

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Corporate Governance Country Assessment

EGYPT

March 2004

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This Corporate Governance Assessment was completed as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC). It benchmarks the country's observance of corporate governance against the OECD Principles of Corporate Governance and updates the previous assessment carried out in 2001. This assessment was prepared by Alexander Berg and Miarta Capaul of the Investment Climate Unit (CICIC) of the World Bank. The ROSC assessment was cleared for publication by the Ministry of Foreign Trade on February 28, 2004.

EXECUTIVE SUMMARY

This report provides an updated assessment of Egypt's corporate governance policy framework, enforcement and compliance practices. It highlights recent improvements in corporate governance regulation, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in Egypt. In recent years there have been a number of major reforms, mostly incorporated in new stock exchange listing rules. However, experience in other countries suggests that implementation and enforcement of the rules remain central.

The report identifies several key next steps that focus on implementation, including (i) building a Center for Directors that can help develop a Code of Corporate Governance on the role, duties, and functions of the board, and create a director training capability; (ii) focused enforcement of the new listing rules and disclosure provisions, with continued emphasis on a review of content, and (iii) implementation of legislative reform to bring the policy framework into greater compliance with the OECD Principles. Together, these measures will help to implement the recent reforms and provide new opportunities for issuers to implement best practices.

I. CAPITAL MARKETS AND INSTITUTIONAL FRAMEWORK

At end-2002, Egypt's equity market capitalization was USD 26.1 billion, or 29 percent of GDP,¹ the second largest in absolute size in the Middle East and North African region, after Saudi Arabia. 1,079 companies were listed on the Cairo and Alexandria Stock Exchange (CASE) at the end of September 2003. Many companies are listed because of the tax advantages associated with listing.² About 36 percent of market capitalization comes from the largest ten companies,³ and 18 companies represent about 90 percent of trading volume.⁴ Ownership is highly concentrated; average free float is approximately 20 percent.

In July 2002 new listing rules went into effect that increased disclosure and corporate governance requirements for listed firms, and CASE has renewed its commitment to enforce the listing rules. As a result, a net of 99 companies had been de-listed for failing to observe the new listing rules by end-September 2003, and 300 mostly small and closely held companies could be de-listed over the next few months.⁵

The corporate legal framework has its origins in French civil law. Law 159 of 1981 provides basic company law (CL).⁶ Anglo-American common law concepts are more prominent in the

¹Source: World Bank, World Development Indicators. Please see data tables in Annex C.

²The tax exemption is equivalent to the three months' deposit rate paid by the Central Bank on paid-up capital.

³CASE Monthly Bulletin, data for end of July 2003. The listed company with the largest market capitalization is Telecom Egypt, which is 100 percent owned by the State. If only actively traded issues are included, the ten largest account for 13.3 percent of total market capitalization.

⁴These 18 companies no longer have a price fluctuation ceiling of plus/minus 5 percent, and their settlement cycle is T+2.

⁵Companies were required to make new listing applications to one of the four "tables": Official 1 (the top tier); Official 2 (for public sector companies); and Unofficial 1 and 2. As of September 30, 2003, 61 companies were listed on Official 1, 29 on Official 2, 27 on Unofficial 1, and 246 were listed on Unofficial 2. Seven hundred sixteen companies had temporary status, as their applications were under review. Companies with more than 100 shareholders are considered to be "public" companies, and are mostly listed on the "Official 1" schedule (see table in Annex C for details).

⁶In December 2002, there were about 29,000 companies in Egypt, including 22,000 joint stock companies and 280 limited by shares companies. Only joint stock companies and limited by shares companies can be listed. Source: *Assessment of Corporate Governance in Egypt*, ECES Working Paper No. 82.

Capital Market and Central Depository Laws. The Capital Market Law 95 of 1992 (CML) regulates the capital market, and provides the framework and supervision of the stock exchange and market intermediaries. The CMA can draft new secondary regulations, which are then issued as decrees of the Minister of Foreign Trade. New executive regulations and rules have been issued to address a number of issues, including disclosure, stock exchange listing, tender offers, minority shareholder rights, and securitization. The Central Depository Law 93 of 2000 (CDL) regulates shareholder record keeping, clearing and settlement. In 2003, the National Democratic Party endorsed reforms to the company and accounting/auditing laws.

The Capital Market Authority (CMA) is the securities market regulator, reporting to the Minister of Foreign Trade (MOFT). Two of the seven board members, including the chairman, are appointed by the President for a renewable three year term. The others are appointed by the Prime Minister for a two-year renewable term.⁷ CMA's budget is derived from fee income. It employs 250 people, whose salaries are in line with comparable private sector positions.⁸ CMA has wide administrative sanction powers, including warnings, delistings, suspending and revoking licenses, imposing monetary penalties, canceling transactions (even after settlement if there has been an illegal act), conducting inspections, and suspending shareholder decisions. It can refer cases to the prosecutor general to initiate proceedings. The Companies Department⁹ at GAFI¹⁰ also supervises the enforcement and implementation of company law.

CASE is a quasi-governmental body under the supervision of CMA,¹¹ which can veto board decisions. CASE is responsible for monitoring compliance with listing rules and may impose penalties on companies that do not meet disclosure requirements, including monetary payments, trading suspension, and delisting. Misr for Clearing, Settlement & Central Depository (MCSD) is the central clearing, registry and depository organization.¹²

Awareness of corporate governance has increased significantly due to a number of banking scandals and the role of the press in uncovering scandals. The corporate governance framework for the banks has been significantly upgraded, especially at the four large State-owned banks, and more outsiders have been brought onto bank boards. Improved corporate governance is an explicit policy goal of the CMA.

II. REVIEW OF CORPORATE GOVERNANCE PRINCIPLES

This section assesses Egypt's compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed.¹³

⁷A proposal for a new governance structure of CMA is under preparation.

⁸Source: CMA. There is also a special fund to recruit top level experts at market prices.

