

REPORT No.: 56402

West Bank and Gaza

Report on the Observance of Standards and Codes (ROSC) Accounting and Auditing

July 2010

Middle East and North Africa Region
Operations Policies and Country Services



Document of the World Bank

FISCAL YEAR

January 1- December 31

ABBREVIATIONS AND ACRONYMS

A&A	Accounting & Auditing	ISA	International Standards on Auditing
AFAAC	Arab Federation of Accountants and Auditors	MFIs	Micro Finance Institutions
AGM	Annual General Meeting	OECD	Organization for Economic Co-operation and Development
BPA	Board of Professional Auditing	PACPA	Palestinian Association of Certified Public Accountants
CPA	Certified Public Accountant	PCMA	Palestine Capital Markets Authority
CPE	Continuing Professional Education	PIE	Public Interest Entities
FCMA	Mediterranean Federation of Certified Accountants	PIF	Palestine Investment Fund
GAAP	Generally-Accepted Accounting Principles	PMA	Palestine Monetary Authority
GAAS	Generally- Accepted Auditing Principles	PRDP	Palestine Reform and Development Plan
IASB	International Accounting Standards Board	PSE	Palestine Stock Exchange
IAS	International Accounting Standards	ROSC	Report on the Observance of Standards and Codes
IES	International Education Standards for Professional Accountants	SME	Small- and Medium-sized Enterprise
IFAC	International Federation of Accountants	SMO	IFAC Statement of Membership Obligations
IFRS	International Financial Reporting Standards	WB&G	West Bank and Gaza
IMF	International Monetary Fund		

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Preface

This report was prepared by the World Bank, on the basis of a diagnostic review carried out between April and November 2009, including three field missions.

The report was prepared by a team led by Akram El-Shorbagi (MNAFM) and included Henri Fortin (PRMPS), Suhair Musa (MNAFM), and consultants Ana Cristina Hirata Barros and Samir Sahhar, under the guidance and supervision of Patricia McKenzie (Manager, MNAFM). Héctor Alfonso provided assistance with regard to the financial statements review. The task team also received the support of Samia Msadek (Manager, EAPFM), Behdad Nowroozi (MNAFM), and the World Bank Country Management Unit (MNC04) in Jerusalem and Washington.

The review was conducted through a participatory process involving many West Bank & Gaza institutions, including the Palestinian Ministry of Finance, Monetary Authority, Capital Market Authority, Stock Exchange and Association of Certified Public Accountants, as well as representatives of the private sector and the donor community. In addition, comments on the draft report were received from Douglas Pearce (MNAFP), Zubaidur Rahman (OPCFM) and Thomas Zimmerman (IFAC).

The task team gratefully acknowledges the support and comments received.

The publication of the report was authorized on *August 19, 2010*.

Executive Summary

About the ROSC

This report provides an assessment of corporate sector accounting and auditing practices in the West Bank and Gaza (WB&G), using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and drawing on international experience and best practices in that field. It sets forth several policy recommendations aimed at strengthening the regulatory framework governing financial reporting by corporate entities and the audit practice.

Due to circumstances prevailing in the Gaza Strip at the moment, coverage of accounting and audit practices in that part of the WB&G has been limited.

Background

Forty years of conflict in WB&G has had a significant, negative impact on the economy. However, since its inception, the Palestinian Authority has attempted to provide a supportive environment for the private sector.

In spite of the difficult political and security environment, the Palestinians have managed to establish a financial sector offering most of the expected services, i.e., banking, securities, and insurance. In fact, the Palestinian Stock Exchange is vibrant, with 41 listed companies, and an additional 11 listings expected for 2010. There are 19 registered banks with total market capitalization of about USD 2.5 billion as of June 2010¹, and the Palestine Monetary Authority (banking supervisor) is well regarded internationally for its high level of technical competence. Additionally, large investment companies operate in the country with ambitious programs.

Statutory Framework

There is a dual company law framework in WB&G. The basic pieces of company legislation are a Jordanian law from 1964 in the West Bank, and an Egyptian law from 1929 in Gaza. The laws' requirements are broadly similar. Despite this, there is a need to update some aspects of the laws, and an effort is underway to issue a new, unified law for WB&G.

However, because of the political discord between authorities in the West Bank and Gaza, the Legislative Council has not convened since June 2006, and no laws have been able to be passed during this period. As a result, changes to the legal framework have been enacted through presidential decrees that are not considered to be final from a constitutional point of view and may be subject to revision once the political situation is resolved. Specifically, recent amendments made to the Jordanian Companies Law may be contested in the future. This situation represents a major source of legal uncertainty for Palestinian companies and accounting practitioners.

¹ Source: Palestinian Securities Exchange (PSE).

In general, the statutory framework as it applies to accounting, audit, and financial reporting is broadly up to par with international good practice for regulated companies (listed companies, banks, insurance companies, and micro-finance institutions). Regulated entities are required to follow IFRS, undergo annual independent audits, and make their financial statements available to the public. In addition, separate codes of corporate governance have been adopted for banks, and for listed and insurance companies.

The rules for non-regulated entities tend to be somewhat fragmented and overly stringent, and a specification is lacking in the statutes regarding which accounting standards are to be applied. In practice, non-regulated companies tend to utilize IFRS, which is considered the standard of reference, or USGAAP, as there are no local accounting standards. All companies with limited liability, including small and medium-sized entities (SMEs) are required to undergo an annual independent audit, which represents an unusually heavy regulatory burden on such companies. All companies with limited liability are also required to file their financial statements with the Companies Registrar. These financial statements are made available to the public.

The Audit Profession

The market for the provision of audit services is fairly broad. Demand for services is enhanced by the requirement that all companies publish audited financial statements annually. Intense donor activity in WB&G also generates a significant demand for audit and assurance services. The profession is diverse and is generally dominated by three global firms and one regional firm. These four are responsible for auditing almost all banks, insurance companies, listed companies and other large corporate entities. Accordingly, there is limited competition at this time for the audits of public-interest entities. The activities of mid-sized firms and sole practitioners are mainly geared toward tax return preparation and certification. Independent audit activities in WB&G are regulated by Audit Law no. 9 of 2004.

The audit profession is organized under two bodies recognized by the Audit Law:

- Board of Professional Auditing (BPA), responsible for licensing audit practitioners. BPA was activated through a Presidential decree in 2008. The BPA's revenue resource still represents a major challenge as no provision was made in the law.
- Palestinian Association of Certified Public Accountants (PACPA), which currently has 240 members, including 190 in the West Bank. PACPA is currently seeking IFAC membership, but adherence to IFAC's Statements of Membership Obligations (SMOs), especially with regard to quality assurance, continuing professional education, and discipline, represents a significant challenge for a still nascent profession.

The BPA has yet to issue regulations for the Audit Law, most importantly those relating to entry into the auditing profession (including examinations and experience requirements). In the absence of such regulations, no professional licenses have been

issued since 2004, which has limited the supply of audit services for private businesses, donors and government bodies.

Education and Training

The accounting education system tends to follow the US model, with much less emphasis on international standards. This divergence creates a disparity between accounting education and professional requirements, because IFRS are required by statute for the financial sector and securities market, and are the most commonly used standards in WB&G.

Currently, there is no continuing professional education (CPE) requirement. Regulations of the 2004 Audit Law, currently being drafted, would require 30 hours of CPE every year. Nevertheless, no institution is accredited to provide CPE, and PACPA's education committee is currently dormant. These issues must be addressed in order for the forthcoming CPE requirement to be properly applied in practice.

Monitoring and Enforcement

Initial efforts to enforce financial reporting requirements in WB&G have begun and are relatively developed in the banking sector. In the case of listed companies, both PCMA (Issuance and Disclosure Department) and PSE perform checks of financial statements and conduct enforcement actions. In other sectors, enforcement efforts are still at an incipient stage of development and much remains to be done.


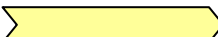
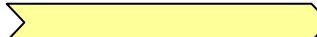
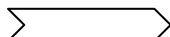
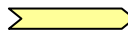
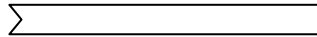
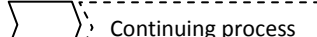
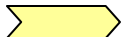
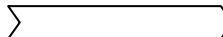
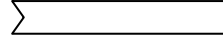

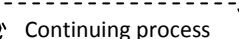
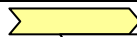
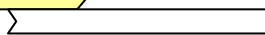
Regarding the audit profession, PACPA's enforcement actions are very limited at the moment. PACPA has recently set up an Office Committee to carry out visits of registered members. This is a first step in the right direction.

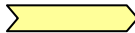
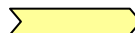
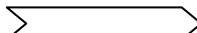

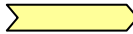

Recommendations

The recommendations arising from this ROSC Accounting and Auditing (A&A) will be discussed with the authorities and in-country stakeholders in Ramallah where a Country Action Plan, to be developed under the supervision of the Ministry of Finance, will be considered. The three key principles underpinning the recommendations are as follows:

- A&A requirements, including ethics, quality control and professional standards, should be complete, appropriate for the WB&G and consistent with international standards;
- In order for preparers, auditors and users to operate under such system, they should have adequate professional capacity and level of competence; and
- A well-designed and properly funded system of monitoring and enforcement should be in place.

The report's recommendations are summarized in the table below.

