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INVITED PAPER

FINANCIAL REPORTING REGULATIONS IN KUWAIT: A SYNTHESIS AND FRAMEWORK FOR EVOLUTION

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This paper examines and analyzes the disclosure regulations in the State of Kuwait. The relevant literature has been reviewed to provide the bases for the analysis of disclosure regulations; experiences of developed countries such as the USA and UK - in enacting reporting regulations have been drawn on, too.

Over the last two decades, the disclosure regulations imposed on the financial environment in Kuwait have expanded dramatically. Much concern resulted from some well-publicised failures of public and non-public companies in the wake of the 1982 stock-market crash in Kuwait. This, further supported the application of reporting regulations. Some benefits were achieved such as the standardization and higher quality of information.

Suggestions for improvement are proposed here concerning research directions, non-financial information, the expansion of the base for tradable shares, and the bases for the preparation of financial statements.

The disclosure of information is a highly controversial subject in the regulation of financial reporting. For example, there is a misconception that financial reports include only income statements, balance sheets and cash flow statements, whereas in many countries financial reporting includes more than just these three statements. (Al Hashim and Arpan, 1992; Carey, 1973).

The disagreement between the disclosure regulations and the social, economic and political environments led to different regulations for each environment ranging from the private sector to the governmental sector or a mix of both. For example, the regulation of financial reporting in U.S.A. received its impetus

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from the Securities Acts of 1933 and 1934 which gave the SEC the power to ensure full and fair disclosure. The promulgation of financial regulations proceeds at an unprecedented rate and is likely to continue. As a result, the quantity and estimated life-span of any regulation is shorter than it has ever been (Beaver, 1989: 176; Chow, 1983: 73). As to the United Kingdom, the regulations were carried out by the Stock Exchange as a private body, (The Accounting Profession in the United Kingdom 1987).

The objectives of the regulations were : 1) To protect the investors and 2) to promote broader public interest. These objectives could be achieved largely by policies designed to: 1) require full disclosure, 2) prevent manipulation of securities prices, 3) curb unfair trading practices, 4) maintain orderly and liquid markets; and 5) control excessive use of credit to finance speculations. This listing is not a mutually exclusive group since there can be broad overlappings (Friend, 1976: 1).

In this respect, Kuwait is not different from other countries. On October 10, 1993, the World Bank mission stated that: "The existing institutional and regulatory framework in which the private sector operates reflects a long standing philosophy that the appropriate role of the government is to extensively intervene in the private sector so as to encourage, protect and assist private business. This is sometimes characterized as a close cooperation between the government and private business, sometimes as a paternalistic or protective philosophy towards private businesses, or in more traditional terms as "Kafala" (sponsorship of the State)". (World Bank, 1993: 60).

As a result of the 1960's business sector expansion, which led to an increased awareness of the value of information, the government moved to regulate financial reporting. The first law passed in this regard was the Commercial Companies Law (No. 15 of 1960). Since then, the Government is still enacting laws and regulations that would satisfy the changing needs of the financial reporting environment in the country.

PURPOSE AND METHODOLOGY

The purpose of this paper is to examine and analyze financial reporting regulations in Kuwait. This analysis aims to highlight the important implications of these regulations on the evolution and development of the process of setting accounting standards in Kuwait, as well as to provide some insight into the reporting environment in Kuwait and to compare it with what exists in the developed countries. It also aims to provide basic input for the upgrading of these regulations in Kuwait. In line with these objectives, the relevant literature has been reviewed as a basis for analyzing the enactment of these regulations. Similar experiences in developed countries, such as the USA AND UK, have been referred to in assessing the evolution of these regulations in Kuwait. Additionally, annual reports of all listed companies in the official Kuwait stock market, as well as government laws and regulations, have been examined. These laws and regulations will be reviewed briefly as a background for the study.

THE KUWAIT STOCK MARKET DEVELOPMENT

The stock market in Kuwait was established with the inception of the first shareholding company in 1952. The offer for subscription of its shares to the public was accompanied by limited over-the-counter negotiations. The ensuing limited stock dealings created the first over-the-counter market in Kuwait. This section will address the following:

a) Legislative Development and b) Organizational Structure of the Kuwait Stock Exchange.

LEGISLATIVE DEVELOPMENT

The establishment of shareholding companies necessitated the separation of management from the ownership, and shareholders, investors and creditors to assess how far the business has progressed toward public and credible financial disclosure practices. This part examines briefly the legislative acts and the Kuwait Stock Exchange (KSE). The economic expansion in the early sixties, and the start of economic and social development planning led to an expansion in the establishment of shareholding companies. In the late sixties, the stock market started to expand, and the number of companies further increased. At the beginning of the seventies, considered a turning point in the development of the stock exchange in Kuwait, the stock market became more organized due to the laws and decrees issued in this regard.

Financial statements are considered one basic success factor for any stock exchange in the accomplishment of its economic goals, in the absence of other means to assess the financial position of companies with marketable shares. In other cases, dealings are concluded in the market on the basis of estimations, rumors, guessing, personal judgement rather than the real value of the shares. Consequently, the government started to regulate the newly established companies and their security dealings.

The principal statute governing commercial companies in Kuwait is the Law

No. 15 of 1960, which requires the directors of a company to present to the shareholders annual accounts that provide a true and fair view of the company's state of affairs and profit or loss for the year. Also, all companies are required to submit financial statements annually to the Companies Control Department at the Ministry of Commerce and Industry. These accounts must be audited by registered accountants appointed at the annual meeting of the company. The auditor is responsible for ascertaining that the information in his report is correct because he is considered by law to be an agent of the shareholders who are entitled to any queries and clarifications.

Another legislative act (Law No. 2 of 1961 amended by No. 68 of 1981, Commercial Law) states the accounting records that companies must maintain. The required accounting records are journals containing all entries made, inventory books and a mail register. The journal is required to be authenticated by the Ministry of Justice. The inventory book and the mail register are not seen in practice. In practice, companies are maintaining a general ledger and subsidiary ledgers for internal management reporting and financial statements preparation.

Law No. 32 for the year 1970 relates to the conditions for trading in marketable securities and provides the Ministry of Commerce and Industry (MCI) with the right to issue any laws it deems fit to regulate the trading of marketable securities until the issuance of a law for the establishment of the stock exchange. Also, in August 1971, a resolution was issued relating to the daily press publication of information on marketable security transactions. The Companies Insurance Supervision Section in the MCI was entrusted to regulate trade in securities and compile statistical analysis (Central Bank, 1969-1979: 104).