⁹Formerly the Companies Organization (COOR).The Companies Department also has supervision over companies founded according to Law No. 8 /1997. Companies founded according to Law No. 203/1991 are subject to the supervision of the Ministry of the Public Enterprise and its Holding Companies. The draft company law proposes to put all listed companies under the exclusive supervision of CMA.

¹⁰GAFI is the General Authority for Investment and Free Zones.

¹¹CASE is expected to become a for-profit company in the medium term.

¹²MCSD is governed by the Central Depository Law, and acts under the supervision of the CMA.

¹³**Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices, and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

Section I: The Rights of Shareholders

Principle IA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (1) secure methods of ownership registration; (2) convey or transfer shares; (3) obtain relevant information on the corporation on a timely and regular basis; (4) participate and vote in general shareholder meetings; (5) elect members of the board; and (6) share in the profits of the corporation.

Assessment: Observed

Description of practice: **Secure methods of ownership registration.** Registration with MCS D provides legal proof of ownership.¹⁴ MCS D acts as central registry and tracks beneficial ownership.

Convey or transfer shares. Listed shares are freely transferable.¹⁵ Settlement is T+3 for MCS D registered securities. For the 18 most actively traded stocks the settlement period is T+2.

Obtain relevant information on the corporation on a timely and regular basis. Shareholders can review financial statements at the company two weeks before the annual general meeting (AGM).¹⁶ Summaries of semi/-annual statements and auditor reports must be published in two daily newspapers.

Participate and vote in general shareholder meetings. Shareholders have the right to participate and vote at general meetings. Shares are blocked for at least one day prior to the AGM. Bearer shareholders can attend the meeting but not vote. Partially paid up shares can vote.

Elect members of the board. Shareholders elect members of the board of directors according to the bylaws. Cumulative voting, while theoretically not prohibited, is not known.¹⁷

Share in the profits of the corporation. The AGM approves the distribution of dividends. It has the power to propose higher dividends than those proposed by the board. Some companies facing liquidity problems pay dividends in installments.

Policy recommendations: Policymakers could consider introducing provisions to allow minorities to place candidates on the board, possibly through cumulative voting, or by allowing a minority block of shareholders to appoint candidates to the board.¹⁸ Partially paid up shares should not have full voting rights.

Principle IB: Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as: (i) amendments to the governing documents of the company; (ii) the authorization of additional shares; and (iii) extraordinary transactions that in effect result in the sale of the company.

Assessment: Largely observed

Description of practice: Fundamental decisions are made by the extraordinary general meeting (EGM). These are held at the request of 10 percent of share capital, the board of directors, the

¹⁴The Central Depository Law requires MCS D registration for listed companies, and 927 companies are registered at MCS D as of October 2003. More than 150 listed companies remain unregistered. However, once the relisting / delisting process currently underway at CASE is completed, all remaining companies are expected to be registered.

¹⁵There are two exceptions. According to Article 63 of the Capital Market Law Executive Regulations, founders' shares are non-transferable for two years. In addition, Article 45 of Companies Law 159 states that most board members must be shareholders.

¹⁶Inspection rights include company's balance sheets, profit and loss statement and audit report for the previous three years.

¹⁷Cumulative voting allows minority shareholders to cast all their votes for a single candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. If there is no cumulative voting rule in place, each shareholder will have to vote separately for each director. The majority shareholder will get all five seats, since he will outvote the minority shareholder each time by 80:20. With cumulative voting, the minority shareholder can decide how to place his votes. The optimal strategy would be to take all his votes (five times 20 percent) and cast them for one board member. The minority shareholder will then win that seat.

¹⁸"Proportional representation" gives shareholders with a certain fixed percentage of shares the right to appoint a board member.

auditor or the Companies Department. The legal quorum is 50 percent of share capital. If the quorum is not met, the requirement for the second meeting is 25 percent of share capital. A 2/3 supermajority of votes attending the meeting is required to modify the company statutes, waive pre-emptive rights¹⁹ (if granted in company statutes), or add to the corporate objective.²⁰ A 75 percent supermajority is required to increase or reduce capital, change the corporate purpose, prolong or shorten the life of the company, change company form and decide on dissolution, merger or voluntary delisting.²¹

Share repurchases are allowed, and treasury shares can be held up to one year before they must be cancelled.²² Boards may increase share capital, within the limits of authorized capital, without specific shareholder authorization.²³ The sale of substantial assets does not require shareholder approval unless it is considered a hidden form of liquidation, in which case the reduction of capital requires shareholder approval.

Policy recommendations: Large transactions should require shareholder approval, even if they do not lead to a reduction of capital.²⁴ In addition, policymakers could review rules and detailed experience regarding capital increases, and take action if necessary.

Principle IC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern them. (i) Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting. (ii) Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations. (iii) Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

Assessment: Largely observed

Description of practice: The AGM meets within three months of the financial year's end. It is usually convened by the chairman of the board, although shareholders representing 5 percent of capital, the Companies Department and the auditor have the authority to call the meeting if the board does not do so. They may also attend the meeting. The notice must include date, time and place of the meeting, as well as an agenda. The AGM requires a quorum of 25 percent of capital. If the quorum is not met, a call may be included in advance for a second meeting. No minimum quorum is required by law for the second meeting. Shareholders must register their intent to vote with their custodian; these shares are blocked from trading until the day after the AGM. MCSD's systems allow blocking up to one day before the date of the meeting.

Shareholders representing 5 percent of capital may add items to the agenda until three days before the meeting. Urgent matters can be discussed and voted on without being on the agenda, if a majority of shareholders at the meeting agrees.²⁵ Shareholders have the right to ask written²⁶ and oral questions. The board answers the questions to the extent to which it does not cause

¹⁹Pre-emptive rights give existing stockholders the opportunity to purchase shares of a new issue before it is offered to others. The purpose of these rights are to protect shareholders from dilution of value and control when new shares are issued.