West Bank and Gaza ROSC Accounting and Auditing: Summary of Recommendations and Preliminary Action Plan Outline							
Action		Priority (High/ Medium)	Reference (paragraph of ROSC report)	Leading Entity	Timing of Implementation		
					1-6 months	6-12 months	2 years
Objective 1: Managing the Reform Process							
1.	Establish steering committee for A&A development in WB&G	H	76	MOF-BPA			
2.	Prepare a detailed action plan to implement ROSC recommendations	H	76	MOF-BPA			
Objective 2: Modernizing the A&A Statutory Framework							
3.	Provide relief from unduly burdensome A&A requirements to local small enterprises	H	79 1	MOF-BPA			
4.	Set clear boundaries between PCMA's and PSE's role regarding enforcement of financial reporting	M	79 a	MOF-BPA			
Objective 3: Adopting International Accounting Standards							
5.	Provide simplified accounting and financial reporting standards for small and medium-sized enterprises a. Adopt for IFRS for SMEs b. Develop accounting basis for small enterprises c. Activate committee responsible for accounting standards	H M M	79 b	<div><div></div><div>BPA/ PACPA</div><div>PACPA</div></div>	<div></div> <div></div> <div> Continuing process</div>		
Objective 4: Strengthening the Audit Profession							
6.	Finalize the Regulations of the Audit law <ul style="list-style-type: none">Entry into the accounting professionContinuing professional education (CPE)Other aspects	H M M	79 c	BPA	<div></div> <div></div> <div></div>		
7.	Assume oversight role and monitor application of auditing and ethical standards.	H	79 c	BPA	<div></div> <div> Continuing process</div>		
8.	Adopt ISQC 1 Assist PACPA members with their implementation	H M	79 c	PACPA	<div></div> <div></div>		

West Bank and Gaza ROSC Accounting and Auditing: Summary of Recommendations and Preliminary Action Plan Outline							
Action		Priority (High/ Medium)	Reference (paragraph of ROSC report)	Leading Entity	Timing of Implementation		
					1-6 months	6-12 months	2 years
Objective 5: Education and Training							
9.	Establish relevant training programs for each professional category	H	79 d	PACPA			
10.	Draw upon IESs in designing detailed procedures for auditor licensing and CPE arrangements	H	D	BPA			
11.	Develop a CPE program consistent with IFAC's International Education Standards	M	D	PACPA			
12.	Engage in a dialogue with universities in WB&G to: a. update and redesign accounting syllabi and faculty training programs for adequate coverage of IFRS / IFRS-for-SMEs b. provide practice-oriented teaching focusing on business administration and case studies	M	79 d	PACPA (in cooperation with WB&G universities)			
Objective 6: Capacity Development							
13.	Develop institutional and technical capacity to meet statutory responsibilities	H	79 e	BPA			
14.	Develop its capacity in key areas that are essential for the profession to achieve high quality of practice	M	79 e	PACPA			

I. BACKGROUND

A. Introduction and Country Background

1. **This Report on the Observance of Standards and Codes for Accounting and Auditing (ROSC A&A) is a part of the World Bank (WB) and International Monetary Fund (IMF) joint initiative to review countries' use of 12 internationally recognized standards/codes related to economic stability and private and financial sector development,** including evaluating the country's accounting and auditing practices based on internationally recognized benchmarks and, based on that review, to make policy recommendations to help it bridge the gaps between current practices and those considered adequate.

2. **ROSC policy recommendations are intended to help strengthen a country's financial architecture, attract more foreign direct investment and foreign portfolio investment, and mobilize domestic savings, which, in turn, would allow for pension savings.** In addition, improved financial reporting allows investors to better evaluate corporate prospects and make informed investment and voting decisions, which results in a lower cost of capital and a better allocation of capital and resources. Financial reporting is also the bedrock of corporate governance, allowing shareholders and the public at large to monitor management's performance.

3. **Forty years of conflict in West Bank and Gaza (WB&G) has had a significant, negative impact on the economy. However, since its inception, the Palestinian Authority (PA) has attempted to provide a supportive environment for private sector.**

4. **The formal financial sector in WB&G emerged after the signing of the Oslo Accord in 1993 and the Paris Protocol in 1994.** The Paris Protocol provided Palestinians the authority to administer monetary and financial affairs in order to support expected economic growth. Those expectations were never fully realized because of ongoing tension among stakeholders, political instability and restrictions on the mobility of persons and goods. The economic recovery that began in 1994 came to an abrupt halt in 2000 and then went into reverse in 2006 after the election of Hamas and its divisionary consequences between the West Bank and Gaza. In June 2007, Hamas took control of Gaza by force, and on June 17, President Abbas dissolved the Hamas-led government and swore in an emergency government, which has since become known as the Caretaker Government, until new presidential and parliamentary elections can be held. The international community rallied around the new Caretaker Government and restarted their programs of financial and technical support.

B. Current Macroeconomic Context

5. **Improving accountability and transparency is one of the Caretaker Government's highest priorities and is an area of focused support for private sector development and sustainable economic growth.** In the context of the current financial crisis and with the current political and economic situation in West Bank and Gaza, improving corporate financial reporting is essential to create an environment in which commercial business can thrive. Strengthening the

international and national financial architecture is a prerequisite to promoting investment and improving access to credit through comprehensive disclosure and strong accounting and auditing practices.

6. In WB&G, the WB's efforts to promote economic growth and poverty reduction include diagnostic work and non-lending advisory services for policy and institutional support. The ROSC A&A serves in this context to strengthen the role of the oversight bodies in WB&G and apply international accounting and reporting standards that are essential for economic growth and a better investment environment. The important function of such study is not only to underpin the role of the supervising and monitoring authorities of the financial sector, the Palestinian Monetary Authority (PMA) and Capital Market Authority (CMA), but also to reinforce reliance on the external audit reports that represent the backbone for monitoring the PA's use of WB funds and those of other donors.

7. WB&G's fiscal situation has been battered by the political situation in the region. Following the cessation of donor aid as a result of the Hamas victory in the June 2006 elections, progress on the financial reforms that had been underway ceased, and in some cases regressed. Following the subsequent formation of the Caretaker Government, a realignment of aid assistance has taken place to focus on supporting the Government's proposed Palestinian Reform and Development Plan. The December 2007 Paris Conference resulted in donor commitments of US\$7.5 billion over the 2008-2011 period to boost economic growth and address the welfare of its citizens. The Government has requested a large proportion of unrestricted aid in the form of direct budgetary support in order to enable it to address its high operating costs (salaries and pensions) and government net lending to municipalities to cover electricity costs provided by the Israeli Electricity Company. Currently, domestic revenues are insufficient to cover these costs.

8. The WB's recent Palestine Reform and Development Plan estimated that the WB&G per capita GDP had fallen from US\$1,610 in 1999 to US\$1,259 in 2007 (est).² Except for 2003-2005, growth has been negative every year since 2000. GDP contracted by nearly 8.8 percent in 2006 and by 4.2 percent in the first quarter of 2007. The Government and IMF forecasts for GDP nominal growth are in the range of 10.7 to 10.2 percent for the period 2008 to 2010.³ The net effect is that GDP levels have been maintained by government recurrent expenditures and private consumption funded by donor aid and remittances, while investment has fallen to exceedingly low levels. Public investment has nearly ceased and in the last two years, almost all government funds have been used to pay salaries and cover operating costs. Private investment is also low and the IMF estimates that it fell by over 15 percent between 2005 and 2006. This stagnation in investment will impede recovery efforts when conditions for economic growth return.

9. One of the top priorities of the WB&G government is to stabilize the budget over the period 2008-2010. Measures supporting the achievement of that objective include improving governance; assigning a priority to expenditures and investments in public goods and the social sector; controlling the wage bill; reducing subsidies, reforming tax administration; reducing

² World Bank, *Program Document for a Proposed Grant.... to West Bank and Gaza for a Palestinian Reform and Development Plan Development Policy Grant*, April 2008, pp 3-15.

³ *Ibid.*, p. 16.

payment of arrears; creating an Accountant General within the Ministry of Finance (MoF); re-establishing a single Central Treasury Account; and implementing a modern government financial management information system.

10. The ROSC A&A for the WB&G addresses the following three key strategic objectives in the WB FY08-10 Strategy Note presented in April 2008: private sector development; transparency; and capacity development of institutions involved in the regulation of accounting and auditing. An important step towards improving the investment climate is the consistent application of international standards. Adhering to international standards will increase market access to financing, essential for healthy growth in the financial and investment sectors.

C. WB&G's Financial Sector

11. In spite of the difficult environment and the fact that WB&G lacks its own currency and still uses Israeli shekels, along with the US dollar, Jordanian dinar, and euro, the Palestinians have managed to establish a financial sector offering most of the expected services: banking, securities market, and insurance. In fact, the Palestinian Stock Exchange is very vibrant, with 41 listed companies, and an additional 11 IPOs expected for 2010. A more detailed description of the sector may be found in a 2008 Financial Sector Review.⁴

Banking Sector

12. WB&G has 19 banks including seven listed on the PSE. The majority of the banks conduct business internationally with 208 branches in the Palestinian territories and total assets of US\$8.1billion. Eleven of the 19 banks are foreign (Jordanian/Egyptian), including one international bank (HSBC).⁵

13. As in most developing countries, the banking sector dominates the financial sector. Banks are generally in sound financial condition and products are well developed as is the regulatory infrastructure. However, the sector remains vulnerable due to its high dependence on the Jordanian banking system and, from an operational point of view, on the Israeli one. Due to a large extent to the current political instability and to the depressed economic activity, the banks' role in the financing of the WB&G economy is yet nascent. Important steps have been taken by PMA to develop the banking system and improve its stability (credit bureau, payments system, capital requirements). Additionally, two bank loan guarantee programs were successfully launched in order to substitute for the lack of acceptable collateral for small and medium enterprises (SMEs). Despite the current economic situation, those programs are expected to continue to expand.