The great demand for shares, the appreciation in their prices and the increase in the number of companies with tradable shares reached a combined peak in 1973 and 1974, and attracted various investors and dealers. Among these, some small investors entered the market without having sufficient information on the basic selection criteria of marketable securities or the market mechanisms. Also, some of these investors entered the market with the false hope of guaranteed profits, and based their investment decisions on rumors rather than on financial information.

The reason for this change is felt to be the forward market dealings. This led to the MCI resolution No. 52 in December 1974 suspending forward market transactions temporarily. This suspension was abolished by resolution No. 31 of 1977 which set the rules for the method of payment, the duration of the contract and the registration with MCI (Central Bank, 1969-1979: 104).

In 1974, a committee was formed to study the conditions of shareholding companies under the supervision of the Planning Board. In order to expand the base share as much as possible, the committee recommended the reductions of maximum limit for subscriptions. Also, Law No. 3 of 1975 reduced the minimum nominal value of shares to one dinar.

In November 1976, the MCI issued the resolution No. 61 of 1976 concerning the Kuwaiti shareholding companies. A Committee of Securities was set up and entrusted with wide powers including the right to:

- draw up organizational rules for trading in securities such as methods and procedures, registration of companies and brokers, and the setting of minimum data requirements.

- investigate complaints by dealers and brokers.

- submit recommendations for the promotion of security dealings and the diffusion of investment practices.

- submit studies to create a stock exchange and suggest the necessary by-laws.

A number of resolutions and regulations were issued concerning the stock market in 1977. In April 1977, the KSE was opened. In the same month, a resolution was issued regulating forward market dealings in securities and making these transactions subject to the Ministry's supervision; thus, repealing the ministerial decision issued in 1974.

The stagnation in the market in 1977 was caused by many factors such as public expectations and forward market dealings. The government issued a resolution in August 1977 to handle the situation. These measures include:

- Suspending the establishment of new shareholding companies. During the period August 1977 - May 1979, no public company was established, except one in June 1979.

- Prohibition of increase in the capitals of existing companies, except within a given minimum.

- Another resolution was issued in December 1977, whereby the government could purchase any quantity of shares at the price prescribed by the government. This resolution remained valid until April 1978. The value of shares purchased by the government totalled KD 150 million, (Central Bank, 1969-1979: 106).

The characteristics of the Kuwait Securities Market were:

- Speculation
- Sensitivity to foreign and political developments
- High public demand for the shares. For example, the shares of Kuwait International Investment Company were oversubscribed 136 times (Central Bank, 1969-1979: 108).

Towards the end of the 70's few investment opportunities existed in Kuwait, which led to investors resorting to Gulf countries such as the United Arab Emirates and Bahrain because of easier legal requirements to form Gulf shareholding companies (Al Tuhaih, 1983: 14).

Most of the Gulf shareholding companies were established in the late seventies and early eighties. Between the period 1979-1981, 24 companies were established. The establishment of the Gulf companies created a parallel market which was known as Souk Al Manakh. The total number of these companies was 42 by the end of 1983 (Central Bank, 1980-1984: 91).

As predicted in an early study (Shuaib, 1980: 89), the stagnation was witnessed in the financial market in 1977 and 1979 and the outlook for the early 1980s was uncertain and somewhat gloomy, since the market continued its downward trend and most fundamental factors that affected the market during 1979 did not change. These factors heightened the need for investigating the stock market operations in Kuwait.

During 1980-1981, the public attention began to focus on the Gulf Public Companies shares. These Gulf Companies shares were traded in the unofficial market - The Souk Al Manakh. Up to the first half of 1982, the share prices were soaring. There was intensive demand by the public to buy shares. This description closely resembled to some extent the behaviour of investors buying shares in the U.S. market rush in 1929 (Galbraith, 1980).

There was an increase in the use of deferred payment deals. For example, the total value outstanding for the period from May 82, to December 82 aggregated to KD 1.5 ($ 5.26 billion), while the total value of Souk Al Manakh transactions was estimated at KD 1 billion for the same period. In view of the fact that Al Manakh transactions were not officially recorded, the actual estimated amounts tend to understate the true value (National Bank of Kuwait, 1982: 25-32). Table (1) and Exhibit (1) show the maturity date of deferred payments in the official market only.

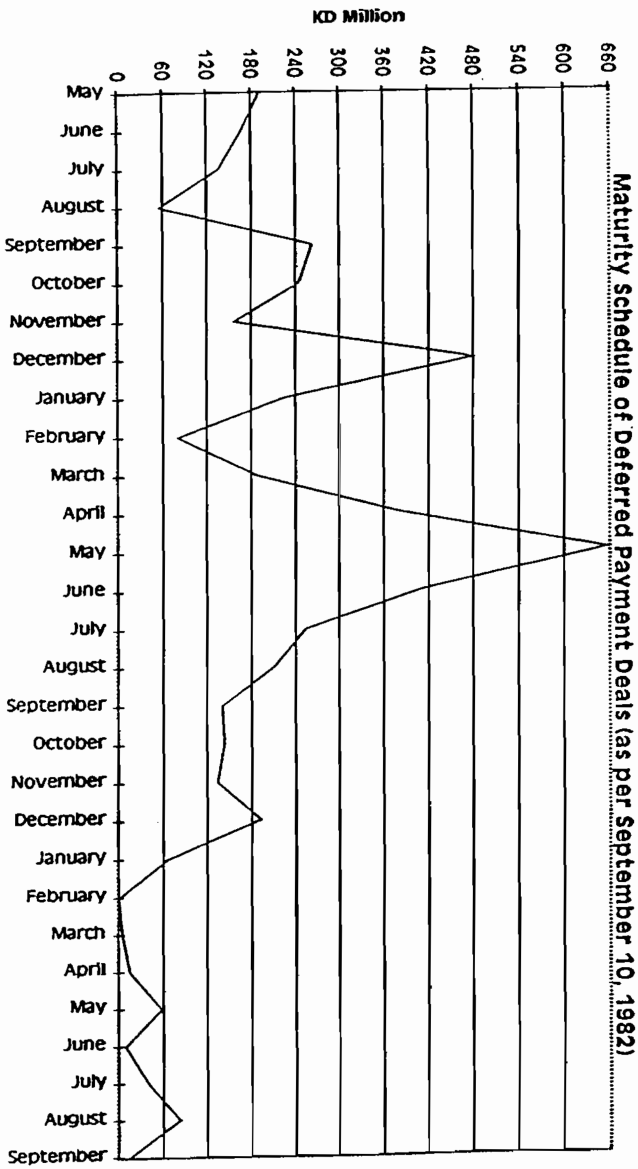
Table (1)

Public and Closed Kuwaiti Shareholding Companies Formed and Liquidated during the period 1940-1995

