. هل حصلت على أحد هذه الشهادات المهنية؟
١. لا يوجد
٢. عضو مجمع المحاسبين الأمريكيين CPA
٣. عضو اتحاد المحاسبين المرخصين الدوليين ACCA
٤. عضو أحد مجامع المحاسبين البريطانيين المهنيين (مثل CIMA أو ICAEW)
٥. القيد حسب القانون الكويتي
٦. آخر - الرجاء تحديده

١٤. هل قمت بالدراسة لأكثر من سنة خارج الكويت؟
١. نعم
٢. لا

١٥. هل قمت بالعمل لأكثر من سنة خارج الكويت؟
١. نعم
٢. لا

١٦. إذا كان جوابك "نعم" على أي من سؤال ١٤ أو ١٥، الرجاء وضع إشارة في المربع المناسب الذي يحدد الفترة التي درست أو عملت بها بالخارج

درست	عملت	
		عهد الستينات
		عهد السبعينات
		عهد الثمانينات
		عهد التسعينات

شكرا لكم على تعبئة الاستبيان

هـ - أسئلة تتعلق بمعلومات عنك

تعليمات : الرجاء وضع دائرة حول الرقم الذي يمثل أجابتك

١. الرجاء تحديد منصبك في ديوان المحاسبة؟
.....
٢. ما هو نوع المنشآت والشركات التي تقوم بالتدقيق عليها باستمرار؟
١. الشركات المساهمة
٢. الوزارات
٣. الشركات المملوكة للدولة (الخطوط الجوية الكويتية ، مؤسسة البترول الكويتية)
٤. الهيئات المملوكة للدولة (الهيئة العامة للاستثمار ، مكتب الاستثمار الكويتي)
٥. آخر - الرجاء تحديده

٣. ما هي فترة عملك لدى ديوان المحاسبة؟
١. ١-٢ سنة
٢. ٣-٤ سنوات
٣. ٥-١٠ سنوات
٤. ١١-١٥ سنة
٥. ١٦-٢٥ سنة
٦. أكثر من ٢٥ سنة

٤. هل قمت بالعمل لدى مكتب تدقيق بالسابق؟

١. نعم
 ٢. لا
- إذا كان جوابك "نعم" ، فالرجاء تحديد المدة

٥. ما مدى معرفتك بالآتي:

معروف جداً	معروف	لا أعرف شيئاً	معروف	لا أعرف شيئاً	معروف	معروف جداً
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١

٦. ما هو سنك؟

١. ٢١-٢٤
٢. ٢٥-٢٩
٣. ٣٠-٣٤
٤. ٣٥-٣٩
٥. ٤٠-٤٥
٦. ٤٦-٥٠
٧. ٥١-٦٠
٨. ٦١-٧٠

٧. ما هو نوع جنسك؟

١. نكر
٢. أنثى

٨. ما هي جنسيتك؟

١. كويتي
٢. هندي
٣. لبناني
٤. أردني
٥. أمريكي
٦. مصري
٧. باكستاني
٨. سوري
٩. بريطاني
١٠. أخرى - الرجاء تحديده

٩. ما هو مستواك التعليمي؟

١. ثانوية عامة
٢. نجوم
٣. بكالوريوس
٤. ماجستير
٥. دكتوراه
٦. آخر - الرجاء تحديده

١٠. هل حصلت على أحد هذه الشهادات المهنية

١. لا يوجد
٢. عضو مجمع المحاسبين الأمريكيين CPA
٣. عضو اتحاد المحاسبين المرخصين الدوليين ACCA
٤. عضو أحد مجامع المحاسبين البريطانيين المهنيين (مثل CIMA أو ICAEW)
٥. القاد حسب القانون الكويتي
٦. آخر - الرجاء تحديده