⁴ For more information, please refer to the World Bank's WB&G Financial Sector Review (2008)

⁵ Information source: PMA on May 26, 2010

Securities Market

14. The capital market, which consists of underwriting of share issues and trading of shares on the Palestinian Stock Exchange (PSE), began 10 years ago. The market is regulated by the PCMA and the PSE, according to an allocation of responsibilities that needs further clarification. PSE, which became a public shareholding company as of February 2010, is owned by PADICO, a privately owned listed company, and is based in Nablus with offices in Ramallah.

15. The Palestine Stock Exchange is quite dynamic; however, it is thinly traded and volatile. There are 41 listed companies. Although PSE has state-of-the-art trading systems and is well equipped to deal with volatile market trading conditions, it is thinly traded. Two-thirds of PSE market capitalization is dominated by three companies: Palestinian Telecommunications Company, PADICO and Bank of Palestine. In addition, the index is volatile, which could potentially amplify economic shocks.

Insurance

16. With ten insurance companies, representing 2.5 percent of the financial sector's total assets, the insurance sector is not an important institutional investor in WB&G. The contribution of insurance premia to GDP was only 1.6 percent in 2006 while spending on insurance per capita was about US\$18, compared to an average of 2.7 percent and US\$60 in other developing countries. This situation mainly reflects the depressed level of economic activity, transit restrictions and limited public awareness of insurance products.

17. The PCMA took over supervision of the insurance industry from the MoF insurance supervisor at its creation in 2005 and has a number of remedial supervisory measures underway. Insurance products are varied but overall income has declined due to the marked reduction in underwriting of compulsory motor vehicle insurance. The legal and regulatory infrastructure for insurance is based on international practices, and the Council of Ministers and PCMA have issued prudential and market conduct regulations. Market development depends mostly on an increase in economic activity though some new products were recently introduced that are promising.

Pension Funds

18. There are no privately managed pension products in WB&G, and the domestic financial sector currently lacks entities other than insurance companies that could offer or manage pension products.

II. INSTITUTIONAL FRAMEWORK FOR CORPORATE FINANCIAL REPORTING AND AUDITING

A. Statutory Framework

19. Regulated entities subject to the PMA and PCMA regulations, such as financial institutions, insurance companies and listed companies, are required to follow IFRS, undergo annual independent audits, and make their financial statements available to the public. The rules for non-regulated entities tend to be somewhat fragmented and overly stringent, and a specification is lacking in the statutes regarding which accounting standards are to be applied. All companies with limited liability, including small and medium-sized entities (SMEs) are required to undergo an annual independent audit, which imposes a heavy regulatory burden on such companies.

20. There is some uncertainty with regard to the legal framework currently in force in WB&G. The Legislative Council has not convened since June 2007, when Hamas came to power in Gaza. Since no laws have been able to be passed during this period, presidential decrees have been issued instead. However, such decrees are not considered final from a constitutional point of view, and as a result, may be subject to revision once the political situation is resolved. Specifically, recent amendments made to the Jordanian Companies Law may be contested in the future.

21. The basic pieces of legislation setting forth the legal forms private companies may take are Companies Law no. 12 of the Hashemite Kingdom of Jordan (1964) as amended in the West Bank, and Egyptian Companies Act no. 18 (1929) in Gaza. The types of companies are broadly similar to the ones found in other jurisdictions (public corporation, closely-held corporation, general partnership, and limited partnership).⁶ In the West Bank, corporations represent 32 percent of all companies, and partnerships, 67 percent.⁷ All corporations are required to have at least 20 shareholders. Private corporations are restricted to a maximum of 50 shareholders and may not be listed. Public corporations must be listed;⁸ 41 currently are.

22. No specific accounting standards are required by statute except in regulated sectors. The company laws also set forth the minimum accounting, auditing and publication requirements for companies. The two laws are generally in alignment, and the financial reporting requirements of WB&G companies are broadly similar. All limited liability companies are required to prepare financial statements; however, the laws do not specify the form and content of the financial statements that must be prepared (e.g., balance sheet, income statement, etc.). In addition, all companies are required to abide by the Income Tax Law of 1995, as amended. The tax authority sets forth tax accounting rules; however, they are rarely applied in practice. **In practice, IFRS are the standards of reference in WB&G, and many public interest entities (PIEs) apply IFRS (see below and Section III).**

⁶ Art. 9, 36, 39 and 44 of the Jordanian Companies Law no. 12 (1964) stipulates the legal forms companies may take.

⁷ Source: Companies Registrar. No breakdown by type of company is available for the Gaza Strip.

⁸ Art. 103 of Securities Law (2004).

23. The WB&G statutes do not provide for a differentiated reporting framework allowing SMEs to apply a simpler set of standards, which poses the risk of an excessive regulatory burden on these SMEs. Full IFRS are designed for PIEs, i.e. companies in which the public has a significant interest, such as listed companies. Full IFRS are considered too burdensome for smaller companies. In this regard, since WB&G has adopted IFRS (*de jure* for PIEs and *de facto* for other companies), it should consider adopting the IFRS for SMEs, a simplified and abridged version of full IFRS.

24. All companies are required to file annual financial statements with the Companies Registrar within four months of the year-end. As per the PCMA Disclosure Regulations Article 20, unlisted companies are required to disclose annually their audited financial statements and other material information to the PCMA.⁹ Additional rules apply to regulated entities (listed companies, financial institutions, etc.). The application of corporate financial reporting and auditing requirements to different enterprises is summarized in Table 1. A detailed table of requirements is provided in **Annex 1**.

Table 1 – Overview of Financial Reporting and Auditing Requirements in WB&G

	Regulatory Agency	Financial Reporting Standards	Audit Requirement	Publication and Other
Listed companies	PCMA and PSE	IAS	Yes	- Publication on PSE website - Audit partner/staff rotation every 5 years
Banks	PMA	IAS and PMA regulations	Yes	- Publication in two newspapers of general circulation - Audit partner rotation every 5 years - Audit committee required
Insurance companies	PCMA	IAS and PCMA regulations	Yes	- Publication in one newspaper
Non-bank Financial Institutions	PMA	IAS	Yes	- No publication - Audit partner rotation every 5 years
Non-listed companies	Companies Registrar PCMA	Not specified	Yes	- F/S available through the Companies Registrar

25. Listed companies are required to follow IAS, as well as additional requirements of the Palestine Stock Exchange (PSE) and the Palestine Capital Markets Authority (PCMA). The requirements of the PSE and PCMA are substantially the same. Listed companies are required to

⁹ Material information definition is stated in the PCMA 2004 Disclosure Regulations, page 5.

submit audited financial statements—comprising a balance sheet, income statement, statement of changes in equity and cash flow statement—on an annual basis to the PSE and PCMA.¹⁰ Annual financial statements, audited by an external auditor, must be submitted within three months of the year-end.¹¹ Semi-annual financial statements reviewed by the external auditor must be submitted within 45 days of the semester-end. Quarterly financial statements audited by the company's internal auditor, if applicable,¹² must be submitted within 45 days of the end of the first and third quarters. In addition, any other developments in a company's business, management and financial position should be communicated to the PSE within one working day (e.g., changes to the board of directors, executive management, etc.).

26. The PSE has set up an e-disclosure system through which listed companies are able to submit all relevant information. This information is shared with PCMA. The PSE requires listed companies to prepare their financial statements in accordance with International Accounting Standards (IAS),¹³ although the most current version of IFRS is used in practice. The audited financial statements of listed companies are published on the PSE website.¹⁴ The PSE is required to disclose to the PCMA all information pertaining to listed companies as well as material information that may affect the stock exchange market.¹⁵

27. Banks are required to prepare financial statements in accordance with IAS.¹⁶ In practice, the most current version of IFRS is applied. As required by IAS 1, *Presentation of Financial Statements*, the financial statements of banks must comprise a statement of financial position (balance sheet), income statement, statement of changes in equity, cash flow statement, and notes.¹⁷ Annual financial statements must be submitted to the PMA at least two weeks prior to the annual general meeting of shareholders (GAM). The GAM must be held no later than four months after the year-end.¹⁸ The balance sheet, profit-and-loss statement, and audit report of banks must be published in two newspapers by June 30 of the following year.¹⁹

28. Insurance companies are required to apply IAS and specific PCMA instructions in the preparation of their financial statements.²⁰ In practice, insurance companies apply the most current version of IFRS. The PCMA also requires that the financial statements of insurance companies follow a prescribed template. Their financial statements must comprise a balance sheet, profit-and-loss statements, profit distribution statement, as well as other reports for prudential purposes.²¹ These must be submitted within 90 days of the year-end to the PCMA.²² Unlisted insurance companies must publish their financial statements in one newspaper within

¹⁰ Art. 31.4 and 73.2 of PSE Reporting Regulations (2006).

¹¹ Art. 35 of Securities Law (2004); Art. 3.1.b, 3.1.c, 5.1.a of PSE Reporting Regulations for listed companies (2006) and Article 75 of PCMA law, regulation 6T for unlisted

¹² Art. 3.1 of PSE Reporting Regulations (2006).

¹³ Art. 5.3 of PSE Reporting Regulations (2006).

¹⁴ Art. 17.3 of PSE Reporting Regulations (2006).

¹⁵ Art. 15 of the PCMA Disclosure Regulations (2004)

¹⁶ Art. 40 of the Banking Law (2002).

¹⁷ Banks are required to apply IAS per Art. 40 of the Banking Law (2002).

¹⁸ Art. 42.4 of the Banking Law (2002).

¹⁹ Art. 45 of the Banking Law (2002).

²⁰ Art. 75 of PCMA Regulation 6T (2007).