Year	Formed			Liquidated		
	Public	Closed	Total	Public	Closed	Total
1940-1950	1	-	1	-	-	-
1951-1960	6	-	6	-	-	-
1961-1970	14	9	23	-	-	-
1971	1	1	2	-	-	-
1972	22	6	28	-	-	-
1973	5	8	13	-	-	-
1974	3	9	12	-	-	-
1975	2	23	25	-	4	4
1976	1	33	34	-	-	-
1977	2 -	21	23	1	2	3
1978	1	30	30	-	-	1
1979	-	16	17	-	-	3
1980	-	27	27	-	1	1
1981	1	35	35	-	4	4
1982	1	66	67	-	-	-
1983	-	19	20	-	2	2
1984	-	15	15	1	4	5
1985	-	12	12	2	13	15
1986	-	6	6	1	33	34
1987	-	5	5	-	16	16
1988	-	6	6	-	4	4
1989	-	9	9	-	7	7
1990	-	4	4	-	-	-
1991	-	1	1	-	-	-
1992	-	11	11	-	7	8
1993	-	19	19	-	3	3
1994	-	12	12	-	4	4
1995	1	11	12	-	3	3
Total	**41**	**414**	**455**	**6**	**113**	**119**

Source: Ministry of Commerce & Industry - Until July, 1995

Exhibit: 1



Source: The National Bank of Kuwait 1982, P. 18.

On September 20, 1982 a new law was issued which required the registration for deferred payment dealings made by official and non-official markets using post-dated cheques. The actual total figures were around ($ 90 billion). A Cheque Clearing company (Kuwait Clearing Company) was created to gather all information about the details of all forward dealings. The company started its operations on September 23, 1982.

By mid August 1982, the market collapsed. The shares prices started declining. The post-dated cheques were overdue. The government urged the parties concerned directly to seek compromises with their creditors followed by a decree requiring registration of post-dated stock market cheques and details of the transaction. To deal with the stock exchange crisis, with the collaboration of the National Assembly and sometimes with the Kuwait Chamber of Commerce and Industry, the government issued a series of resolutions and laws (See Law No. 57-1982, Forward Dealing and the Protection of the Rights of Debtors, Law No. 75-1983, Settlement of Transactions Connected with Forward Dealing and Law No. 100-1983, some provisions connected with the settlement of transactions related to forward dealing).

The Souk Al-Manakh crash supported the laying down of rules and regulations in a way similar to that which stimulated the 1933 and 1944 acts following the American Stock Market crash. As evidence of improvement, the government issued on August 14, 1983 a decree to establish the KSE. The decree dealt with the organization, regulation and development of a formal stock market in Kuwait. In another development on February 15, 1984, the Stock Exchange Committee issued a resolution requiring all listed companies to submit half-yearly financial statements in addition to the year-end statements. The stock exchange, beginning June 30, 1985, started the implementation of this requirement. The requirements closely resemble the U.S. practice, SAS-36, Review of Interim Financial Information and APB 28 Interim Financial Reporting. Also the committee required that the companies submit their financial information as follows: (resolution No. 16 of 1987).

- Yearly financial information should be submitted within three months after the end of the financial year.
- Half yearly financial information should be submitted by August 15, of every year. It should be noted that for most listed companies the year ends in December.
- Provide the KSE with all minutes of the general assembly meetings within 15 days from such events.

- Dealings in shares of the companies which do not adhere to this resolution, would be suspended by the committee.

Until the end of 1986, the KSE did not have any clearing system resulting from securities dealings, as each transaction was settled separately, irrespective of how many times the same trader bought and sold on the same day. To overcome this, a decree was issued on December 27, 1986 regulating the settlement of securities trading through the clearing room at the KSE. The purpose of this decree is to reduce the necessary procedures for the completion of transactions and to achieve discipline in finalizing deals procedures (Central Bank, 1986: 5).

In 1986, the Decree Law No. 132 was issued to reduce the minimum limit of a share nominal value to 100 fils in April 1987. This led to brisk trading by investors. The reduction in nominal value was aimed to expand the market, attract investors and curb the competition by non-Kuwaiti companies (Central Bank, 1987: 66).

On February 16, 1987, the resolution No. 10 was issued as an amendment to the companies law. This resolution consisted of 13 articles dealing with organizing, buying stocks of public shareholding company by the same stock company, and how to utilize and assign the stocks bought. Article 4 stated that if the Company desired to buy its stocks or sell any of its previously bought stocks, the KSE should be notified in writing of such intention. Article 8 stated that the dividends corresponding to the shares owned by the Company shall be charged to the income statement. This is not according to GAAP because this stock (Treasury Stock) is not an asset when a Company buys back some of its own outstanding shares, which has reduced its capital.

Other articles of this resolution deal with the fund which will be used to buy the treasury stock either from undistributed profits or reserves for the purpose of financing the said buying. Also, the company should prepare, every three months, a statement showing the details of buying and selling of the Company's own stock. These stocks should be shown as an asset in the financial statement at the end of each year.

On May 28, 1988, a day-to-day clearing system was applied, based on the net dealings of shares and sums. Individuals who wanted to deal in the market could do so by opening an account with the Kuwait Clearing Company and have their broker constantly advising them of their financial position.

Dealing in the KSE securities has been restricted to Kuwaiti nationals only. The Law No. 133 of 1988 was issued allowing Gulf Co-operation Council (GCC) nationals to buy and sell shares in KSE. This permission required certain conditions and procedures which excluded the shares of banks and insurance companies.

Another important measure taken by KSE was the decision suspending parallel market activity as from January 2, 1989. Also, a committee was established to study the ways and means to set up and establish a new parallel market. During 1989, the KSE took some measures regulating the procedures of the market activity such as: (Central Bank, 1989).

- The amendment to the resolution No. 11 of 1989 regulating the purchase by shareholding companies of their own shares. Article 2 replaced article 5 of resolution No. 10 of 1987. It stated that the capital of the company may not be used to finance the purchase of its own shares. The purchase should be financed from the reserves accumulated from the distribution of net profits and premiums. As to companies under the supervision of the Central Bank, they should obtain the approval of the Central Bank before purchasing their own shares.

- A decision to cancel the maximum limits of increasing and the minimum limits of decreasing the prices of companies' shares traded in the market.

- A decision related to the requirement for registration in the parallel market. This included that the paid up capital should not be less than KD One Million or its equivalent, the company's general assembly should approve the request for listing, the company should have issued at least two audited financial statements for the last two fiscal years, and the company shareholders or founders should hold 30% of the company's shares for two years after the date the company was listed in the market. As a result, the parallel market was re-opened in July 1989 after a trading suspension in 1988. Two companies were listed in the market after satisfying the required conditions.

