

Transparency & Disclosure:

IFRS for MENA's Markets & Role of DIFC

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Transparency & Disclosure : IFRS for MENA markets & Role of DIFC

Agenda

- Sustaining growth and wealth management
- Financial Markets: Core Standards; Accounting, Auditing & Corporate Governance
- Empirical Evidence on Transparency & Disclosure and adoption of IFRS
- Role of DIFC in promoting international standards:
 - Accounting standards and IFRS
 - Hawkamah Institute for Corporate Governance



A MENA Economic & Financial Renaissance?

- MENA has achieved above average growth rates sustained by
 - Average real GDP growth 6.5% over 2003-2006 vs. 3.7% in 1998-2002
 - Favorable global developments: high growth, low inflation and interest rates, no financial crises
 - Growth boom has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity and ↑ in productivity growth
 - Growing regionalism: investment (markets, FDI), tourism, labour flows
- Private sector is leading and driving regional economic integration
- Accumulation of assets & international reserves leading to a tripling of international reserves between 2002 and 2006: \$188.7bn (2002) to \$517.7bn (2006) and cumulative current surplus of \$870 billion
- Inflation higher, but limited pass-through of higher oil prices to consumers



GCC Sustaining Growth: Economic Issues

- Central challenge is to use oil wealth and demographic dividend to create economic & financial incentives for sustained growth and job creation
- Economic reforms, diversification and state divestment & privatisation.
- Growing private sector participation in infrastructure in GCC
- Greater regional economic integration:
 - GCC Monetary Union in 2010,
 - Expand trade liberalisation to include services
- Lack of GCC Financial Sector development is now a barrier to sustained growth and competitiveness. **Financial sector can and should be an engine of growth:**
 - ‘Manage region’s growing wealth
 - Finance Infrastructure: physical, human, social



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12 Core Standards for Sound Financial Systems