²¹ Art. 75.1 of the Insurance Law (2005)

²² Art. 4.3.2 of PCMA Regulation 6T (2007).

four months of the year-end.²³ For listed insurance companies, financial statements must be published in one newspaper, within three months of the year-end.²⁴

29. Micro-Finance Institutions (MFIs) are required to apply IAS; they will soon be required to also follow specific PMA regulations, which are still in draft. MFIs are required to prepare a consolidated balance sheet, consolidated profit-and-loss statement, statement of changes in equity, cash flow statement, and notes to the financial statements on an annual basis. These financial reports need to be audited and submitted to the PMA within three months of the year-end.²⁵ There is no publication requirement for MFIs.²⁶

30. Listed companies, banks, insurance companies, and MFIs are required by PCMA and PMA regulations to be audited by a certified public accountant (CPA) registered with PACPA. The PSE must be informed of listed companies' auditor appointments and terminations within one day of their occurrence.²⁷ In the case of banks, external auditors must be approved by the PMA. Prospective auditors and firms must submit an application to PMA demonstrating that they are licensed with PACPA and have adequate experience auditing financial institutions. For the insurance sector, PCMA must be notified of auditor appointment and terminations within three days.²⁸ Further, a statutory auditor may not audit more than one insurance company at a time.²⁹ This rule, however, is not strictly enforced. There is no such limitation for listed companies, banks, or MFIs. There is currently no regulation requiring MFIs to inform PMA or PCMA on the appointment and termination of auditors.

31. All limited liability companies—regardless of size—are required to undergo a statutory audit on an annual basis.³⁰ As mentioned previously, all limited companies are required to submit audited annual financial statements to the Companies Registrar as well as to the Tax Authority. The external audit must be performed by a licensed member of the PACPA, who must sign the financial statements. In practice, however, non-CPAs are signing the financial statements that are submitted to both the Companies Registrar and Tax Authority. The wholesale requirement for a financial statement audit for all limited companies is somewhat unusual. In many other countries, closely-held companies are not subject to such requirement. In others, statutory audits are only applicable to large non-listed entities. Given the large number of small and medium-sized enterprises in WB&G, the general audit requirements seems excessive, and raises the cost of doing business, or may even result in habitual non-compliance.

32. PACPA has adopted ISA in its bylaws. Since all statutory audits are required to be carried out by PACPA-licensed auditors, they should be carried out in conformity with ISA.

33. Listed companies are required to undergo statutory auditor rotation every five years, similar to banks and MFIs. The PCMA requires that listed companies undergo a statutory audit

²³ Art. 168.1 of the Insurance Law (2005) and PCMA Regulation 6T (2007).

²⁴ Art. 4.3.2 of PCMA Regulation 6T (2007) and Art. 17.3 of PSE Reporting Regulations (2006).

²⁵ Art. 3.1.b of the order 20/5 and Art. 5.1.a of PSE Reporting Regulations (2006).

²⁶ Art. 17.4 of draft PMA regulation (2009).

²⁷ Art. 39 of PSE Reporting Regulations (2006).

²⁸ Art. 10 of Insurance Law (2005).

²⁹ Art. 76 of Insurance Law (2005).

³⁰ Art. 168.1 of the Companies Law no. 12 of the Hashemite Kingdom of Jordan (1964).

partner or staff rotation at least every five years,³¹ whereas banks and MFIs are required to rotate the audit *partner* every five years, per PMA rules.³² PCMA is currently in the process of developing an auditor rotation requirement for the insurance sector.

34. Banks are required to form an audit committee.³³ The members of the audit committee are appointed by the board of directors, and the majority of its membership must be independent (i.e., not officers or employees of the bank). Among other things, the audit committee is responsible for reviewing the financial statements of the bank, reviewing the recommendations made by the external and internal auditors, and recommending an external auditor to the board and shareholders. The law does not require that audit committee members have specific skills or experience in accounting, finance, or related areas. Communications with the external auditors are governed by the rules specified in Code of Corporate Governance.³⁴

35. The PMA and PCMA have both recently adopted a code of good corporate governance. The PMA's code, which applies to the banking sector, contains mandatory requirements (for which sanctions apply in cases of non-compliance) as well as additional guidelines (actions that represent good practices and are encouraged, but not required). The code, which is based on the OECD Corporate Governance Principles (2004), as well as on the Basel Committee's paper on corporate governance for banks, covers a broad range of issues, including composition, structure, and role of the board of directors; compliance, internal and external audit; disclosure and transparency; and risk management. Similarly, PCMA issued a separate code of corporate governance applicable to public entities in November 2009 that contains mandatory requirements as along with additional guidelines representing good practices that are encouraged, but not required.

B. The Audit Profession

36. Independent audit activities in WB&G are regulated by Audit Law no. 9 of 2004 (Audit Law). Audit is understood to include assurance services such as the verification of tax returns. The audit profession is regulated by two bodies, established by the Audit Law:

- **Board of Professional Auditing (BPA):**³⁵ The professional board is the regulatory body for the audit profession and is responsible for licensing practitioners in the Palestinian Territory. The BPA was activated through a Presidential decree of 2008. However, the law made no provision for revenue resources and underfunding represents a major challenge. The audit board is a multidisciplinary body chaired by the Deputy Minister of Finance. It also includes members from the Public Control Commission (Vice Chairman), Ministry of National Economy, Palestine Monetary Authority, PACPA, and academia.

³¹ Paragraph 56 PCMA Code of Corporate Governance (2009).

³² Code of Corporate Governance Third Principle.

³³ Art. 41 of Banking Law (2002).

³⁴ PMA Code of Corporate Governance Third Principle.

³⁵ According to the 2004 Audit Law article 5, BPA is responsible for awarding licensing, issuing implementing regulations for the law, applying disciplinary actions, carrying out the licensing exams and any other function stipulated by the 2004 Law.

- **The Palestinian Association of Certified Public Accountants (PACPA):**³⁶ the professional association of auditors, which currently consists of 240 members (190 in West Bank and 50 in Gaza). PACPA is a member of the Arab Federation of Accountants and Auditors (AFAAC) and of the Mediterranean Federation of Certified Accountants (FCMA).

37. Non-audit activities, including bookkeeping and preparation of tax returns, are unregulated. PACPA membership is required only for firms or individuals issuing independent audit reports. Coupled with the fact that all companies with limited liability are required by law to have their annual financial statements audited and the importance of audit and assurance services to donor agencies, the lack of regulation of non-audit accounting functions explains why the Palestinian accounting profession is essentially an *audit* profession.

38. Under the Audit Law, the principal requirements for obtaining a license to practice as an auditor, in addition to passing the examination set by the BPA, include obtaining a university degree in accounting or related discipline, and at least five years of practical experience in audit.³⁷ In addition, prospective CPAs must be Palestinian nationals. According to article 9 of the Audit Law, the Ministry of Education and Higher Education is the competent authority to accredit and assess academic qualifications stipulated in the Law. Currently, there are no examinations given to CPA candidates. However, offering such an exam is being studied under new licensing regulations, which are currently under development by the BPA. There are no clear arrangements for monitoring practical experience gained by candidates to ensure it is acceptable. Also the 2004 Audit Law is not clear on whether the monitoring of practical training experience should be the responsibility of the BPA or the PACPA membership committee.

39. No licenses have been issued since 2004, and regulations have yet to be issued regarding entry requirements for licensing. Regulations are expected to be issued by the BPA in 2010. In the meantime, the licensing process is on hold and over 120 applications for licenses are pending, but cannot be approved until matters relating to professional examinations, qualifications, and professional experience are regulated. This blockage has become a major hindrance to the development of the profession. The regulatory vacuum for licensing and regulations in Gaza is further exacerbated by the BPA's decision to accept West Bank applications only. The BPA indicated that its decision is contingent on the resolution of the conflict between WB&G.

40. The market for the provision of audit services is fairly broad. Demand for services is enhanced by the requirement that all companies publish audited financial statements annually. Intense donor activity in WB&G also generates a significant demand for audit and assurance services. The profession is diverse and includes three of the large audit firms that audit almost all banks, insurance companies, listed companies and other large corporate entities (e.g., PIF,

³⁶ Even though the literal translation of the official name in Arabic is "Palestinian Association of Certified Auditors", the commonly used translation is "(...) Association of CPA". PACPA is registered as a society under registration no. 5026 issued by the Ministry of Interior.

³⁷ Graduate degrees in accounting (master or doctorate) reduce the number of years of practical experience that are required. Undergraduate degrees in fields other than accounting (commerce or economics) increase the years of practical experience required. Full details on the requirements are set forth in Art. 9 of the Audit Law (2004).

PADICO). There is limited competition for the audits of public interest entities. Mid-sized firms and sole practitioners are mainly geared toward tax return preparation and certification.

41. The legally sanctioned professional association, PACPA, is still a nascent body; it maintains two full-time and one part-time paid staff. All licensed auditors are required to become members of PACPA. Every three years, elections are conducted for the 13 members of its Board of Directors, which must include at least four members from West Bank and four from Gaza, to ensure fair representation.³⁸ PACPA has nine committees, one each for examinations, professional conduct, continuing professional education, discipline, membership, research,³⁹ public relations and magazine, external relations, and retirement.⁴⁰ However, most of the committees are not active.

42. PACPA's revenues are insufficient to operate effectively. PACPA collects revenue from application fees, annual subscription fees for members, annual licensing fees, courses, seminars and workshops, and other sources, such as donations, which are minimal.

43. PACPA began the IFAC application process in June of 2008 but is not yet a member. It does not yet meet most of the IFAC's SMOs (see Table 2).