In May 1990, the Law No. 31 organizing the traded securities and establishment (promotion) of investment funds was issued. This law deals with creating investment funds for securities and bonds, and replaced the Law No. 32 of 1970 allowing non-Kuwaitis to purchase shares in these funds.

Due to the Iraqi invasion of Kuwait on the 2nd of August 1990, the KSE was suspended for 26 months. On September 28, 1992, the KSE was reopened. In April 1992 the by-laws for regulating investment funds were issued. The decision No.1 of 1993 was issued by the KSE, and aimed to merge both the parallel and official markets and lay down the conditions for shareholding companies to be listed in the KSE. Also in June 1993, resolution No. 2 was issued providing the conditions for the investment funds to be listed in the KSE. As to investment funds, two such funds were established as of August, 1994. Exhibit (2) summarizes the development of financial reporting regulations in Kuwait.

Efforts are continuing by the KSE to set up the necessary procedures and regulations to develop the market. Despite the efforts exerted by KSE, there is still a need for more procedures and directions to keep the market abreast with the changes in the financial market environment and activity. Exhibit (3) shows the number of companies listed in KSE as of August 1994.

ORGANIZATIONAL STRUCTURE OF THE KUWAIT STOCK EXCHANGE

With the foregoing historical background in mind, the KSE went through different stages of developments. In 1971 a resolution No. 10 was issued to create a division in the department of Companies and Insurance in the MCI to supervise dealings in securities. The aim of this division was to enable the MCI to exercise its authority (Law No. 32 of 1970) of issuing regulations relating to Kuwaiti shareholding companies.

On November 2, 1976, the resolution No. 61 was issued; it contained 25 articles, which specified the following, in essence: there shall be a Committee to regulate securities and pave the way to create a stock exchange; the committee shall discharge its responsibilities according to the relevant laws and regulations in order to normalize transactions and protect investors; the functions of the committee should include, among others, the registration of companies, the recording of the required data and information etc; the Committee shall meet at least 10 times annually at the invitation of its chairman. (Exhibit (4) shows the structure of this committee). There shall be two committees, the executive committee (EC) and the permanent arbitration committee (PAC). The EC will be chaired by the government representative. It will monitor security trading and operations. As to the PAC, it will look into the disputes or complaints from traders and brokers, (Al Tharban, 1981).

The creation of an independent body resembles the creation of SEC in 1934 in the U.S.A. The securities act was administered by the Federal Trade Commission. In 1934, the act was amended to provide for the creation of a special body, SEC, to assume its administration (Hawkins, 1972: 39).

Exhibit (2)
Summary of the Development of Financial Reporting Regulations in Kuwait

Prior to 1960	1960's - End of 1970's	1980's - 1990's
* 1952 witnessed the first shareholding company inception. This led to limited negotiations of its shares, which could be considered an over-the-counter market.	* 1960s is considered a takeoff period for the development of accounting * The Government enacted laws which influenced the development of accounting, such as: - Law No. 15 of 1960 - Commercial Companies Law. - Law No. 2 of 1961 - Commercial Law amended in 1981. - Law No. 6 of 1962 - on the practice of auditing profession - amended in 1981 by Law No. 5 of 1981. - Law No. 27 of 1962 - procedures for trading in the marketable securities of companies established outside Kuwait. - Law No. 32 of 1970 - pertaining to the Regulation of Trading in Securities of Companies. * 1963, the government established the first secondary school of Commerce. * 1967, the commerce, economics, political sciences faculty of Kuwait University was established. * In the early seventies, considered to be the beginning of the development of the stock market in Kuwait: - The financial information provided by the companies were inadequate. - In some cases the dealings were concluded on the basis of estimation, rumours, questing, personal judgement. - 1973-1974, attracted various investors. - 1976-1977, stagnation of the market. - 1976, the Ministry of Commerce and Industry issued a number of organizational procedures. - Committee to organize dealings in securities, established.	* Towards the end of 1970's, the Gulf shareholding companies traded in the unofficial market. * Law No. 5 of 1981 - on the practice of auditing profession. In June 1981 a technical committee was formed. * Mid - August of 1982 collapse of the market * To deal with the Stock Exchange Market Crisis, the government issued series of resolutions in collaboration with the National Assembly and the Kuwait Chamber of Commerce & Industry. * As a reaction to the accounting problems generated by the Stock Exchange Market Crisis, the Ministry issued resolutions to be used as a guidelines for preparing financial statements. - January 1984 memorandum for December 1983 financial statements. - January 1985 resolution No. 4 for December 1984 financial statements. - February 1986 resolution No. 10 for December 1985 financial statements. * August 14, 1983 the government established Kuwait Stock Exchange. * February 15, 1984, the Stock Exchange required half yearly financial statements. This requirement resembles to the U.S. practice - Interim Financial Reporting - SAS - 36.

Summary of the Development of Financial Reporting Regulations in Kuwait

Prior to 1960	1960's - End of 1970's	1980's - 1990's
	* April 1977, the Kuwait Stock Exchange was opened. * December 1977. the government decided to buy any quantity of shares at the price determined by government, until April 1978. * The share nominal value reduced to one Dinar. * Accounting and auditing practices were derived from those of U.K., U.S.A., and neighhoring Arab countries; there is no official pronouncements.	* March 1986 new Permanent Technical Committee formed - January 1987 issued resolution No. 4 of 1987 for December 1986 financial statements and after, * the resolution consisted of the following: a. Objectives and procedures for setting Accounting * Principles b. Three guides relating to the following areas: * Financial Statements * Accounting for Investments * Accounting for Real Estate * February 16, 1987 resolution No. 10 of 1987 dealing with organizing, buying of stocks of public shareholding companies from the same stock company. * The share nominal value reduced to .100 fils. * March 13, 1988 resolution No. 11 of 1988 amending resolution No. 10 of 1987 as to fund used for purchasing the companies its own shares. * May, 1990 law No. 31 issued related to the traded securities and establishment of investment fund. * August 1990, Due to the Iraqi invasion of Kuwait, the KSE was suspended for 26 months. * September 1992, the KSE was reopened. * Decision No. 1 of 1993 was issued related to the investment funds. * Decision No. 2 of 1993 was issued listing the conditions for the investment fund to be enlisted in the KSB