Macro Standards

1. Data Dissemination
2. Monetary Policy
3. Fiscal Policy Transparency

Agency

IMF
IMF
IMF

Market and Infrastructure

4. Governance

5. Accounting

6. Auditing

7. Insolvency

8. Money Laundering

OECD/ World Bank

IFAC

IFAD

World Bank

FATF

Financial System

9. Core Principles of Bank Supervision

10. Core Principles of Insurance Supervision

11. Core Principles of Securities Supervision

12. Systemically Important Payment System

BIS

IAIS

IOSCO

BIS

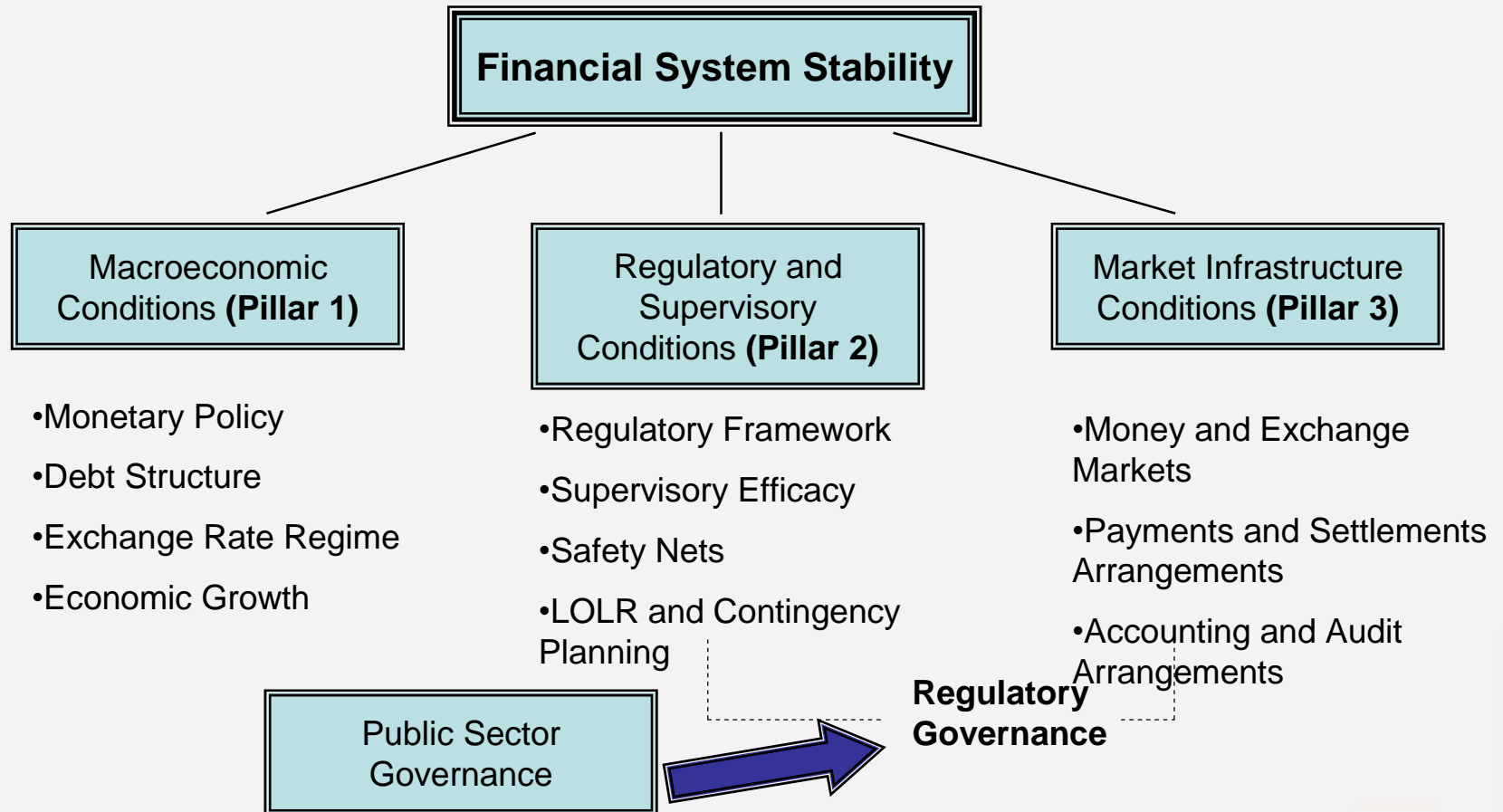


Why The Core Standards?

- Deficiencies in these policy areas were a source of crises, and magnified, complicated and extended economic & financial crises
- Countries complying with core standards can achieve:
 1. Transparency of economic risks
 2. Economies characterized by well governed institutions and companies valued and audited according to agreed upon international standards
 3. Protection of contracts & property rights
 4. An ethical business environment
 5. A financial system governed and regulated in a safe and sound manner, which sustains growth and economic development.



Financial Stability and its Three Pillars



Source: IMF Working Paper – Udaibir S. Das, Marc Quintyn, and Kina Chenard
Does Regulatory Governance Matter for Financial System Stability?

Basel Core Principles

- **Chapter 1: Preconditions for effective banking supervision**
- **Chapter 2: Licensing and Structure**
- **Chapter 3: Prudential Regulations and Requirements**
- **Chapter 4: Methods of On-Going Supervision**
- ***Chapter 5: Information Requirements***
 - **CP 19** requires supervisors to conduct on-site examinations, or to use external auditors for validation of supervisory information.
 - **CP 20** requires the conduct of consolidated supervision.
 - **CP 21** requires banks to maintain adequate records reflecting the true condition of the bank, and to publish audited financial statements.
- **Chapter 6: Formal Powers of Supervisors**
- **Chapter 7: Cross-Border Banking**



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Basel CP Compliance & Bank Soundness

Podpiera (2004): BCP compliance for 65 countries. BCP compliance lowers Non Performing Loans

Demirgüç-Kunt, E. et al. (2006): Sample: 203 banks, 39 countries

Basic equation: Dependent variable: bank rating (scale 1-15). Variable of interest: BCP compliance overall index (scale 1-4) and BCP compliance with individual chapters

Overall index of BCP compliance is positively correlated with Moody's ratings. Robustness tests show that what matters is compliance with information requirements

Using Z-score*: the only element of compliance that seems to matter for bank soundness is compliance with information requirements

Source: Banking on the Principles: Compliance with Basel Core Principles and Bank Soundness, A. Demirgüç-Kunt, E. Detragiache, and Thierry Tresselt, September 2006

**Z-score definition: $(\text{mean return on assets} + \text{equity/assets}) / \text{standard deviation of returns}$*



Conclusions from Empirical Evidence

- Market infrastructure (Pillar III) is what works best:
 - accurate information disclosure
 - foster incentives for private sector to monitor and exert corporate control
- Ensure broad, frequent, and accurate information disclosure both to supervisory authorities and to the markets.
- Countries should give priority to transparency, when allocating limited resources and considering reforms to strengthen their regulatory and supervisory systems

Source: Banking on the Principles: Compliance with Basel Core Principles and Bank Soundness, A. Demirgüç-Kunt, E. Detragiache, and Thierry Tresselt, September 2006



Stock Market Reaction to the Adoption of IFRS in Europe*

Sample: 3,265 listed firms, 16 events associated with the adoption of IFRS, between March 2002 and November 2005

Results:

- Significant positive (negative) market reactions to events that increase (decrease) the likelihood of IFRS adoption
- Market perceives net benefits associated with convergence of accounting standards
- Market perceives net benefits associated with improved information quality under IFRS
- European equity investors perceive net benefits to adoption of IFRS outweigh any expected costs of implementation and lost diversity from eliminating domestic accounting standards

* Source: C. Armstrong, M. Barth, A. Jagolinzer, E. J. Riedl, Working Paper Jan. 2007

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DIFC and Role of Financial Sector Development for MENA & GCC

- Invest, Manage and Control region's financial wealth of \$2+ trillion and growing as a result of high energy prices:
 - Strategic issue: security and safety of assets
- Financing Infrastructure & Regional Economic Integration
- Develop new markets and instruments:
 - Shari'a compliant financial sector & market
 - Bond market
 - Securitisation
- Enable & support economic and financial reforms:
 - Enable separation of oil revenue management from fiscal policy & investment
 - Privatisation and Private sector Participation in Infrastructure
 - Housing Finance & Mortgage markets



DIFC - Core Divisions

**DIFC
Authority**

*DIFC
Authority*

Responsible
for the
strategic
development
of the Centre.

DIFX

*Dubai
International
Financial
Exchange*

Developing
the
international
financial
exchange

DFSA

*Dubai Financial
Services
Authority*

Rule-Making
and Policy
Development
Licensing and
registration of
DIFC
Participants
Supervision of
DIFC
Participants
Enforcement
of legislation

DJA

*DIFC Judicial
Authority*

An independent
court with
unlimited civil
and commercial
jurisdiction.

ROC

*Registrar of
Companies*

Responsible
for
incorporating
and registering
all the
companies
that operate
within the
DIFC, and for
administering
the
Companies
Law and
Regulations.

DIFCI

*DIFC
Investments*

Responsible for
all non public
admin activities
such as the
operation and
management of
any current and
future
subsidiaries.



DIFX listing Rules and IFRS

- All entities that wish to list an instrument on the DIFX should publish audit accounts that are in accordance with the IFRS.
- Any financial statement that an entity listed on the DIFX publishes should be in accordance with the IFRS.

DIFX Listing Rules Appendix E



DIFC Register of Companies

- Entities registered in DIFC have to prepare their accounts and financials statements in accordance with IFRS as evidenced by provisions set out in Clause 6.2.1 of DIFC Companies Regulations, and Clause 28 (2) of the Limited Liability Partnership Law
- http://www.difc.ae/about_difc/structure/roc/



DFSA promotes a clear set of transparency and disclosure procedures in accordance with IFRS

- All regulated entities should maintain all financial accounts and statements in accordance with the International Financial Reporting Standards (IFRS)
- Islamic Financial Institutions prepare and maintain all financial accounts and statements in accordance with the accounting standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

DFSA General Module (GEN) [VER13/02-07], section GEN 8.2.1
<http://www.dfsa.ae/dfsa/>

DFSA & Corporate Governance: *DFSA Market laws Part 5, article 20*

Art. 20:

- (1) A Reporting Entity and its directors shall comply with the corporate governance principles set out in Article 21 together with the requirements of this Law and the Offered Securities Rules.
- (2) A Reporting Entity shall include in its annual report a statement on how it applies the corporate governance principles and the Rules relating to corporate governance referred to in Article 20(1).
- (3) A Reporting Entity must comply with, and observe, the spirit and the wording of the corporate governance principles.



DFSA & Corporate Governance: *DFSA Market laws Part 5, article 21*

Art. 21:

- (1) A Reporting Entity shall have a clear and appropriate division of responsibilities amongst and between senior management and the directors. The division should ensure there is clear guidance for the Reporting Entity and accountability of its directors to the Reporting Entity and its shareholders.
- (2) A director of a Reporting Entity shall exercise his powers and discharge his duties in good faith and act honestly and in the best interests of the Reporting Entity and its shareholders.
- (3) Controllers of a Reporting Entity shall exercise their rights of control in good faith and any abuse or oppression of minority shareholders of the Securities is unacceptable.
- (4) The directors of a Reporting Entity shall present a true, balanced and understandable assessment of the entity's position and prospects when making financial reports and relevant disclosures of material and other information to the market.
- (5) The directors of a Reporting Entity shall establish formal and transparent arrangements for considering how it should apply the financial reporting corporate governance principles and for maintaining an appropriate relationship with the Reporting Entity's auditors.



Hawkamah: Mission and Vision

MISSION:

To assist the countries and companies of the region to develop and implement sound and globally well integrated corporate governance frameworks.

VISION:

To drive institution building, corporate sector reform, good governance, and sustainable economic development and growth in the region.