²⁰CL 159, Article 70 (c).

²¹The requirement for shareholder delisting approval was added by Article 35 of the listing rules.

²²According to the new listing rules, the company must inform CASE of its intention to purchase treasury shares. This information is published on CASE screens.

²³CL 159, Articles 32-33. A capital increase must take place within three years of the decision to increase authorized capital.

²⁴The OECD Principles recommend that shareholders approve large transactions, although shareholder approval thresholds vary from country to country. In Chile, for example, shareholders vote on decisions to dispose of or mortgage 50 percent or more of the company's assets.

²⁵The removal of the board can always be voted on, regardless of whether this is on the agenda.

²⁶Questions must be submitted up to three days before the AGM.

“harm to the interests of the company or the public interest.” If the answer is judged insufficient by the interested parties, they may appeal to the AGM to decide on the issue.

Voting is allowed in person or by proxy.²⁷ Voting is anonymous, if it involves the election/removal or sanction of directors or if the chairman or 10 percent of shareholders make a request. Postal voting is unavailable. Electronic voting is permitted, but legal problems and a lack of procedures make electronic voting unavailable in practice.

Policy recommendations: Policymakers should consider extending the meeting notice period to 30 days, removing rules requiring share blocking (in line with international investor requests).²⁸ International good practice suggests that only items on the agenda should be put to a vote.

Principle ID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Assessment: Largely observed

Description of practice: Shareholders can obtain information about share classes from the company statutes, which are available at the Companies Department (for a fee of about USD 3.50). Another source of information is the prospectus. Share class information is not available through periodic disclosure. Shareholder agreements need not be disclosed.²⁹ The listing rules require companies to disclose the ownership of shareholders with more than 5 percent of capital to CASE on a semi-annual basis. In addition, important changes to the ownership structure must be disclosed as material events. These reports are based on MCS D’s shareholder registry.³⁰

There are two classes of shares: common and preferred. Common shares are either registered (also called “nominal”) or bearer.³¹ Preferred shares may have privileges in terms of voting, receive a fixed percentage of dividends to be paid before other dividends or have priority in liquidation. In most cases, voting rights are capped at two votes per share, but there is no legal limit. Common shares represented 99.7 percent of total market capitalization at end-July 2003.³²

Policy recommendations: In line with international trends, the onus should be on shareholders to disclose when their ownership crosses specific thresholds.³³ The thresholds should take into consideration shares held by third parties but under the control of the disclosing shareholder, including shares covered by shareholder agreements. These should also be disclosed.

Principle IE: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Assessment: Largely observed

Description of practice: The CML provides the basic rules governing tenders and changes of

²⁷Proxy voting is subject to certain limitations: if the proxy is a physical person, then the proxy must be a shareholder, have a power of attorney, cannot be a board member, and cannot represent more than 10 percent of total shares and 20 percent of represented shares at the meeting. These requirements do not apply to institutions (legal persons).

²⁸See e.g. Institute of International Finance, “Policies for Corporate Governance and Transparency in Emerging Markets,” 2002.

²⁹Shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations. Such agreements are common in Egypt.

³⁰As a central registry, the MCS D maintains an up-to-date list of beneficial shareholders.

³¹Bearer shares were introduced by the Capital Market Law Executive Regulations. Bearer share capital must not exceed 25 percent of total share capital and must be fully paid up. Owners of bearer shares may attend the AGM if their shares are deposited at a bank, the company or MCS D; however, they are not allowed to vote. Bearer shares are reported by the MCS D to be very rare, and are absent among widely-held listed companies.

³²CASE Monthly Bulletin, July 2003.

³³For example, in Slovakia: 5, 10, 20, 33, 50 and 60 percent of their share of voting rights.

control.³⁴ Any person intending to acquire at least 10 percent of capital (5 percent for directors or employees) must give the company two weeks notice via registered mail. Within one week of this notification, the company must inform shareholders owning at least 1 percent or publish this information in two widely circulated newspapers. The transaction must be concluded within one month from the date of notification. If ownership will exceed 15 percent, a tender offer for the required amount of share capital must be issued to all shareholders. The tender price must be greater than the average closing price during the week prior to the notification and is valid for one week, but can be extended. If tendered shares exceed those demanded, allotment is made on a pro rata basis.

Given the ownership structure, no hostile takeovers have been recorded as of date, while friendly takeovers do take place from time to time. The existing tender rules are recognized by the market and regulators as inadequate. The CMA has recently started to refuse to approve tender offers, unless the offer is for 100 percent of the shares.

Policy recommendations: To maximize transparency and avoid surprises to investors, the CMA should clearly state its tender rules. Policymakers should review recent international experience in takeover policy and the recent EU recommendations for squeeze-out and sell-out rights.³⁵

Principle IF: Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

Assessment: Materially not observed

Description of practice: It is not common for institutional investors to have explicit voting policies, and some major investors do not vote. This might be changing; there is reportedly growing recognition that voting can be a powerful tool, and institutional investors are starting to put pressure on asset managers to vote on their behalf.

Policy recommendations: Voting should be made as easy as possible. Revisions to the investment funds laws could include provisions on the roles and responsibilities of investors acting in a fiduciary capacity. In some countries (including the US and the UK), mutual funds are obliged to disclose their voting policy.

Section II: The Equitable Treatment of Shareholders

Principle IIA: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. All shareholders of the same class should be treated equally. (i) Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. (ii) Votes should be cast by custodians or nominees in a manner agreed upon with the share's beneficial owner.

Assessment: Largely observed

Description of practice: Shareholders have a number of redress possibilities. First, any shareholder who attends the AGM and registers his opposition in the minutes can initiate a case in court within one year of the meeting. However, most observers consider the courts to be a slow and inefficient form of shareholder redress, and they are reportedly rarely used to settle

³⁴Article 61 of Executive Regulations CML.