Exhibit (3)
Shareholding Companies in the KSE As of August, 1994

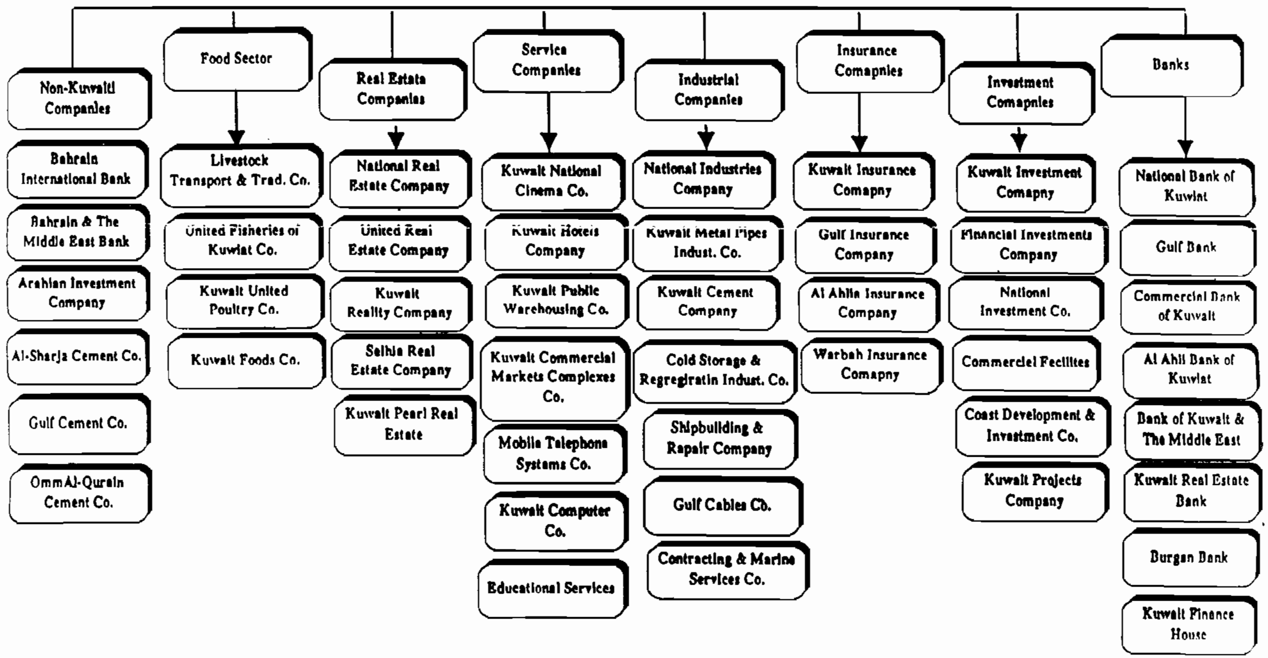
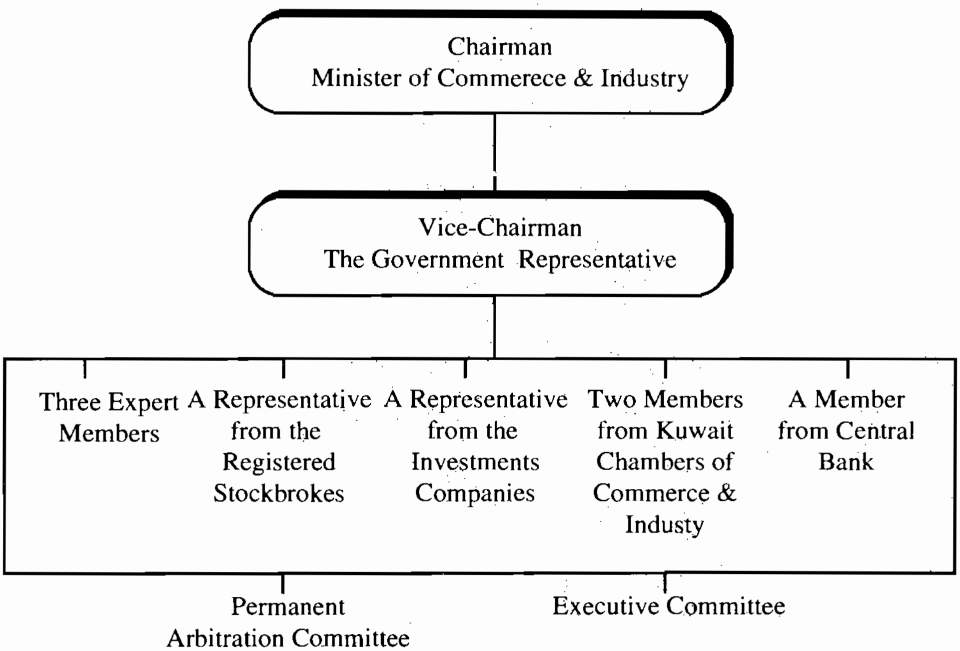


Exhibit: 4

Structure of the Securities Committee

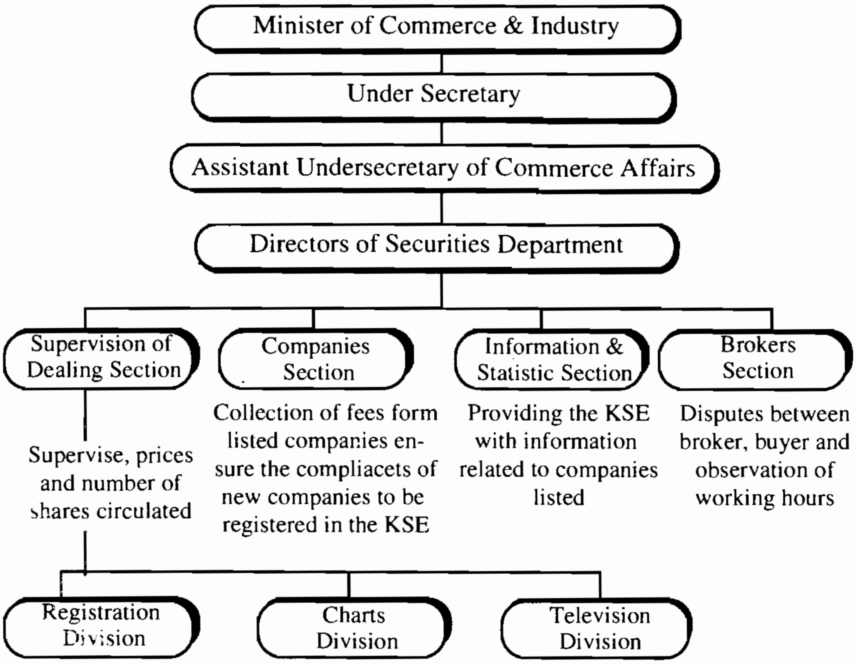


Source: Al Tharban, 1981, P. 7.