Table 2 – PACPA Compliance with IFAC Membership Obligations

SMO	Observance by PACPA
SMO 1: Quality assurance	No quality assurance system is in place and no quality control standards have been adopted, although an initial attempt in the form of an Office Committee has been set up. This represents a commendable effort, and a first step in the right direction. International Standard on Quality Control (ISQC) 1 has not been adopted. ⁴¹
SMO 2: International education standards for professional accountants and other IAESB ⁴² guidance	Professional accountants are required to have a bachelor's degree as a minimum requirement in addition to practical experience in audit. PACPA's CPE committee is not active and adequate follow-up is not conducted. No arrangements are in place for monitoring the adequacy of practical experience gained by candidates.
SMO 3: ISA and other papers IAASB statements.	Adopted ISA in 1998. ISQC 1 has not been adopted. No ongoing process exists for promulgating and supporting implementation of new and amended ISAs by members.

³⁸ Article 18 of PACPA bylaws of December 2008.

³⁹ Research committee, not yet active, under PACPA is responsible for translation, update and promulgation of the standards.

⁴⁰ The nine committees are set forth in Article 50 of the PACPA by-laws.

⁴¹ ISQC 1 sets requirements for "quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements". It is considered an essential link in the system of quality assurance that starts with quality control at the level of individuals audit and assurance engagements and extends to the system of quality reviews and inspections at the level of the profession as a whole.

⁴² International Accounting Education Standards Board.

SMO 4: IFAC code of ethics for professional accountants	Adopted the 2006 version of the Code. No mechanism exists for ensuring that the accountants and auditors in public practice follow an internationally comparable professional code of ethics.
SMO 5: International public sector accounting standards (IPSAS) and related	<i>Public-sector standards (not covered under this ROSC) are not under PACPA's purview.</i>
SMO 6: Investigation and discipline	PACPA holds hearings when a complaint is brought before it; however, very few complaints are presented. The results of the investigation and disciplinary procedures are not normally published.
SMO 7: IFRS	IFRS endorsed by financial sector regulators, even though some differences exist in practice. PACPA has not formally adopted/endorsed IFRS (the bylaws state that "PACPA will work on applying ... International Accounting Standards.").

44. **In Gaza, the audit profession suffers from severe handicaps.** PACPA does not have the means of adequate oversight over the profession in Gaza. The BPA decided not to accept membership applications from Gaza due to the current political situation, thus hindering the development of the profession. While there are no reliable statistics in this regard, it is unlikely that compliance with ISA is common practice, and most audit firms find it difficult to conduct audits in Gaza. Recipients of audit reports, mainly international donor organizations, complain about the lack of professional reports. Internationally affiliated audit firms, on the other hand, complain about a lack of professional staff. Due to the current political situation, it was impossible to conduct verification on audit practices in Gaza.

45. **A sizable number of practitioners offering tax and accounting services did not have a background in audit when they were initially licensed,** due to the fact that they were already practicing during the Israeli Civil Administration of the WB&G. An attempt by the BPA to grade auditors into categories was widely opposed within the profession, and the issue is still under deliberation.

C. Professional Education and Training

46. **The content of accounting education at the tertiary level must be approved by the Ministry of Education and Higher Education, with the purpose of ensuring consistency and quality. This requirement can pose a problem, as it makes the introduction of new courses difficult.** As a result, some universities use the course on "contemporary issues in accounting" to teach international financial reporting standards and ethics, which are not directly covered under the accredited courses. Other universities had introduced a course of international standards but have recently cancelled them due to lack of sufficient material on the topic.

47. **The teaching materials used in universities are focused on US GAAP and US GAAS, with little coverage of IFRS and ISA.** Universities use the latest editions of accountancy and auditing textbooks, mainly from American publishers. The textbooks are selected by the

professor and the staff based on their knowledge of available textbooks. Selections are made every two years. There are no specific courses on international standards in most universities, and no courses are tailored specifically to cover the code of professional ethics, a topic only touched on in other audit classes. As a result, there is a gap between what is taught and what must be applied, as IFRS are required for regulated sectors.

48. There is a shortage of qualified professors to teach IFRS. University professors often lack knowledge of international standards, as most were educated in the United States. They are more familiar with US GAAP than with international standards.

49. An internship is required by most universities for undergraduate students. The internship is supervised by a professor, who receives weekly reports. At the end of the internship, a comprehensive report should be submitted by the student. Internships are mainly in audit firms, private sector companies, government bodies, and banks. The internship is required to be in the field of the student's major. However, students have limited options when it comes to internships, and universities do not assess potential internship providers in order to ensure that proper and adequate training is offered to students.

50. Currently, there is no continuing professional education (CPE) requirement. New BPA bylaws currently being drafted would require 30 hours of CPE every year. However, there are no institutions accredited by PACPA to provide CPE, and PACPA's education committee is currently not active. These issues must be addressed in order for the forthcoming CPE requirement to be properly applied in practice.

D. Ensuring Compliance with Accounting and Auditing Standards

51. The PCMA conducts some basic reviews that provide a basis for developing a more robust enforcement regime in the future. The primary responsibility for enforcing listed companies' financial reporting obligations lies with the PCMA. Companies that do not comply with the reporting and disclosure regulations are subject to penalties that can vary from a written warning to a heavy fine.⁴³ Currently, there are 58 companies under PCMA's purview, including the 41 listed companies and an additional 17 non-listed public limited companies. Listed companies submit their non-audited (preliminary) basic annual financial statements to the PCMA for review, no later than 45 days after year-end. Companies are to submit the full set of financial statements with notes and the accompanying audit report no later than three months after year-end.

52. Within the PCMA, the Issuance and Disclosure Department performs several reviews, including (a) an analysis of changes between preliminary and final versions; (b) a review of unusual items such as "abnormal changes" in amounts compared to the previous years, changes in accounting policies, and subsequent events; and (c) a review of specific elements of the financial statements such as investments. When a material issue is uncovered, the PCMA sends a

⁴³ Regulation number 11/2008 sets out the penalties that are divided into: category (1) a written warning with a request for an immediate corrective action, categories (2), (3) repetitive non-compliance for which the penalties can range between JOR500-JOR100, 000 and category (4) for delisting.

note to the company's general manager requesting clarification or corrective action. The note can take the form of a written reprimand. The process for conducting reviews is not documented and does not follow a formal, approved procedure. It should be noted that the PCMA's supervisory framework is currently being reassessed with the support of WB technical assistance in order to revamp the securities market regulatory framework.

53. The PSE has recently started conducting its own enforcement actions on recurring financial reporting by listed companies, besides the usual reviews of the financial information contained in the offering documents at the time of the issues. The Securities Market Law of 2004 did not set clear boundaries between PCMA's and PSE's roles regarding enforcement of financial reporting requirements. The PSE's vision is that it should leave the role of setting rules to the PCMA and focus on enhancing PSE monitoring and enforcement of issuers' financial reporting. Starting June 30, 2009, for the first time PSE personnel began reviewing financial statements filed by issuers. In the near future, PSE plans to retain a professional firm or hire specialized staff to carry out more thorough reviews on its behalf.

54. For the banking sector, the PMA performs a broad range of on-site and off-site monitoring and enforcement actions, including specific actions regarding financial reporting. Off-site supervision is based on the CAMELS rating system and monthly ratio analyses, using an offsite, in-house banking supervision system. In order to foster adherence to its standards the PMA has issued specimen financial statements including minimum disclosures. The PMA's banking supervision department has 59 employees and 16 in Gaza including some Arab Certified Public Accountants (ACPA). Coordination takes place with PCMA regarding listed banks' disclosures. Before banks may release their financial statements to the public, they must be approved by the PMA.

55. Regarding insurance companies, the regulatory framework for financial reporting and enforcement is still being developed. The PCMA supervises the insurance sector through an ad hoc department with a staff whose professional experience averages five years. In addition, a three-member committee (two members from the PCMA and one from the Insurance Federation) oversees the results of inspections and other monitoring actions. The outcome of inspections is communicated verbally to the inspected entities. The procedures for reviewing insurance financial statements under IFRS and the related information and documentation need to be formalized.

56. The registry of companies conducts basic enforcement actions regarding non-listed companies. One of these is a notice issued in the press to remind all companies that they are required by law to file their financial statements. For public limited companies, if the Registrar does not receive the financial statements, it normally issues a reminder letter to the general manager. For closely-held companies that do not file their financial statements, no follow-up action is taken.

57. Monitoring of the audit practice is currently very limited and there is no Quality Assurance review system in place. PACPA does not conduct practice reviews or inspection of its membership. It has recently set up an Office Committee to carry out visits to registered practitioners in order to ensure that they actually practice accounting and auditing and do not

conduct business activities that are deemed incompatible with PACPA membership or detrimental to the profession's image.

58. PACPA's Ethics Committee reviews cases of complaints against members but there have been very few such complaints. According to PACPA, for 2008, approximately seven meetings were held to review six cases, most of which related to complaints from PACPA members, and no sanctions have been published recently.⁴⁴

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

A. Accounting Standards as Designed

59. IFRS are currently required in all regulated business sectors in West Bank & Gaza, for legal entity and consolidated financial reporting. As noted in section II.A above, International Accounting Standards (IAS, the predecessor of IFRS) are mandated by PSE regulations (2008), the banking law (2002), and PCMA Regulations pertaining to insurance (2007). For MFIs, the draft regulations prepared by the PMA, which may be issued in 2010, include a requirement for IAS-based financial statements. The adoption of IAS (interpreted as meaning IFRS) was done directly, that is, without an endorsement process. WB&G has no standard-setting body for accounting, and it is not clear how such an endorsement process could add value for WB&G and how it could be sustained given the costs associated with it and the current circumstances. The text of the standards used by the local practitioners is an Arabic-language translation published by a regional audit firm and printed abroad; the most up-to-date translation is based on the 2007 IFRS handbook.