³⁵The squeeze-out right (sometimes called a “freeze-out”) is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.

disputes.³⁶ Second, shareholders have withdrawal rights³⁷ and can withdraw from the company in the case of mergers with other companies. The share price is determined by agreement or by the court.³⁸ Third, every shareholder has the right to file a complaint with the relevant administrative agency (e.g. the Companies Department) regarding any violation of the law.³⁹ Upon request of shareholders representing at least 10 percent of capital, CMA or the Companies Department can also carry out company inspections to ensure that procedures are followed correctly and that decisions do not unfairly favor one group of shareholders over another.

The fourth and most powerful form of redress may be a special power of the CMA: Shareholders who represent 5 percent of share capital are entitled to submit a complaint to the CMA, and the CMA has the power to suspend AGM resolutions that are considered to unfairly favor a given group of shareholders, or cause harm to them, or unfairly bring about a benefit to the members of the board or others.⁴⁰ When acting in this role, CMA becomes, in fact, a special court for shareholder disputes. The decision of the CMA board can be appealed to the appeals committee housed within CMA, and only then to the courts. Since 1995, shareholders have petitioned the CMA 43 times, and the CMA board has ruled in favor of the petitioning shareholders 29 times (or in just over 67 percent of applications).⁴¹

Custodians vote according to the instructions of the beneficial holders. Reportedly, it is frequent practice for clients to give their custodians and portfolio managers a general power of attorney to vote on their behalf.

Policy recommendations: Policymakers could consider extending appraisal rights to other fundamental decisions (e.g. sale of assets, or de-listing), rather than mergers only.

Principle IIB: Insider trading and abusive self-dealing should be prohibited.

Assessment: Partially observed

Description of practice: General provisions of the CML 95 can be used to pursue insider trading and self-dealing cases.⁴² Insider trading is recognized as a problem by CMA and CASE, and its prosecution is considered a priority. Most cases are resolved on an administrative basis (often by reversing suspicious trades) rather than in court. CMA has developed an insiders' database of board members and executives. Market participants report close supervision. Three cases have been forwarded to the prosecutor in recent years; these cases remain in court. The new listing rules contain a number of disclosure requirements designed to reduce insider self-dealing.⁴³

³⁶There are no specialized commercial courts in Egypt.

³⁷Withdrawal rights (sometimes referred to in other jurisdictions as the “oppressed minority,” “appraisal” or “buy-out” remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

³⁸CL, Article 135.

³⁹CL, Article 155.

⁴⁰The CML only provided this power for 15 days after the AGM. However, a constitutional court removed the time limitation.

⁴¹Source: CMA internal data. Of the nine shareholder meeting resolutions that have been suspended by the CMA since 2002, four cases were appealed. The CMA appeals committee rejected all four appeals, but all four suspensions were eventually successfully overruled by the administrative court.

⁴²Article 64 of CML 95 states that “any person who divulges a secret, which is in his possession by virtue of his duties under government by the provisions of this law, or has benefited him, his spouse and his children, from insider information of his work, or who used material misstatement, or omitted any material information in reports, submitted by him, to the extent that it affects the results contained in such reports” is punishable by law. Penalties include fines in the amount of L.E. 20,000-50,000 (USD 5,000-13,000) and/or prison terms of two years.

⁴³See Insider Trading in the Annex.

Board members and executives with access to internal information must inform CASE and CMA 24 hours before making any trades, and this information can be published.

Policy recommendations: Insider trading and self-dealing provisions should be strengthened in new laws and regulations.

Principle IIC: Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

Assessment: Largely observed

Description of practice: Egyptian accounting standards require directors and managers to disclose any material interest in transactions or other matters affecting the company, irrespective of whether such transactions have taken place. Disclosure must be made in the notes to the financial statements. However, the World Bank Accounting and Auditing ROSC (2002) noted several problems in compliance with the related party transaction disclosure requirements. Specifically, "...required disclosures are rarely fully provided. The financial statements of many companies that seem to have related parties, do not disclose information on either the existence of related parties or related-party transactions."⁴⁴

According to the listing rules, companies must disclose the transactions between the issuer and any of the shareholders in the company or its affiliates. Company law provides additional self-dealing protections. Directors must not enter into contracts with companies where board colleagues are directors or senior managers. Companies cannot make loans to directors.⁴⁵ Directors with conflicts of interest must notify the board, have it recorded in the minutes of the meeting, and abstain from voting; the board must then notify the AGM. Directors must obtain special authorization from the AGM to do business in the same sector as the company, or to be a party to any contract submitted to the board for approval.⁴⁶ However, it is not uncommon for the board to obtain blank approval for any contracts between the company and themselves.

Policy recommendations: Enforcement of disclosure rules on related-party transactions should become a top CMA and CASE priority. AGMs should not grant blank approvals, but authorize specific transactions or transactions up to a specified amount. In many jurisdictions, independent audit committees must now express opinions on related party transactions and other potential conflicts of interest. Policymakers should consider adding a shareholder approval mechanism for large related-party transactions.

Section III: Role of Stakeholders in Corporate Governance

Principle IIIA: The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

Assessment: Observed

Description of practice: Stakeholders have a number of legal protections. Article 84 of the CL 159 states that employees of joint stock companies shall participate in "management" and that the company's statutes shall specify appropriate methods and rules. Rather than direct board representation, companies often create "employee committees" or similar bodies to deal with all

⁴⁴Please see the Accounting and Auditing ROSC and the discussion under Principle IVB for more details.

⁴⁵CL, Article 96.

⁴⁶CL, Article 97.

matters related to employees, and a director is assigned the task to liaise with this committee.

CML 95 provides bondholders with special protections. They may form a bondholders' association (BHA) and elect a legal representative, who acts on their behalf and attends the AGM. The association may submit recommendations to the AGM or the board of directors. The unified labor act prohibits child labor and the environmental law protects the environment.