In 1976, MCI changed the division of the securities dealing into a department. Exhibit (5) shows the organization chart of this department. Which consists of four sections and three divisions. Prior to 1983, the security market was administered by a Committee and through MCI. On August 14, 1983, a decree was issued to organize KSE. The decree established an independent judicial entity with the mission to administer all aspects of new securities tradings, brokers, and financial reporting.

Exhibit:5

Organization Structure of the Securities Department



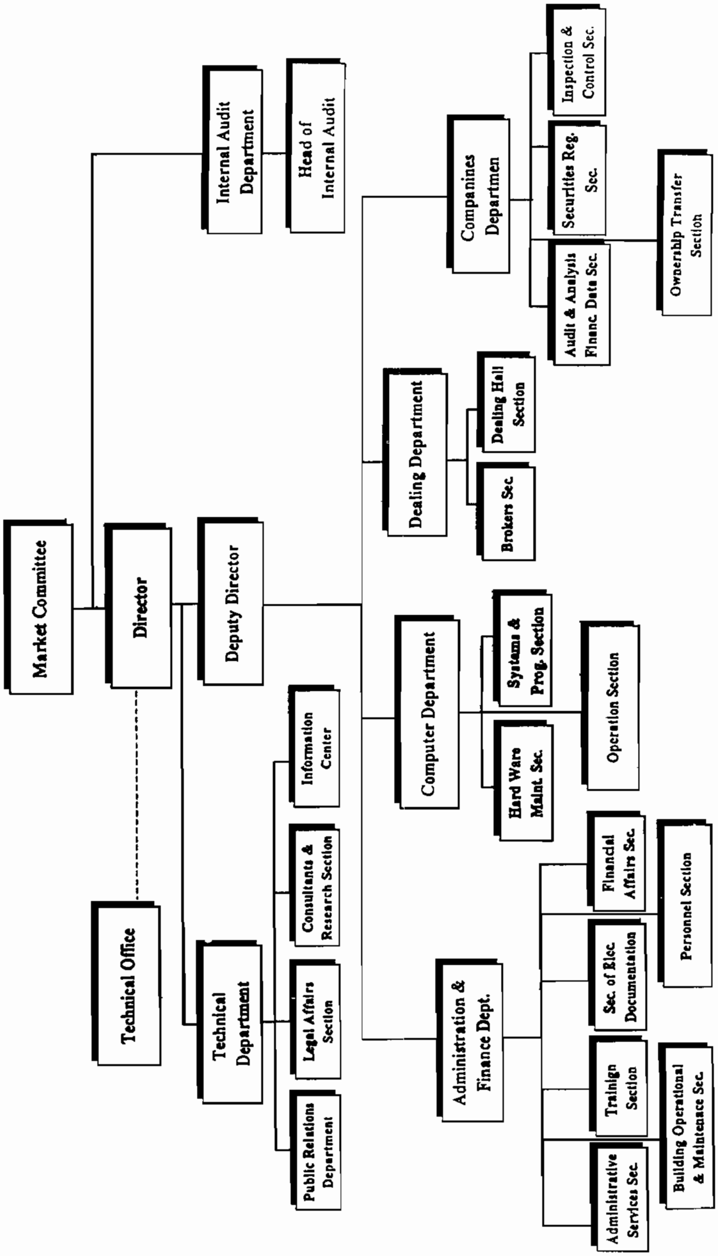
Source: Al Tharban, 1981, P. 9.

The early years of KSE were devoted to developing the basic necessary procedure for this new entity. For example, the by-laws of the KSE were issued by virtue of the ministerial resolution No. 35 of 1983. It contained stock exchange objectives, listing and acceptance of securities, stock exchange membership, dealing in securities, stock exchange administration, stock budget and financial accounts, disputes and arbitrations, disciplinary action and final and transactional provisions. To achieve its objectives, the KSE developed an organizational structure presented in Exhibit (6).

The organizational structure consists of six departments; each department comprises several sections.

Exhibit (6)

Organizational Structure of the Kuwait Stock Exchange



ANALYSIS

As indicated above, regulations started in the sixties, commercial entities grew both in size and number, more and more people were willing to assume the risk of ownership but unwilling or unable to participate in management. This change led to the issuance of securities. The separation of ownership from management created a need for a market where securities could be exchanged for capital resources. Ownership and management separation increased the need for information and objective verifications of financial data. The regulation of the stock market can be better understood in the light of the financial reporting environments. The Kuwaiti environment consists of different groups that have an interest in financial reporting. These groups include investors, brokerage firms, investment companies managing portfolio for others, regulators, management and auditors. These groups may include subgroups. For example, regulators include the stock market, MCI and National Assembly. These groups resemble and follow the pattern in the U.S.A. financial reporting environment. (Beaver, 1989: 16).

These groups and subgroup could be summarized as follows:

1. Investors
- Professional and Non-professional
- Active and Passive

2. Information Intermediaries
- Brokerage Firms
- Investment Company managing portfolio for others.

3 Regulators
- Stock Market
- Government
- National Assembly

4 Management
- Large and Small Companies
- Publicly and Closely Held Companies

5 Auditors
- International and Local Firms
- Listed Companies and non-listed Companies

As stated before, the inception of the first shareholding company in 1952 created a limited stock market and financial statements were produced prior to government regulations being issued. For example, the articles of incorporation of the National Bank of Kuwait in 1952 stated that the bank will have audited financial statements at the end of each year. This voluntarily disclosure was produced by the founders to increase their welfare. This conclusion was reached by prior research, which stated that the voluntarily supply of information by the promoters of corporations (managers) will lead to an increased welfare of the corporation in terms of easier capital raising, as it reduces agency costs, (Watts and Zimmerman,1979; Jensen and Meckling,1976). While other studies have emphasized that voluntary disclosure is aimed at controlling conflicts of interest among shareholders, debt-holders and management. It is a mechanism for containing the conflicts of interest among these groups (Chow and Boren, 1987).

The popular misconception is that securities regulation in Kuwait resulted from the crash of the stock market in 1982 and the subsequent financial stagnation. There was an attempt at such regulation as early as 1962 and in the 1970s. In October 1962 a Law was issued to regulate dealings in foreign financial papers with the increase in the number of Kuwaiti shareholding companies, Law No. 32/70 was issued to regulate trading in financial securities. The regulations, it could be said, started in the sixties and early seventies and intensified in the mid seventies and eighties because of the financial crisis and widespread abuses. Also, the financial difficulties of 1970s and 1980s provided the impetus for the imposition of restrictive laws to regulate the stock market. These laws and regulation did not provide a comprehensive treatment for the development of adequate financial reporting. As a result of such lack of regulations, certain common practices appeared in the market.