١١. هل قمت بتأريسة لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١٢. هل قمت بالعمل لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١٣. إذا كان جوابك "نعم" على أي من سؤال ١١ أو ١٢، الرجاء وضع إشارة في المربع المناسب الذي يحدد الفترة التي درست أو عملت بها بالخارج

عملت	درست	
		عهد الستينات
		عهد السبعينات
		عهد الثمانينات
		عهد التسعينات

شكرا لكم على تعبئة الاستبيان

هـ - أسئلة تتعلق بمعلومات عنك

تعليمات : انرجاء وضع دائرة حول الرقم الذي يمثل أجابتك

١. ما نوع المنظمة التي تعمل بها؟
١. بنك تجاري
٢. شركة تأمين
٣. شركة استثمار
٤. شركة نفط
٥. شركة عقارات
٦. شركة صناعية
٧. شركة خدمات
٨. شركة أغذية
٩. مؤسسة حكومية
١٠. أخرى - الرجاء تحديده

٢. الرجاء تحديد المسمى الوظيفي لمنصبك؟

.....

٣. الرجاء تحديد نسبة ملكية الحكومة في رأس مال منطمتك؟

١. مملوكة ١٠٠٪ ملكية خاصة
٢. الحكومة تملك بها أقل من ٢٥٪
٣. الحكومة تملك ما بين ٢٥٪ و ٥٠٪
٤. الحكومة تملك أكثر من ٥٠٪

٤. ما مدى معرفتك بالآتي:

معروف جداً	معروف	لا أعرف شيئاً	معروف	لا أعرف شيئاً	معروف جداً	
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١
٧	٦	٥	٤	٣	٢	١

٥. ما هو سنك؟

١. ٢٤-٢١
٢. ٢٩-٢٥
٣. ٣٤-٣٠
٤. ٣٩-٣٥
٥. ٤٥-٤٠
٦. ٥٠-٤٦
٧. ٦٠-٥١
٨. ٧٠-٦١

٦. ما هو نوع جنسك؟

١. ذكر
٢. أنثى

٧. ما هي جنسيتك؟

١. كويتي
٢. هندي
٣. لبناني
٤. أردني
٥. أمريكي
٦. مصري
٧. باكستاني
٨. سوري
٩. بريطاني
١٠. أخرى - الرجاء تحديده

٨. الرجاء اختيار دائرة تمثل مستواك التعليمي

١. ثانوية عامة
٢. دبلوم
٣. بكالوريوس
٤. ماجستير
٥. دكتوراه
٦. آخر - الرجاء تحديده

٩. الرجاء إيضاح أن كان مجال دراستك على علاقة بالدراسات التجارية؟

١. نعم
 ٢. لا
- وإذا كان جوابك "نعم" ، فالرجاء تحديد التخصص

١٠. هل قمت بالدراسة لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١١. هل قمت بالعمل لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١٢. إذا كان جوابك "نعم" على أي من سؤال ١٠ أو ١١ ، الرجاء وضع إشارة في المربع المناسب الذي يحدد الفترة التي درست أو عملت بها بالخارج

درست	عملت	
		عهد الستينات
		عهد السبعينات
		عهد الثمانينات
		عهد التسعينات

١٣. هل حصلت على أحد هذه الشهادات المهنية؟

١. لا يوجد
٢. عضو مجمع المحاسبين الأمريكيين CPA
٣. عضو اتحاد المحاسبين المرخصين الدوليين ACCA
٤. عضو أحد مجامع المحاسبين البريطانيين المهنيين (مثل CIMA أو ICAEW)
٥. القيد حسب القانون الكويتي
٦. آخر - الرجاء تحديده

شكرا لكم على تعبئة الاستبيان

هـ - أسئلة تتعلق بمعلومات عنك

إرشادات : الرجاء وضع دائرة حول الرقم الذي يمثل أجابتك

.١ ما نوع المنظمة التي تعمل بها؟

١. بنك تجاري
٢. شركة تأمين
٣. شركة استثمار
٤. مكتب سمسة أسهم
٥. هيئة حكومية
٦. مؤسسة أكاديمية
٧. أخرى - الرجاء تحديدها