Principle IIIB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Assessment: Observed

Description of practice: Stakeholder rights are protected by contract or specific laws, such as the labor act, environmental law or insolvency regime. Bankruptcy rules are subject to the Commercial Code. Stakeholders have access to the legal process to obtain redress for the violation of rights. Creditor rights (though not specifically reviewed for this assessment) are considered to be relatively weak in international comparisons.⁴⁷

Principle IIIC: The corporate governance framework should permit performance-enhancement mechanisms for stakeholder participation.

Assessment: Observed

Description of practice: CL 159 grants employees the right to the lesser of 10 percent of the company's profits or the employee's annual salary. Employees may also establish an employee shareholder association (ESA) for the purpose of owning shares and distributing profits among members. In privatized companies, ESAs hold 5 percent or more of share capital on behalf of the employees. At 10 percent, the ESA usually has a seat on the board of directors. Some companies have share ownership programs for their employees and executives. Stock option plans are not regulated by the legal framework, but are permitted. They are rare.

Principle IIID: Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Assessment: Largely observed

Description of practice: Stakeholders, such as employees, associations of bondholders and others, have the right to all information by law. Bondholder associations have the right to inspect the financial statements. Reportedly, many stakeholders are unaware of their rights to obtain relevant information.

Section IV: Disclosure and Transparency

Principle IVA: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and the governance of the company. Disclosure should include, but not be limited to, material information on: (1) The financial and operating results of the company. (2) Company objectives. (3) Major share ownership and voting rights. (4) Members of the board and key executives, and their remuneration. (5) Material foreseeable risk factors. (6) Material issues regarding employees and other stakeholders. (7) Governance structures and policies.

Assessment: Partially observed

Description of practice: According to the listing rules, companies with 100 shareholders or more must make audited annual and semi-annual disclosures within 90 working days after the end of the period, and quarterly disclosures that are 'reviewed' by the auditor after 45 working days of the end of the quarter. All other listed companies must make annual disclosures only. Mandatory

⁴⁷A creditor rights index developed by the World Bank for 130 countries gives Egypt a score of 1 out of a possible 4, equal to the regional average. See *Doing Business 2004* at rru.worldbank.org.

financial disclosure includes the balance sheet, income and cash flow statements, changes in stockholder equity and board composition, as well as the external auditor's report and directors' report. Companies are required to publish a summary of their semi-annual and annual reports in two newspapers, at least one of which is in Arabic. Companies are not required to publish a full annual report, although many actively traded companies do publish a detailed report (but without any standard form). Article 15 of the listing rules requires companies to appoint a person to be responsible for relations with the shareholders and the stock exchange. Listed companies are required to make immediate disclosure to CASE of any material events that affect its activities or financial position, or the trading of its shares. Companies must notify CASE in time to electronically publish these events either immediately, or before the first subsequent trading session after the occurrence of these events.⁴⁸

Some of the non-financial disclosure recommendations of the OECD Principles are required by law and regulation. Share class voting rights are disclosed in company statutes. Board remuneration is disclosed in the aggregate in the financial statements; executive remuneration is not reported. CMA requests companies to submit annually a list with the names, nationalities and other pertinent details of board members and senior management. It is up to company statutes to determine what level of disclosure relating to the board should be divulged to shareholders. Senior management must declare that there are no foreseeable risks, but there is no requirement to report on them other than the qualified auditor opinion when there is serious doubt that the company is a going concern.⁴⁹ There is no disclosure on policies related to business ethics, the environment and other public policy commitments. Issues such as lock-outs, strikes or litigations are not routinely disclosed. There is no disclosure of governance structures and policies. Perhaps most significantly, market participants commented on the absence of an in-depth management discussion and analysis section in the annual reports of many listed companies.

Compliance with the filing rules has traditionally been a problem. The Accounting and Auditing ROSC noted that many companies surveyed were late in filing their financial statements. However, the new listing rules are expected to improve compliance. First, monetary penalties can now be assessed to companies that file late.⁵⁰ Second, CASE is beginning to actively delist companies that continue to ignore the requirements. In Egypt, where delisting carries the penalty of losing tax credits, this is a significant step.⁵¹

Policy recommendations: Standardized annual reports would enhance the comparability of financial statements and make them more user friendly for investors. Policymakers should consider adding explicit non-financial disclosure requirements that meet OECD recommendations. CMA and CASE should ensure that the disclosure deadlines are reasonable, and then adopt a zero-tolerance policy on late disclosures. Longer term listing rule strategy

⁴⁸Material events are published in coordination between the company and CASE. Events are not published during trading hours unless the information must be published immediately. In such cases, trading on the company's securities will be suspended for up to one hour. The company must undertake the necessary guarantees to secure the confidentiality of the financial information and to prevent exposure before the announcement to traders. The listing rules regulate what a company has to do if important events occur during formal holidays, and provide special rules for GDR-listed companies..

⁴⁹The listing rules require company senior management to verify that there is no unrecorded information that may affect the company's financial position and that there are no lawsuits filed against the company that may require additional provisions other than the provisions mentioned in the financial statements.

⁵⁰Late filing penalties can reach as high as LE 3000 (about USD 500) per filing.

⁵¹A policy was recently adopted to waive penalties for the first year of transition to the new rules. Fines that were assessed during the last year are being returned.

should evolve to create incentives for companies who want to distinguish themselves by following higher standards of disclosure, transparency and accountability. Companies listed on tiers with limited disclosure requirements could be encouraged to graduate to tiers with greater transparency.

Principle IVB: Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

Assessment: Largely observed

Description of practice: Financial statements must follow Egyptian Accounting Standards issued by MOFT in conformity with the IFRS (IAS).⁵² IFRS must be applied in the absence of a specific Egyptian standard.⁵³ CMA is responsible for the compliance of issuers with accounting and audit standards and disclosure requirements. They have a staff of 15 in their disclosures department, aided by four experts who monitor disclosure and accounting standards of 1,100 companies. A checklist has been developed to review financial statements. CMA can request more information, and in the case of non compliance can require the company to publish its conclusions at company expense, suspend trading, or delist the securities.