60. For the banking sector, even though IAS (understood as meaning IFRS) is mandated by the banking law, in effect some differences with the international standard do exist. Areas of difference relate to (a) the valuation of loan-loss provisions, (b) loan-loss provision disclosures and (c) the accounting treatment of certain types of transactions pertaining to Islamic banking. The PMA-required method to measure provisions follows a matrix-based approach, that is, it requires fixed percentages of provisions to be applied to the principal amount based on the number of past-due days for different categories of loans. This differs from the approach of IAS 39, Financial Instruments: Recognition and Measurement, which requires assessing loss provisions on the basis of estimated future cash flows by loan or group of loans. Significantly different amounts are likely to result from applying these different approaches.

61. No legally-mandated accounting standards exist for non-regulated sectors. The Companies Law is silent on the question of which accounting standards should be applied and on the source of accounting standards. No local standards have been developed and standards from other countries are not used.

⁴⁴ The committee has looked into two cases of misconduct, but no actions were taken against the auditors. In one case of gross negligence, one auditor's membership has been suspended by a board's decision, but no implementation of the decree has been enforced.

B. Observed Reporting Practices

62. **Consistent with the methodology developed for the ROSC A&A program, 11 sets of corporate financial statements were reviewed as part of this ROSC.** These financial statements, issued as of December 31, 2008, or at an earlier date (one of them in 2004), were English translations of the official financial statements in Arabic. The entities included in the sample are public-interest entities doing business in the financial services, insurance, trading and development, utilities and food distribution industries. The financial statements of a large not-for-profit organization were also reviewed. These reports were audited by Big-4 firms, except in two cases.

63. **Overall, the review of the financial statements of the 11 enterprises included in the sample showed a degree of compliance with IFRS, even though the instances of non-compliance it revealed call for a more robust enforcement regime.** In particular, disclosure inadequacies appear to be prevalent. Moreover, the financial statements for Islamic banking institutions are silent about discrepancies with IFRS on areas such as revenue recognition and recognition and measurement of assets and liabilities. Sweeping statements such as “fair value is in line with carrying values” are commonly found but no information is provided supporting such claims. Often the quality of the English language in the notes to the financial statements is sub-standard, affecting the understandability of the statements. The extent and nature of problems identified within the sample of financial statements reviewed are summarized in Table 2. A summary of individual observations arising from the review is provided in **Annex 2**.

Table 3 – Summary of Findings from the Financial Statement Review

Entity	Sector	Type of F/S	Year-end (MM/YY)	Recognition/ Measurement Issues	Disclosure Issues	Audit Report Issues
A	Utility	Consolidated	12/08		1	
B	Holding	Consolidated	12/08		8	1
C	High technology	Consolidated	12/08		5	1
D	Banking	Consolidated	12/08	1	6	2
E	Insurance	Consolidated	12/08		3	1
F	Insurance	Consolidated	12/07	1	3	3
G	Islamic Banking	Legal entity	12/06	6	5	8
H	Holding	Consolidated	12/04	2	3	2
I	Commercial	Legal entity	12/07	1	2	1
J	Not-for-profit	Legal entity	12/07		1	1

64. **Fair value accounting, a distinctive feature of IFRS, poses a significant challenge in the WB&G.** In particular, the quality of appraisals for property, plant and equipment is at times not considered sufficiently reliable, in which case the reporting entity needs to revert to historical cost basis.

65. There are indications that, in some cases, the notes to the financial statements are prepared by the auditors instead of the companies themselves. This practice is fairly commonplace in countries where professional accountants in business (i.e., outside audit firms) are still learning how to deal with the requirements of IFRS, often with the help of the auditors. However, the fact that auditors prepare the notes tends to limit the company's concerns for the quality of the disclosures and, since the auditor prepares rather than reviews the notes, it represents a lower level of assurance on their accuracy.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

66. PACPA has officially adopted ISA.⁴⁵ Many audit firms assert that they apply ISA in their audits. In practice, however, non-compliance with the standards is widely observed, as there are no quality assurance mechanisms in place to enforce ISA and training on ISAs is generally lacking. The team's review of a sample of financial statements found material departures from international standards. This finding is consistent with the finding that most auditors are neither acquainted with ISA nor trained in their use, and the manuals on ISA and international literature are not readily available to local auditors. In fact, auditors in public practice are better acquainted with US GAAS than ISA, as the US standards are widely taught in local universities and over 30 practitioners are US CPAs.

67. A number of audit clients lack financial reporting expertise and therefore expect the auditors to prepare IFRS-based financial statements; as previously noted, there are clear indications that audit firms are involved extensively in the preparation of those financial statements. Clients emphasize that audit firms gradually transfer knowledge to company staff, who then can take over drafting financial statements. This practice has implications for ownership by preparers of the financial statements and raises issues of audit independence.

68. Some audit firm representatives consider that management attitudes tend to keep audit fees low, which can have a detrimental effect on audit quality. The degree of compliance with applicable auditing standards varies between large and small audit firms. In general, the larger audit firms are better equipped to provide quality audit services, but even in those firms compliance with standards is not always ensured. When management in some companies does not place a high value on the required independent audit, allocating only a small budget to hire a very small audit firm, the low priority assigned to the audit is reflected in the quality of the audit performed.

69. Big-4 network affiliates and other large internationally affiliated firms are required to apply ISA and they are normally subject to intra-networks quality reviews. Based on discussion with firm leadership, random samples of engagements that are classified as high risk are subject to such a review. The audit firms are notified two weeks in advance on engagements to be reviewed, which casts doubt on the actual benefit of this exercise. In addition, a regional review partner is mandatory for those engagements. These quality review procedures are not considered a substitute for an independent professional oversight and quality assurance

⁴⁵ PACPA Bylaws (2008), Art. 49

mechanism under the new framework developed in the wake of the accounting failures of Enron and other large corporations in the late 1990s.

70. While audit reports are generally in line with ISA in terms of content and wording, a significant degree of non-compliance was found. Instances of non-compliance related to (a) the acceptance of obvious transgressions in the application of IFRS accounting and disclosure requirements, (b) the inclusion of additional paragraphs not contemplated by IFAC rules and, (c) in one case, departures from the text of ISA 700, The Independent Auditor's Report on a Complete Set of General-Purpose Financial Statements, which made the relevant report difficult to understand. Except in one case, the audit reports are silent on the uncertainties arising from the current political situation in WB&G, despite the associated business risks for the companies whose financial statements are audited.

71. Auditors are requested by the PMA to conduct additional compliance testing for companies under their purview. The auditors are asked to issue an opinion on the effectiveness of internal controls and compliance with regulations. However, because checking for compliance with PMA regulations beyond the financial audit is not a compensated activity, in the absence of independent monitoring, compliance is uncertain.

V. PERCEPTIONS ON THE QUALITY OF CORPORATE FINANCIAL REPORTING

72. Overall, financial statements users and corporate financial stakeholders are of the view that large, PIE-type entities show a high degree of compliance with IFRS and that their reports, particularly those audited by Big-4 firms, are reliable. However, the view is mixed regarding reporting by mid-sized and smaller entities, which is held to be insufficient and not to be relied upon. In order to gauge the perceptions regarding the quality of the financial reporting in WB&G, the project team held discussions with various users of financial reports including donors, commercial banks, supervisory bodies (PCMA and PMA), the PSE, and audit practitioners. The common perception from all these parties is that the quality of financial reports varies enormously from PIEs who produce IFRS-based financial statements that are almost systematically audited by a Big-4 firm, to mid-sized companies whose financial statements vary greatly in quality depending on who audits them, and sole proprietorships who produce cash-flow statements.

73. As in most countries, perceptions surrounding the accounting and audit profession are also mixed. Users and stakeholders tend to distinguish three groups within the profession:

- Big-4 affiliates, who audit almost all PIEs and large entities and are seen as placing more emphasis on quality reviews;
- Local firms with international affiliation, who are seen as providing audits of better quality that adhere to international standards; and
- Purely local audit firms whose practice is much less aligned with international standards.

74. Based on these mixed perceptions, financial statement users tend to hire staff of international audit firms who are deemed to be properly trained and have acquired

sufficient competence from their experience working with these firms. This phenomenon, which is well known and observed in other countries, results in high staff turnover within international audit firms, obliging them to repeatedly recruit and train replacement staff.

75. In response to this trend, the profession in WB&G has been trying to formalize and improve the quality of accounting and audit practice by all licensed professionals in order to achieve greater consistency and enhance recognition for the profession as a whole within the business community. PACPA's decision to further develop their activities and apply for IFAC membership is part of this effort. As the overseer of the quality of audit practice in WB&G, the BPA also has a critical role to play in helping address these perceptions and ensure that corporate financial reporting practices meet the users' expectations in terms of quality and reliability.

VI. RECOMMENDATIONS

76. This section sets out 13 policy recommendations based on the findings of this review of accounting and auditing practices, incorporating valuable inputs from stakeholders interviewed by WB staff as part of the ROSC due diligence exercise. **It is expected that these policy recommendations will be used as inputs to preparing a detailed action plan for accountancy reform in WB&G.** In order to best manage the reform process and create the detailed action plan, it is first recommended that the PA and MoF establish a steering committee to expand accounting and auditing development in WB&G.

77. Implementation of these policy recommendations will be beneficial to private and financial sector growth, insofar as they will:

- Strengthen the financial architecture and reduce the risk of financial market crises, and their associated negative economic impacts;
- Provide useful policy advice on financial reporting during the continuing transition to an open market economy, with a view to underpinning confidence in the functioning of the markets;
- Help to attract more foreign direct investment, foreign portfolio investment and help to mobilize domestic savings which may be fed by pension savings;
- Help to facilitate access by smaller-scale corporate borrowers to credit from the formal financial sector by providing better financial information;
- Allow investors in larger-scale enterprises to better evaluate corporate prospects and make informed investment and voting decisions, lowering the cost of capital and improving allocation of capital and resources. Financial reporting is also the bedrock of corporate governance, allowing shareholders and the public at large to monitor management's performance.