One of the practices was price manipulation. For example, matched orders, where successive buy and sell orders created a false impression of activity and forced prices up higher than their true market level.

The second practice was the misuse of financial information. Most of the time, the dealings were concluded on the basis of estimation, rumours, guessing, and personal judgement. For example, the shares of most of the companies established in 1981 and 1982, were traded before the inception of their actual operations. A survey of 30 companies established between the period of January 1981 and August 1982, showed that their first financial statement of these companies was to be published for the year ended December 1982 or 1983. Keep in mind that the crash of the market started by late August 1982. This means, shares of these companies were traded before the inception of actual operations and there was no financial information about their activities.

Another practice was the excessive use of credit to finance speculative deals. This type of credit occurred in 1981, whereby investors agreed to buy and sell at a certain price but payment would be made with post dated cheques. These transactions were based on the mutual trust that the cheques will not be cashed before the agreed date. The buyer may in turn sell the shares for cash or sell them forward. This would result in making profit without any cash commitment. The premium in some cases reached over 200 percent. These transactions could be repeated several times. In some cases the seller may either hold the cheques until the maturity date or use them as a collateral for borrowing or discount them with a bank,. For example, the balance of credit facilities granted by commercial banks financing the purchase of shares and real estate amounted to KD 854.7 Million at the end of 1981, i.e. 26.9% of the total credit facilities of commercial banks. The trends continued and reached in March 1982 the remarkable level of KD 1209.8 Million, i.e. 57.5% of the total credit facilities of commercial banks (Al Tuhaih, 1983: 36). By the end of 1982, the post-dated cheques at banks held for collection or against facilities are presented in Table (2).

Table (2)

Total Maturities*
KD Million

	82	83	84
Jan	•	225	66
Feb	•	80	•
Mar	•	188	5
Apr	•	385	15
May	192	657	58
Jun	167	412	9
Jul	136	254	40
Aug	55	211	83
Sep	263	140	15
Oct	248	143	•
Nov	156	134	•
Dec	481	193	•

*Transactions completed on KSE excluding Al Manakh Market

Source: The National Bank of Kuwait, 1982, P. 18.

Because of this excessive use of deferred payment in late August 1982, some speculators did not meet their payment of post-dated cheques on maturity. This led to a sharp decline in prices on the official KSE and Al Manakh Market. Table (3) presents some insight into the postdated cheques at banks, starting from the period up to March 31, 1982. until after December 31, 1982.

Table (3)

Postdated Cheques at Banks (KD Thousands)

Dates Due	Cheques for collection	Cheques against credit facilities	Total
Up to March 31, 1982	124,478	65,497	198,975
April 1, June 30, 1982	629,504	95,008	724,512
July 1, September 30, 1982	413,533	61,334	474,867
October 1, December 31, 1982	583,438	49,700	633,138
After Decmber 31, 1982	1,028,60	21,821	1,050,43
Total	**2,779,562**	**293,360**	**3,072,922**

Notes:
1. Number of cheques against loans = 519 cheques
2. Number of cheques for collection = 1912 cheques

Source: Al Tuhaih, 1983 P. 38.

Any stock market is given the duty to ensure full and fair disclosure of all information and data related to securities offered for public investment. Yet the establishment of the stock market will not cure all improper practices. This conclusion was held by some individuals in the U.S.A. as to the justification for the securities and exchange commission. For example, they suggested that the regulations do not seem to be useful to investors or being of positive benefit to securities markets. While others assumed that the regulations were in the public interest and achieved the information objectives, which can be used to make better decisions (Burton, 1975). Others observed that all regulations were rooted in self-interest laws to restrict competition and transfer wealth to themselves (Watts and Zimmerman, 1979). With the different points of view concerning the regulations, the writer is of the opinion that the stock market regulations role is to help regulate the securities market. Consequently, the KSE attained the public interest and information objectives. The writer's conclusion does not mean that we have regulations over the securities, it means that there will always be another mispractice as before. Because there has never been a law effectively devised to protect human beings from their own folly (Previts, 1978). Therefore, in any system even a regulated one, in some cases, abuse will incur.

From the above discussion, the following benefits have been achieved by the KSE regulations.

- To some extent, the standardization of the disclosure requirement can be seen in reviewing the annual reports of companies. The regulation imposes uniformity with respect to the format and presentation of financial information disclosed by companies.

- The regulations improved the quality of the financial information available to the users by setting minimum accounting standards. This took place with the cooperation of MCI through the Technical Committee for setting Accounting Standards.

- The regulations issued by KSE provide the means to lessen discriminatory practices in applying the securities laws. Because it is created and founded by the government, it will serve the public interest rather than any persons or groups.

- The regulations issued by KSE were adaptive and responsive to the needs of the changing environment in Kuwait. For example, in 1993 new regulations (law No. 1 of 1993 and No. 2 of 1993) were issued to expand the activities and improve the performance of the market.

The above stated benefits achieved by the KSE were not mutually exclusive. They, to some extent, represent the advantage which has been achieved during the last decade. Regulations were attempted to infuse a new spirit of trust in the securities market and to protect the public. It was a period devoted to developing the administration procedures necessary to establish the market.

In the next decade, a new revitalization of KSE should take place especially in the following area. These points are not mutually exclusive. They appear as an extension to the benefits achieved by the KSE in the past.

- While recognizing the excellent work carried out by the present staff during the early years of the KSE establishment, the coming period needs more technical staff. Staff should be equipped with experts in different areas such as accounting, finance and law. Incentives must be provided to attract qualified and talented individuals to work in the market. Moreover, training programs for Kuwaitis must be made available through overseas or local programs to provide experience and to promote efficiency.

- In order to achieve the stability and progress in the securities market, the coming years should be characterized by innovative activities. A period revision of regulations will be necessary. A research project should be undertaken to investigate the rationales and effects of the regulations. The research should define the purposes of reporting disclosures and suggest areas for improvement. These studies could be carried out by the KSE, as an invaluable source of information to the government for evaluating proposals for new regulations.