.٢ الرجاء تحديد المسمى الوظيفي لمنصبك؟

.٣ الرجاء تحديد نسبة ملكية الحكومة في رأس مال منطمتك؟

١. مملوكة ١٠٠٪ ملكية خاصة
٢. الحكومة تملك بها أقل من ٢٥٪
٣. الحكومة تملك ما بين ٢٥٪ و ٥٠٪
٤. الحكومة تملك أكثر من ٥٠٪

.٤ ما مدى معرفتك بالآتي:

معروف جداً	معروف	لا أعرف شيئاً	معروف	معروف	معروف	معروف	معروف
٧	٦	٥	٤	٣	٢	١	١. أعمال الهيئة العامة للاستثمار (KIA)
٧	٦	٥	٤	٣	٢	١	٢. أعمال مكتب الاستثمار الكويتي (KIO)
٧	٦	٥	٤	٣	٢	١	٣. استثمارات (KIO) في أسبانيا من خلال غروبوتورس (GT)
٧	٦	٥	٤	٣	٢	١	٤. أعمال مكاتب التدقيق في الكويت

.٥ هل تقيم نفسك كـ

١. قارئ ذو معرفة جيدة بالقوائم المالية السنوية للشركات
٢. قارئ ذو معرفة متوسطة بالقوائم المالية السنوية للشركات
٣. قارئ ذو معرفة سطحية (قليلة) بالقوائم المالية السنوية للشركات
٦. في اعتقادك هل يتم بناء تقارير التدقيق الخارجي على أدلة تجمع من خلال فحص عينة لحسابات وسجلات العميل؟
١. نعم
٢. لا
٣. لا أعرف

.٧ ما هو سنك؟

١. ٢٤-٢١
٢. ٢٩-٢٥
٣. ٣٤-٣٠
٤. ٣٩-٣٥
٥. ٤٥-٤٠
٦. ٥٠-٤٦
٧. ٦٠-٥١
٨. ٧٠-٦١

٨. ما هو نوع جنسك؟

١. ذكر
٢. أنثى

٩. ما هي جنسيتك؟

١. كويتي
٢. هندي
٣. لبناني
٤. أردني
٥. أمريكي
٦. مصري
٧. باكستاني
٨. سوري
٩. بريطاني
١٠. أخرى - الرجاء تحديده

١٠. ما هو مستواك التعليمي؟

١. ثانوية عامة
٢. دبلوم
٣. بكالوريوس
٤. ماجستير
٥. دكتوراه
٦. آخر - الرجاء تحديده

١١. الرجاء إيضاح أن كان مجال دراستك على علاقة بالدراسات التجارية؟

١. نعم
٢. لا
وإذا كان جوابك "نعم"، فالرجاء تحديد التخصص

١٢. هل قمت بالدراسة لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١٣. هل قمت بالعمل لأكثر من سنة خارج الكويت؟

١. نعم
٢. لا

١٤. إذا كان جوابك "نعم" على أي من سؤا ١٢ أو ١٣، الرجاء وضع إشارة في المربع المناسب الذي يحدد الفترة التي درست أو عملت بها بالخارج

عملت	درست	
		عهد الستينات
		عهد السبعينات
		عهد الثمانينات
		عهد التسعينات

١٥. هل حصلت على أحد هذه الشهادات المهنية؟

١. لا يوجد
٢. عضو مجمع المحاسبين الأمريكيين CPA
٣. عضو اتحاد المحاسبين المرخصين الدوليين ACCA
٤. عضو أحد مجامع المحاسبين البريطانيين المهنيين (مثل CIMA أو ICAEW)
٥. القيد حسب القانون الكويتي
٦. آخر - الرجاء تحديده

شكرا لكم على تعبئة الاستبيان