The 2002 annual report of CMA and the Accounting and Auditing ROSC note that there are gaps between official accounting standards and actual practices. A review of 2001 financial statements of 30 top-listed companies revealed a number of missing disclosures, e.g. missing financial statements, lack of consolidation according to IFRS, lack of segment reporting, lack of disclosure of related party transactions, and inadequate risk and non-performing loan disclosures by banks.

Policy recommendations: See Accounting and Auditing ROSC. CMA should continue to build on its capability to review disclosure content. Immediate attention should be paid to corporate governance disclosure issues, including consolidation, disclosure of ownership and related-party transactions.

Principle IVC: An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Assessment: Partially observed

Description of practice: Annual and semi-annual financial statements must be audited.⁵⁴ The AGM appoints the auditor and sets compensation.⁵⁵ Any shareholder may submit a motion to fire the auditor after explaining the grounds for removal in writing up to ten days before the AGM. The auditor may respond in a letter, defending any actions under review. The auditor is liable for misrepresentation and errors and should compensate the company and/or shareholders for any resulting loss. The auditor must not be a founder, board member, employee or otherwise associated with company or board. The auditor may not become a board member or employee of the company for three years following contract termination.

A critical aspect of the 2002 CASE listing rules is that companies must form an audit committee

⁵²The standards do not recognize finance leases and the application of accounting treatments required under the relevant international standard. For a detailed review of accounting standards please see the Accounting and Auditing ROSC.

⁵³Ministerial Decree No. 503.

⁵⁴Quarterly statements are submitted with a limited review report, which does not include an opinion. Companies with more than 25 percent state ownership must be audited by the Central Audit Agency.

⁵⁵Consulting fees are not disclosed at the AGM.

of the board.⁵⁶ The audit committee is responsible for the oversight of internal auditing and control procedures and reviews annual reports and prospectuses. The audit committee does not propose the external auditor. The members of the committee should be non-executives, unless there are no non-executive directors on the board, in which case outsiders can be hired. By end-September 2003, about 60 issuers had disclosed the existence of audit committees to CASE.

The Accounting and Auditing ROSC raised a number of concerns about the audit profession and its oversight.⁵⁷ The draft accounting and auditing law proposes the creation of a regulatory body for auditors, imposes penalties on those who do not conform with the Egyptian and international auditing standards, and establishes more stringent procedures for auditor licensing and examinations.

Policy recommendations: See Accounting and Auditing ROSC. Moving forward on the creation of an accounting oversight board should be a top priority. The audit committee should make all recommendations about the external audit function, including proposing the auditor, suggesting audit fees and deciding which consulting functions auditors can provide.

Principle IVD: Channels for disseminating information should provide for fair, timely, and cost-effective access to relevant information by users.

Assessment: Largely observed

Description of practice: Information is available through five main channels: (i) the Companies Department, which keeps company statutes, AGM/EGM and board minutes;⁵⁸ (ii) periodic and material disclosure made to CASE and CMA, which is immediately available to brokers and investors (historical information is available on a fee basis); (iii) information available at the company; (iv) summary financial statements published in the newspaper; and (v) information on company websites. Enhanced electronic filing systems are under development at CASE (through its commercial information subsidiary) and CMA, and the annual financial statements for the most active stocks are already available online on the CASE website. However, for the majority of listed companies, timeliness remains an issue.

Policy recommendations: Relatively high priority should be placed on finalizing the development of an Internet-based electronic filing and data retrieval system to improve information dissemination. CASE and CMA should coordinate system development planning to avoid duplication of effort.

Section V: The Responsibility of the Board

Principle VA: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

Assessment: Largely observed

Description of practice: Egyptian companies have single tier boards comprised of an odd number of members, with a minimum of three. Two "experts" may be appointed to the board; they are full members of the board, and they vote. Directors must be shareholders or represent companies

⁵⁶Banks are already required by law to have audit committees.

⁵⁷See the Accounting and Auditing ROSC for more details.

⁵⁸These documents are also filed with the Commercial Registry.

who are shareholders.⁵⁹ An employee cannot be appointed before having served at least two years with the company.⁶⁰ The AGM elects directors for renewable terms of three years, sets their remuneration, and can remove them if necessary. Directors must submit a CV, including a list of companies with which they have been associated during the previous three years. Frequently, the chairman and managing director (or CEO) are the same person.⁶¹ A recent Prime Ministerial decree mandates that board members are only eligible to serve two terms, and that if the company experiences losses, board members cannot be re-appointed.⁶² The board meets upon request of the chairman or 1/3 of its members.⁶³

There is a significant difference in the level of compensation of executive and non-executive directors. The remuneration of non-executive board members consists of sitting fees and travel expenses. Executive directors receive an annual share of profits of 10 percent of net income.⁶⁴

Policy recommendations: The process of drafting a Code of Corporate Governance could help build a national consensus on the role, duties, and functions of the board. Issuers could be required to “comply or explain” their adherence with the Code. Another good initiative is that policymakers reviewing the draft company law are proposing to remove the share ownership requirement in order to encourage independent technical and professional know-how on boards. The Center for Directors that has now been created should work to quickly develop a basic Directors Manual and training curriculum for directors.

Principle VB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

Assessment: Partially observed

Description of practice: According to Egyptian law, there are two degrees of “care”: (i) care of any ordinary person and (ii) care of a diligent person. Past court decisions indicate that directors are expected to execute their duties with the care of a diligent person. The board is accountable to shareholders and the company and legally responsible for any distortion or forgery of company information.⁶⁵ Law and regulation provide limited guidance on the duties of board members to the company (the “duty of care”) and to shareholders (the “duty of loyalty”). It is usual for the AGM to discharge the board from accountability each fiscal year. Directors have been held personally liable for criminal offenses like fraud or breach of regulations, but it is the government rather than shareholders that usually initiates criminal action.