78. The key principles underpinning the recommendations presented are as follows:

- A&A requirements as well as education, ethics, quality control and other professional standards should be complete, appropriate for the WB&G and consistent with international standards, without undue complexity;
- In order for preparers, auditors and users to operate with full competence under such system, they should have adequate professional capacity and level of competence; and
- A well-designed and properly funded system of monitoring and enforcement should be in place.

79. The 13 recommendations are grouped into five categories.

A. Statutory Framework

1. Provide relief from unduly burdensome financial reporting and audit requirements to local small enterprises.
2. Set clear boundaries between PCMA's and PSE's role regarding enforcement of financial reporting and disclosure requirements.

B. Accounting and Auditing Standards

3. Adopt IFRS for SMEs as the standard of reference for preparing financial statements outside the regulated sectors (i.e., banks, listed companies and insurance undertakings). This would be consistent with the fact that full IFRS has been adopted *de jure* in the regulated sectors and *de facto* by large enterprises operating in WB&G.
4. For small companies required to file annual financial statements under the Company Laws, an even simpler system should be adopted. The example of the United Kingdom which has developed a set of Financial Reporting Standards for Small Entities (FRSSE), could be drawn upon in that regard.

C. Audit Profession

5. Finalize and promulgate the draft Regulations of the Audit law, most urgently and importantly those relating to entry into the auditing profession (professional examinations, qualifications, and professional experience requirements).
6. The BPA should assume its role as an oversight board and monitor application of auditing and ethical standards to ensure that auditors have established a system of quality control and effectively apply ISA, ISQC 1 and the IFAC Ethics Code.
7. Adopt the International Standards on Quality Control (ISQC) 1 and assist PACPA members with their implementation.

D. Education and Training

8. Promote a CPE program consistent with IAESB's Education Standards. This should be one of the first priorities for PACPA's education committee.
9. Update training and related materials to take into account new and amended IFRS and ISAs and assist professionals with the implementation of the standards. The IFRS Foundation has developed training material for IFRS-for-SMEs which is available for free and could be used to that effect.
10. Engage in a dialogue with universities in WB&G with a view to:
 - i. updating and redesigning accounting syllabi and faculty training programs so as to achieve better coverage of IFRS (including the IFRS-for SMEs), ISAs and IESBA requirements; and
 - ii. providing practice-oriented teaching with stronger focus on business administration and case studies to best prepare professional accountants.
11. Ensure that the national professional licensing program in the area of auditing draws upon internationally recognized practices and, in particular, that IESs are taken in account when designing detailed procedures for professional examination, practical experience and other licensing arrangements as well as for CPE requirements.

E. Capacity Development

12. Develop BPA's institutional and technical capacity to ensure it can meet its responsibilities.
13. In view of the long-term goal of achieving IFAC membership, PACPA should also develop its capacity in key areas that are essential for the profession to achieve high quality of practice, especially education, ethics and professional conduct, and contribution to quality assurance.

Annex 1. Corporate Financial Reporting Requirements by Enterprise Type

	Listed companies	Banks	Insurance companies	Non-listed companies	MFIs
Basic laws and regulations ⁴⁶	Securities law of 2004 PCMA Regulation 5 of 2008 PSE Reporting regulations of 2006	Banking Law of 2002	Insurance law of 2005 Companies Law (1964) ⁴⁷ PCMA Regulation 6T of 2007	West Bank: Jordanian Companies Law (1964) Gaza: Egyptian Act (1929)	PMA draft regulations
Financial Statements	Balance sheet, Income statement, statement of changes in equity, cash flow. PSE 31.4. and 73.2.	Per IAS1 Art. 40	BS, P/L, Profit distribution statement, and other prudential reports. Art. 75.1. a- f /2005	All registered companies must file audited FS Art. 168.1	Consolidated balance sheet, consolidated P/L, Changes in equity, cash flow, notes. [PMA regulations 2009]
Deadlines	3 months (annual) 45 days (interim) Securities Law & [PSE 3.1.b. & 5.1.a. annual & 3.1.c. interim]	Annual FS must be submitted to PMA at least two weeks prior to GMA. GMA to be held no later than 4 months after year-end [Art. 42.4]	90 days from year-end [PCMA regulations Order 6T Art. 4.3.2]	4 months from year-end [Art. 149]	3 months from year-end [PMA regulations 2009]
Accounting Standards	IAS [PSE 5.3.]	IAS [Art. 40]	IAS and specific regulations from PCMA. F/S should follow PCMA templates [Reg. 6T Art. 75]	None specified in law	IAS [Draft PMA regulations of 2009, Art. 17.2 & 18.3]

⁴⁶ Income Tax Law 1995 (updated 2007) also applies.

⁴⁷ Hashemite Kingdom of Jordan, as amended by Presidential decree of May 2008.

	Listed companies	Banks	Insurance companies	Non-listed companies	MFIs
External Audit	Yes Securities Law & PSE 3.1.b	Yes Art. 42	Yes. Appointed for 3 years Art. 76. 1	Yes Art. 168.1	Yes [draft PMA regulations 2009 article 18.1]
Auditing standards ⁴⁸	ISA Art. 5.3 PSE Regulations 2006	ISA Art. 42.3.c	Not specified	Not specified	ISA Draft PMA regulations 2009 article 18.3
Publication	Audited financial statements are published on PSE website. [PSE 17.3.]	Yes, in 2 newspapers by June 30 of following year (balance sheet, P/L, audit report) [PMA reporting regulations]	Unlisted: 4 months [Art. 168.1] Listed: 3 months [PSE reporting regulations], In one newspaper [PCMA Reg. 6T Art. 4.3.5] PSE reporting requirement 17.3	All companies must file audited FS with Companies Registrar. The public may access these F/S for a fee Art. 168.1	No Draft PMA regulation 2009 Article 17.4.
Rotation	Partner/Staff rotation every 5 years [PCMA Code of Corporate Governance]	Partner rotation every 5 years [PMA Code of Corporate Governance]	N/A	N/A	Every 5 years [in compliance with PMA draft regulation]
Regulatory agency	PCMA and PSE	PMA	PCMA	Companies Registrar	PMA
Other	PCMA Code of Corporate Governance (Nov. 2009)	Audit committee required Art. 41	PCMA Code of Corporate Governance (Nov. 2009)		

⁴⁸ PACPA adopted ISA in 1998.its bylaws.

Annex 2. Review of Audited Financial Statements for 2009: Individual Observations

Presentation of Financial Statements

ENTITY A

This report presents a number of presentation flaws, including:

- a certain disregard for formal language (“getting rid” instead of “disposed of”, “selling result charged to the income statement” instead of “transaction results taken to the income of the period”),
- lack of precision in language (“subsidiaries” and “affiliates” used as synonyms, “financial assets/liabilities stated at fair value in the income statement”),
- typing errors (“statemet” where it should read “statement”, “intererest” instead of “interest”), and
- the absence of the name of the entity in the heading of the statements and notes.

ENTITY B / ENTITY C/ ENTITY D

There is no indication of the criteria for classification of current and non-current assets.

ENTITY E

The financial statements are expressed in New Israeli Shekels. However, current year figures are also expressed in US dollars without comparatives. Notes offer full information in Shekels and total balances (i.e. not movements) in US dollars. Since Shekels are the functional currency, it is probable that figures in US dollars are presented for the convenience of the reader and their aim is not to “give a true and fair view”. Nonetheless, the report of the auditors gives an encompassing clean opinion.

ENTITY F

A note to the statements explains that “no disclosure has been given therein to the effects of changes in the general purchasing power of the local currency on the accompanying financial statements”. This disclosure is clearly unnecessary.

Inventories

ENTITY G

Inventories are stated at the “lower of cost or market”. Under the circumstances, the expression “lower of cost or net realizable value” would have been more accurate.

Cash Flow Statement

ENTITY H

Movements in items such as *murabaha* receivables and investments were classified within investment activities flows, and those of marriage savings accounts and amounts due to and from banks and other financial institutions were classified under cash flows from financial activities. Under normal circumstances, they would more properly appear to be flows from operating activities.

Events after the Balance Sheet Date

ENTITY I

No disclosure was made of the date of approval of issue of the financial statements.

Description of Accounting Policies

ENTITY H

Certain practices such as the non-recognition of income from operations forbidden by the Shari'ah, the results of investments in *skouk* (taken to income only at the end of the transaction) and the income on *murabaha* and *ijarah* transactions (taken to income in equal portions over the duration of the financing contracts) are, in principle, at variance with IFRS.⁴⁹

Income Taxes

ENTITY C

Although disclosures made indicate that income tax accounting is in line with IFRS, no adequate details of the calculation of income tax figures, movement of deferred items, details of statutory and actual tax rates, etc. were provided.

ENTITY B

The company is exempt from taxes on regular income until 2010. The statutory rate of 7.5 percent is, however, applicable to the excess of non-deductible expenses over non-taxable income. No reasons were disclosed for a significant payment made in 2007 and recorded under current assets.