Hawkamah Institute for Corporate Governance

- First Institute of its kind in the region: “Think & Do Tank”
- An autonomous international association, hosted by the DIFC and serving the wider MENA region
- Partners: DIFC, OECD, WB-GCGF, IFC, IIF, CIPE, YAL, UAB, countries participating in OECD MENA Investment programme
- Source of CG advisory services, technical assistance, monitoring, analysis, research, consultation and reform.
- Foster communication and policy dialogue on CG



Hawkamah: Strategic Partners

International Partners

Organisation for Economic Co-operation and Development (OECD)
WB-International Finance Corporation
WB Global Corporate Governance Forum
Center for International Private Enterprise
Institute of International Finance (IIF)
Financial Services Volunteer Corps (FSVC)
INSOL (Insolvency Professionals)
Information Systems Audit and Control Association (ISACA)
Amsterdam Institute of Finance
IMD

Other Institutions

Countries participating in the MENA-OECD Investment Program
Dubai School of Government
Young Arab Leaders
Corporate Governance centers, universities

Regional Partners

Dubai International Financial Centre
UAE Ministry of Economy
Yemen Ministry of Finance
Emirates Securities and Commodities Authority
Oman Capital Market Authority
Union of Arab Banks
Abu Dhabi Chamber of Commerce and Industry
Dubai Chamber of Commerce and Industry
Jordanian Corporate Governance Association
Central Bank of Jordan
Jordan Insurance Commission
Egyptian Institute of Directors/ MOI
Egyptian Banking Institute/Central Bank of Egypt
Economic Research Forum
Oman Economists Association
Corporate Governance Association of Turkey
Lebanese Corporate Governance Task Force



WHAT WE DO:

- § Provide advisory services & technical assistance on regulatory and firm levels to develop the optimal corporate governance environment
- § Undertake CG assessments of sectors and companies
- § Conduct consultations with various stakeholders
- § Develop and implement training programs
- § Serve as a knowledge centre and clearinghouse for corporate governance best practices from the region and beyond.
- § Monitor, Survey & Report on the state of corporate governance



MENA: Reports Observance Standards & Codes

ACCOUNTING & AUDITING

- Egypt, December 2002
- Jordan, June 2004
- Lebanon, May 2003
- Morocco, July 2002

CORPORATE GOVERNANCE

- Egypt, March 2004
- Jordan, June 2004
- Morocco, May 2003



Comparison of CG frameworks in the GCC Countries with IIF Guidelines (on scale of 1-5 with 5 being fully compliant)

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	United Arab Emirates
Accounting and Auditing	2.0	2.5	4.0	2.0	2.5	2.0
<i>Standards</i>	3.0	3.5	3.5	3.0	3.5	2.5
<i>Audit Committee</i>	0.5	0.0	5.0	0.0	0.0	0.0
Transparency of Ownership and Control	2.5	3.5	3.5	1.0	4.5	2.5
Regulatory Environment	2.0	2.0	4.5	2.5	2.5	2.0
OVERALL ASSESSMENT	2.0	3.0	3.5	2.0	3.0	2.0



Accounting and Auditing Standards in the GCC

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
Accounting Standards	IFRS	IFRS	IASC	N/A	SOCPA	IAS/USGAAP (DFM) IAS (ADSM)
Auditing Standards	ISA	ISA	N/A	N/A	SOCPA	N/A



Improving performance: Main Recommended GCC CG Financial Market Reform Measures

- § Develop a strong regulatory structure by clearly separating and defining the roles of the regulator and the stock exchange
- § Increase effectiveness of regulators by making them fully independent of government
- § Issue meaningful corporate governance codes and require mandatory compliance
- § Build institutional capacity and strengthen surveillance and enforcement mechanisms to ensure compliance
- § Strengthen the underlying corporate governance infrastructure by updating laws and creating specialized courts to deal with financial cases
- § Adopt IFRS for all listed companies
- § Promote training programs for directors of listed companies
- § Promote investor education and enhance public awareness of good corporate governance principles and practices
- § Introduce corporate governance best practices for state-owned and family-owned companies
- § Grant foreign investors full access to equity markets and promote shareholder activism by foreign and domestic institutional investors and the media
- § Create a regional level corporate governance task force to promote convergence and harmonization of laws and codes among GCC countries



Recommendations for MENA Transparency & Disclosure

- Invest in Market Integrity Infrastructure:
 - Statistical infrastructure: comply with GDDS, SDDS
 - Accurate information disclosure
 - Foster incentives for private sector to monitor and exert corporate control: Central Credit Organizations
 - Establish Companies Houses
- Adopt, implement and enforce IFRS
- Establish independent regulator for corporate reporting & governance (e.g. Financial Reporting Council in UK):
 - Accounting Standards Board
 - Auditing Practices Board.
 - Board for Actuarial Standards
 - Professional Oversight Board



Transparency & Disclosure

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