Policy recommendations: Policymakers reviewing the draft company law should consider adding more explicit provisions on the fiduciary duties of directors. As the liability of directors is made more explicit, the notion of a business judgment rule could be introduced in order to protect board members from being held liable for good faith business decisions.

Principle VC: The board should ensure compliance with applicable law and take into account the interests of stakeholders.

⁵⁹CL, Article 91. These shares must be held in trust during the director’s service. The two experts may ignore this requirement.

⁶⁰CL, Article 83.

⁶¹The managing director is sometimes referred to as “delegated member.”

⁶²The November 17, 2003 decree applies not only to listed companies but to all private and public sector companies and government agencies.

⁶³CL, Article 80. The board meeting is considered valid if the number of attendees is not less than half of its members plus one, provided the number of attendees is not less than three board members.

⁶⁴After deducting 5 percent for legal reserves and 5 percent of paid-in capital for dividends.

⁶⁵For example, any member of the board is subject to a penalty of imprisonment of no less than two years and to a fine of L.E. 2,000-10,000 (USD 500-2,500) if profits are distributed against the provisions of CL 159 or company statutes.

Assessment: Largely observed

Description of practice: Company law requires the board to take interests of employees into account.

Policy recommendations: A Code of Corporate Governance may be the best way to address stakeholder issues at the board level.

Principle VD: The board should fulfill certain key functions, including (1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance and overseeing major capital expenditures, acquisitions and divestitures. (2) Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. (3) Reviewing key executive and board remunerations, and ensuring a formal and transparent board nomination process. (4) Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related-party transactions. (5) Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law. (6) Monitoring the effectiveness of the governance practices under which it operates and making changes as needed. (7) Overseeing the process of disclosure and communications.

Assessment: Partially observed

Description of practice: The board is the ultimate body governing the corporation and is responsible for monitoring the implementation of the company's objectives set by the AGM. Board functions include appointing management, calling shareholder meetings and submitting financial statements and reports, investing company funds and making loans. The directors' report includes a summary of activities, market conditions, and plans for the following year. In practice, the boards of most companies do not yet play a central and strategic role, and their functions are not clearly distinguished from those of management. They most often lack independence from controlling shareholders and from management. Boards have no explicit role in approving related party transactions or conflicts of interest between shareholders. Boards do not have responsibility for monitoring governance practices, or for overseeing disclosure and communications, although board members are liable for false statements.

Policy recommendations: Board functionality that is consistent with international standards and the OECD Principles should be explicitly laid out in law or in a Code of Corporate Governance.

Principle VE: The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management: (1) boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination, and executive and board remuneration. (2) board members should devote sufficient time to their responsibilities.

Assessment: Materially not observed

Description of practice: There are no rules that govern "independence" of the board.⁶⁶ The 2002 listing rules introduced the concept of "non-executive director" for the first time. Listed companies now must have audit committees, composed of a majority of non-executive directors. Recent decrees have also mandated audit committees for banks and insurance companies. However, if there are no non-executive directors on the board, the audit committee may be composed of other directors. By most reports, implementation has been slow, and few companies appoint truly independent board members outside the banking sector.

Directors may serve on a maximum of two boards, and managing directors only on one, unless they own 10 percent of the company. The Prime Ministerial decree allows board members to only chair one board at a time. There is no disclosure of board meeting attendance.

⁶⁶The new Banking Law (which was not available for review by the assessment team) contains significant independence requirements for bank boards.

Policy recommendations: The groups reviewing the draft company law and preparing a Code of Corporate Governance for directors should consider introducing the concept of “independent director.” The next revision of the listing rules could include requirements for independent nomination and audit committees, and an expansion of the role of the audit committee.⁶⁷

Principle VF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Assessment: **Observed**

Description of practice: Most directors have full access to relevant information, because they are executives or other insiders. Reportedly, this is more difficult for non-executive board members, especially the audit committee – usually because the information required is not available.

III. SUMMARY OF POLICY RECOMMENDATIONS

This section sets out recommendations to improve Egyptian listed companies’ compliance with the OECD Principles. Annex B details the above policy recommendations. Several key themes that focus on implementation are prioritized as follows:

Legislative reform: This report identifies several areas where changes to the laws would increase compliance with OECD guidelines; these are catalogued in Annex B. Updating both the company and the accounting and auditing laws will resolve many of the issues identified. Changing the two laws is a great opportunity for harmonization and reform, but presents a number of technical challenges. This is an area where carefully targeted technical assistance (in the form of workshops or legal reviews) could be of help. *Priority: high*

Institutional strengthening: Experience around the world suggests that enforcement of corporate governance rules remains the key challenge. The assessment recommends continued enforcement of the disclosure provisions, with an even greater emphasis on a review of content. CMA and CASE should strengthen their capacity to monitor disclosure. Staff should be trained to gain awareness of corporate governance issues and possible abuses. New emphasis should be placed on the disclosure of ownership, and related-party transactions. While focusing on the most actively traded and largest companies is a priority from a practical point of view, the second step should be to focus on the mid-caps. *Priority: medium*

Voluntary/private initiatives: In spite of the increase in awareness of corporate governance in Egypt, it is clear that legal and regulatory changes may be moving faster than changes to business culture. The Center for Directors now in formation can have two major roles to play. First, it could lead to the development of a Code of Corporate Governance (in conjunction with the private sector and CASE) that helps build a national consensus on the role, duties, and functions of the board. Issuers could be required to “comply or explain” their adherence to the Code. Over time, certain key pieces of the Code could move into law. Second, the Center for Directors should quickly create a director training capability. *Priority: high*

⁶⁷In Chile, for example, the audit committee’s responsibilities include (i) reviewing financial statements; (ii) proposing external auditors and authorizing any non-audit services of the auditor; (iii) examining related party transactions; (iv) reviewing board and management remuneration, and (v) assuming other functions as defined in the bylaws or mandated by the board or AGM.