⁴⁹ *Murabaha* and *ijarah* contract types form the basis of a variety of Shariah-compliant substitutes to conventional corporate and trade financing solutions. The basic premise of Islamic finance lies in the need to eliminate both interest and uncertainty from financial transactions. *Murabaha* is often referred to as cost-plus financing and frequently appears as a form of trade finance based upon letters of credit to assist short-term trade transactions. In its simplest form, this contract involves the sale of an item on a deferred basis. The item is delivered immediately and the price to be paid for the item includes a mutually agreed margin of profit payable to the seller. The use of leasing is represented by the *ijara* contract, a transaction in which a known benefit (usufruct) associated with a specified asset is sold for a payment. Source: Faraz Fareed Rabbani, Islamic Finance Basics, May 25, 2007 (<http://islamicfinanceaffairs.wordpress.com>)

ENTITY A

No information is given in the accounts on the rates used to calculate the taxes on income. An amount described as “taxes on the profit of the year” in a note is later described in the same note as an accrual for taxes that could be assessed by authorities on years still open to review. The auditors’ report, in a paragraph of emphasis, adds to the confusion, indicating that the figure relates to 2007 and 2008 although the years open to review are 2005 to 2008.

ENTITY J / ENTITY H

Disclosures of bases of calculation, rates and computation of deferred taxes are inadequate.

ENTITY K

Besides inadequate disclosure, deferred tax benefits have been taken to equity.

ENTITY I

No explanations were given in connection with the elimination of a deferred tax asset in 2007. Possibly the de-recognition was linked to a change in the accounting procedure or to the tax rates utilized to calculate the income tax charge for the year.

Property, Plant and Equipment

ENTITY J

PPE items are stated at historical cost, net of accumulated depreciation and impairment according to disclosures made. However, detailed movements of land and buildings show a revaluation figure recorded in 2007 that is also mentioned in the auditors’ report. Also, it is not clear where the revaluation surplus has been taken to. It might have been deducted from a decrease in an equity item described as “revaluation of assets” but the relevant balance had originated from the valuation of available-for-sale investments at market value. In summary, disclosures are clearly inadequate.

ENTITY H

Property is carried at cost, net of accumulated depreciation. Impairment losses are not mentioned. Depreciation rates for hardware and software (7 percent and 12 percent, respectively) and vehicles (15 percent) appear rather low at first sight. A heading reading “omissions” probably refers to “disposals”.

Leases

ENTITY C

The company is party to lease contracts both as a lessor and as a lessee. The disclosures about details of the contracts fall significantly short of the requirements of IAS 17.31 and 17.35.

ENTITY A

Although there are indications in the accounts (leasehold improvements, rent paid) that the bank is party to lease contracts, no information is given on the arrangements, minimum leases, etc.

ENTITY G

The group owns land and property for leasing to third parties and some offices are rented from third parties. However, there is little information on lease contract details.

ENTITY E

The only information given relates to the recognition of rental income on the straight-line basis over the period of the contracts. No further details are offered.

Revenue

ENTITY A

Disclosures on the topic refer to the use of the “accrual basis”. No clarification is given as to what differences, if any, would exist if the “effective rate method” were applied.

ENTITY H

Although the results of *murabaha* and *ijarah* transactions are close to the concept of financing, due to Shari’ah prohibitions, such transactions are structured in a way that equates them to sales and operating leases. In any case, revenue recognition, made in equal sums upon collection of the installments, is not in line with IFRS.

Related Party Disclosures

ENTITY K

No disclosure was made of compensation paid to key management officials.

Accounting for Investments in Associates

ENTITY C

No disclosure was made of summarized financial information or public quotations of associates which, incidentally, constitute the company's largest asset.

ENTITY D

No disclosure was made of summarized financial information of associates or their public quotations.

Earnings per Share

ENTITY C

The weighted number of shares utilized in 2007 as denominator in the calculation of earnings per share disclosed in notes does not coincide with the corresponding number in the statement of changes in equity and in notes.

ENTITY H

No earnings per share information was presented on the face of the income statement.

ENTITY K

Although the basic information can be found in the statements, there is no direct disclosure of earnings per share on the face of the income statement as prescribed by IAS 33.66.

Impairment of Assets

ENTITY H / ENTITY K

There are no indications of the ways impairment calculation for formal activities are carried out along the lines prescribed by IFRS. The PMA mandates that certain percentages (undisclosed in the reports) be provided for to cover future possible losses with currently performing receivables. This would be unacceptable under IFRS.

ENTITY A

Practices for recognition of impairment of assets are described in different sections of the note on accounting principles. Some descriptions are at variance with expectations: (i) the impairment of available-for-sale financial assets recorded at fair value is "the difference between book value and fair value"; (ii) when the expected recoverable value of PPE items is less than its net book value, carrying values are reduced to the "lower of cost or net realizable value and the difference (if any) is included in the statement of income".

ENTITY I

The allowance for doubtful accounts was calculated based on internally-defined, fixed percentages applied to ageing layers of receivables.

Provisions, Contingent Liabilities and Contingent Assets

ENTITY H

Even if the effect of time value of money were material, since this concept is absent in Islamic legislation (Shari'ah), this IFRS requirement could not be taken into consideration.

Financial Instruments: Recognition and Measurement

ENTITY C / ENTITY D

There are indications that loans and receivables and financial liabilities are carried at original amounts (less a provision for uncollectible amounts in the case of loans and receivables). This procedure may be different from the amortized cost using the effective interest rate method prescribed by IFRS but this is not clarified in the accounts. Also, there are no explanations as to how the provisions for uncollectible loans and receivables are calculated (Palestine Telecommunications Co.)

ENTITY A

The accounting practice for the valuation of loans and receivables is described as “cost net of interest and commissions in suspense and provision for impairment of credit facilities”. This may or may not be equal or close to IFRS requirement of “amortized cost using the effective rate method net of impairment losses” but this is not stated in notes to the accounts.

ENTITY A / ENTITY K

Impairment is measured based on calculations made following instructions from the Palestinian Monetary Authority which, although not described in any detail, apparently prescribe general provisions to cover eventual future losses from currently performing accounts.

Investment property

ENTITY C

Although figures involved would not appear material, the financial statements failed to disclose required information such as a description of the items, the amounts of maintenance and other expenses and fair value.

Agriculture

ENTITY C

Disclosures, such as a full description of biological assets and explanations about why fair value cannot be determined reliably, are missing in the report.

Insurance Contracts

ENTITY G

No clear disclosure has been made of what IAS 4 calls “insurance risk” i.e. management of risk description, sensitivity to insurance risk, actual claims compared to previous estimates, etc. This omission looks particularly important vis-à-vis the environment in which the company operates.

Financial Instruments Disclosure

ENTITY D

The quoted values of instruments negotiated in Palestine and Amman Stock Exchanges were used as the carrying value of those instruments according to disclosures made. Further explanations indicate that “the fair values of financial instruments (as a whole) are not materially different from their carrying values”. It is not clear then whether quoted values were actually used or not. Additionally, the listing of the various financial instruments shown in notes excludes instruments held for trading and those available for sale.

ENTITY H

There is a general provision for investments risk taken to equity, based on instructions from the Palestinian National Authority. There is no disclosure as to basis of calculation and, in any case, it would not be in line with IFRS.

There is no reference to quantitative or qualitative aspects of business risks undertaken or to their nature, or of management response to minimize them.

Audit Reports

The problems described below refer to observations made on ten audit reports submitted for review. To these problems should be added the non-coverage in the financial reports audited, which the audit reports reviewed either ignored or agreed with.

ALL REPORTS

There is a tendency to omit any mention of the political instability prevailing in WB&G territories; only one exception was found in the case of a company doing business in Gaza. The effects of current conflict conditions on all entities operating in these areas

may be pervasive and substantial, especially if conditions deteriorate further or even if sporadic warfare or guerrilla action is maintained. A paragraph of emphasis describing the current status and its eventual impacts would be appropriate in all reports.

ENTITY A

This bank is required by the PMA to provide for non-collectability of certain loans made to officials and employees of this agency. The bank's administration disregarded the instructions on the grounds of improved collectability. The auditors concurred but decided to mention this matter in a paragraph of emphasis. The issue was appropriately disclosed in notes and since it was not extraordinarily material, the emphasis in the opinion appears unnecessary. If the auditors had reservations or were unable to reach a conclusion, they should have appropriately qualified the opinion.

ENTITY E

Certain items of property and investments in property were revalued. The auditors introduced a paragraph dividing responsibility with professional appraisers. This is not a case of division of responsibility and if the auditors were unable to reach a conclusion or had evidence supporting changes in the revalued amount, they should have appropriately qualified their opinion.

ENTITY H

The opinion contains a number of formal problems.

1. The scope paragraph mentions the balance sheet twice.
2. Income, cash flows and changes in shareholders' equity statements refer to the year-end date rather than to the year itself.
3. The only note mentioned in the opinion is the one on accounting policies. Since there is no indication of the other notes being an integral part of the financial statements, effectively they are not covered by the opinion.
4. The conduct of the audit is described as having been in accordance with IAS, "standards issued by the Accounting, Auditing and Governance Standards for Islamic Financial Institutions (AAIOFI) and International Accounting Standards".
5. The opinion paragraph states that the balance sheet presents fairly the financial position without indicating in accordance with what.
6. The rest of the statements "are in conformity with International Accounting Standards and with AAIOFI as well as with the bank's Articles of Association and the Islamic Shari'ah Supervisory and Control Board" although the last two had not been previously mentioned in the opinion.

7. Other minor problems involve the use of incorrect expressions such as “financial policies” rather than “accounting policies” and “financial assumptions” rather than “estimates”. The auditors obviously tried to simultaneously satisfy the different and sometimes conflicting requirements of international and Islamic bodies but failed in the attempt precisely because of the requirements are inherently in conflict. The mixture of accounting and auditing standards may also have been due to a lack of attention in the drafting. As a result, the text remains confusing.

ENTITY K

The report of the auditors contains a paragraph recommending that the General Shareholders’ Meeting approve the accounts. Such a recommendation does not seem appropriate under any standards.