- Non-financial information issues: The KSE has required and emphasized the financial statements. The KSE should include non-financial information, i.e., it should consider the terms of disclosure in its broadest sense to include all the information contained in the annual reports. The supplemental information has been emphasized around the world. The practice has been found in the surveys carried out by the Financial Times (Lafferty, Andrews and Tylopr, 1982). A survey of the listed company annual reports in Kuwait market showed that most or these reports included other non-financial information and data besides financial information. The supplemental disclosures were voluntarily produced by the listed companies. It should be noted that the Law No. 15 of 1960 required the auditor to include, among other things, (Shuaib, 1985), a statement indicating that the information in the report of the board of directors is in agreement with the financial information in the company's books. The survey of annual reports revealed that most reports contain supplemental information and disclosures such as:

  a. Letter from the company's president, the chairman of the board, or the board. This message usually expresses the ability of the firm, significant activities, and prospects for the future.

  b. Analysis of the major activities and performances such as markets and subsidiary companies and their locations. This analysis uses much more detail than the message mentioned in (a).

  c. Review of the economy as a whole. This may contain local, regional and international information, and how it might affect the country and indirectly affect the company's further activities.
  d. Financial statements which contain the auditor's report, the balance sheet, the income statement, (statement of changes in financial positions. Starting 1994, the cash-flow statement will replace this statement), significant accounting policies and footnotes to the financial statements.

- As stated in Article 3 of the law issued in 1983 to establish KSE, the latter should establish connections and links with foreign financial markets. To achieve this, the KSE should expand trading not only in Kuwaiti and Gulf shares, but also in other securities. To place this goal in relation to the accelerating internationalization of the world's financial capital markets, companies are increasingly registering their shares in foreign stock exchanges. Evidence suggests that when firms list their securities on foreign exchanges, financial disclosure levels are an important determinant of exchange choices. Because of this competitive pressure, several authorities in different countries (such as U.S.A., Australia, Canada, Italy and the U.K.) have in recent years debated the financial disclosure requirements, (Bidde and Saudagaran, 1989). Also, the international community showed interest in the harmonization of international regulations in the areas of self-regulator, disclosure, secondary markets and securities regulation (Cosmos Accountancy Chronicle, 1994.

The implication of the significant progress achieved in these directions, necessitates to draw the attention of KSE management to the following:

1. Expanding the base of tradable shares by the privatization of some government entity, establishing specialized companies as market marker or new methods of trading like the option system. This should go in parallel with the automation of procedures to achieve efficiency and speed in finalizing dealings

2. Part of the disclosure is the financial statements, which are prepared according to a set of generally accepted accounting principles (GAAP). As revealed in previous studies (Shuaib, 1984), there was a difference in the disclosure. This led the government to realize the need for improvement. This awareness created realistic attitudes toward the development of accounting standards. As of June 1981, a technical committee was formed to study the development of accounting standards. A representative from KSE was included as a member in the committee. The committee started to study the matter and issued different resolutions until 1990. On April 17, 1990 the MCI issued a resolution No. 18, 1990 which stipulated the adoptions of the International Accounting Principles to be applied by all companies in Kuwait.

   These efforts helped to improve disclosures but did not provide a comprehensive framework for accounting standards. To advance the formulation of accounting standards, many allies should cooperate together. These include KSE, MCI, the profession, Kuwaiti Auditing and Accounting Association (KAAA), the business and financial community and the academicians. Tnese groups, including KSE, should play a major role in the setting of standards. Although the author is a supporter of standard setting by the private sector, it is felt that the government should take this responsibility because of the private sector's limited resources. This goes in parallel with constant consolidation between the government agencies and others. Participation and consolation are essential to keep the system running effectively, until such time when the private sector will be capable of carrying out the responsibility.

SUMMARY AND CONCLUSION

The purpose of the paper was to examine and analyze financial reporting regulations in Kuwait. A brief review of the legislative development was presented. These regulations took place to meet the present and future needs of the country's financial reporting environment. There is a misconception that the securities regulation in Kuwait resulted from the stock market crash. Evidence showed that there was an attempt at regulation as early as the 1960's. For example, before any regulation was enacted, there was voluntary disclosure.

These laws and regulations did not provide a comprehensive framework for the development of adequate financial disclosure. As a result of this deficiency, certain abuses appeared in the market, such as price manipulation, misuse or non-use of financial information, and excessive use of credit to finance speculative deals.

However, in spite of some deficiencies in these regulations, some benefits were achieved, such as the standardization of disclosure requirement, an improved quality of information, and responsiveness to the market needs. These benefits are not mutually exclusive. They represent advantages achieved by KSE. This evidence could be found by reviewing the listed companies annual reports.

As an extension to the achieved benefits, some recommendations have been made such as conducting further research, developing more technical staff, providing non-financial information, expanding the base of tradable shares and standardizing the basis for the preparation of financial statements. These recommendations are practical and relatively easy to achieve. They are clearly not designed for an immediate implementation but for a gradual one. However, they aim to improve the financial reporting environment to live up to its fundamental role in the economy and the society as a whole. Failure to respond promptly and accurately to meet the changing needs of the environment will result in serious damage to the financial system and to the goals and values of the society. Events of the last decades tell us that the time for action is now, in view of the country's changing needs. Our action and response should be preventive rather than a reaction to the events.

Future research is needed in the area of the economic impacts of regulations. This should include the effects of regulations on different segments of the society such as shareholders, securities price, redistribution of wealth and investors. These studies should incorporate political and social factors such as the compromise of the political process.

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مجلة دراسات الخليج والجزيرة العربية

تصدر عن
جامعة الكويت

رئيس التحرير

د. ميمونة خليفة العذبي الصباح

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هاتف: ٤٨١٦٨٠٧
٤٨١٦٧٩٩
٤٨١٦٨٢٤
٤٨١٤٢٩٥

* مجلة علمية فصلية محكمة تصدر ٤ مرات في السنة.
بالاضافة الى اصدارات خاصة في المناسبات.
* تعنى بشئون منطقة الخليج والجزيرة العربية السياسية، الاقتصادية، الاجتماعية، الثقافية، والعلمية.
* صدر العدد الاول في يناير ١٩٧٥.
* تقوم المجلة باصدار ما يأتي:
أ) مجموعة من المنشورات المتخصصة عن منطقة الخليج والجزيرة العربية.
ب) مجموعة من الاصدارات الخاصة والمتعلقة بمنطقة الخليج والجزيرة العربية.
جـ) سلسلة كتب وثائق الخليج والجزيرة العربية
* عقد الندوات التي تهم المنطقة أو المساهمة فيها واصدارها في كتب.
* يغطي توزيعها ما يزيد على ٣٠ دولة في جميع أنحاء العالم.

* الاشتراك السنوي بالمجلة

أ) داخل الكويت. ٢ د.ك للأفراد ـ ١٢ د.ك للمؤسسات
ب) الدول العربية ٢٫٠٠٠ د للأفراد. ١٢٫٠ د.ك للمؤسسات
جـ) الدول الاجنبية ١٥ دولارا للأفراد ٤٠ دولارا للمؤسسات

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