Annex A: Summary of Observance of OECD Corporate Governance Principles

PRINCIPLE	O	LO	PO	MO	NO	Comment
I. THE RIGHTS OF SHAREHOLDERS						
IA Basic shareholder rights	X					• Basic rights observed. Some compliance gaps in clearing and settlement.
IB Rights to participate in fundamental decisions.		X				• Shareholders participate in most fundamental decisions with 66/75 percent supermajority.
IC Shareholders AGM rights		X				• No major reported problems. Notice period 15 days.
ID Disproportionate control disclosure		X				• Companies disclose at 5 percent level. Most ownership reportedly formally and informally well understood.
IE Control arrangements should be allowed to function.		X				• Very limited takeover rules. CMA informally enforcing mandatory bid rule.
IF Cost/benefit to voting				X		• At present, uncommon for institutional investors to have voting policies, and some don't vote.
II. EQUITABLE TREATMENT OF SHAREHOLDERS						
IIA All shareholders should be treated equally		X				• Share voting info may be difficult to obtain. Slow court system. CMA is powerful redress mechanism.
IIB Prohibit insider trading			X			• Insider trading not specifically addressed in law, but is administratively enforced.
IIC Board/Mgrs. disclose interests		X				• Accounting standards follow IAS 24. New listing rules add to RPT disclosure requirements.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE						
IIIA Stakeholder rights respected	X					• Stakeholders have a number of legal protections. Employee board representation relatively rare.
IIIB Redress for violation of rights	X					• Stakeholder have access to legal process to obtain redress.
IIIC Performance enhancement	X					• Company law grants employees automatic rights to 10 percent profit sharing. Employee share ownership in some privatized companies.
IIID Access to information		X				• Employees, bondholders, others have rights to information by law.
IV. DISCLOSURE AND TRANSPARENCY						
IVA Disclosure standards			X			• Annual and quarterly reports. Some missing non-financial disclosure (forward-looking MD&A, risk factors, governance).
IVB Standards of accounting & audit		X				• Standards generally close to IAS; compliance uncertain.
IVC Independent audit annually			X			• No audit oversight board (but included in draft accounting law). New listing rules require audit committee, but slow adoption.
IVD Fair & timely dissemination		X				• Many channels of information.
V. RESPONSIBILITIES OF THE BOARD						
VA Acts with due diligence, care		X				• Single tier boards. Frequently, Chairman and CEO are same person. Two members can be appointed "experts."
VB Treat all shareholders fairly			X			• Limited legislative guidance on duty of care and duty of loyalty, but some jurisprudence.
VC Ensure compliance w/ law		X				• Company law requires board to take interests of employees into account.
VD The board should fulfill certain key functions			X			• In practice, boards of most companies do not play central / strategic role, and are not clearly different from management.
VE The board should be able to exercise objective judgment				X		• No rules that govern independence. Few companies appoint independent directors.
VF Access to information	X					• Most directors are insiders and have access to information. Can be more difficult for non-executives sometimes, because information is not available.

Annex B: Summary of Policy Recommendations

I. THE RIGHTS OF SHAREHOLDERS		
IA	Basic shareholder rights	Introduce provisions to allow minorities to place candidates on the board, possibly through cumulative voting, or by allowing a minority block of shareholders to appoint candidates to the board.
IB	Rights to participate in fundamental decisions.	Large transactions should require explicit shareholder approval. In addition, policymakers could review rules and detailed experience regarding capital increases, and take action if necessary.
IC	Shareholders AGM rights	Policymakers should consider extending the meeting notice period to 30 days, and removing rules requiring share blocking (in line with international investor requests). International good practice suggests that only items on the agenda should be put to a vote.
ID	Disproportionate control disclosure	Shareholders should disclose when their ownership crosses specific thresholds. The thresholds should take into consideration shares held by third parties but under the control of the disclosing shareholder, including shares covered by shareholder agreements. These should also be disclosed.
IE	Control arrangements should be allowed to function.	To maximize transparency and avoid surprises to investors, the CMA should clearly state its tender policy. Policymakers should review recent international experience in takeover policy and the recent EU recommendations for squeeze-out and sell-out rights.
IF	Cost/benefit to voting	Voting should be made as easy as possible. Revisions to the investment funds laws could include a discussion on the corporate governance roles and responsibilities of these investors.
II. EQUITABLE TREATMENT OF SHAREHOLDERS		
IIA	All shareholders should be treated equally	Consider extending appraisal rights to other fundamental decisions (e.g. sale of assets, or de-listing), rather than mergers only.
IIB	Prohibit insider trading	Insider trading and self-dealing provisions should be strengthened in new laws and regulations.
IIC	Board/Mgrs. disclose interests	Enforcement of disclosure rules on related-party transactions should become a top CMA and CASE priority. AGMs should not grant blank approvals, but authorize specific transactions or transactions up to a specified amount. Policymakers should consider adding a shareholder approval mechanism for large related-party transactions.
III. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE		
IIIA	Stakeholder rights respected	NA
IIIB	Redress for violation of rights	NA
IIIC	Performance enhancement	NA
IIID	Access to information	NA
IV. DISCLOSURE AND TRANSPARENCY		
IVA	Disclosure standards	Standardized annual reports would enhance the comparability of financial statements and make them more user friendly. Non-financial disclosure requirements should be explicitly laid out in law or listing rules. CMA and CASE should adopt a zero-tolerance policy on late disclosures.
IVB	Standards of accounting & audit	CMA should continue to build on its capability to review disclosure content. Immediate attention should be paid to corporate governance disclosure issues (consolidation, disclosure of ownership and related-party transactions).
IVC	Independent audit annually	Moving forward on the creation of an accounting oversight board should be a top priority. The audit committee should make all recommendations about the external audit function, including proposing the auditor, suggesting audit fees and deciding which consulting functions auditors can provide.
IVD	Fair & timely dissemination	Relatively high priority should be placed on finalizing the development of an internet-based electronic filing and data retrieval system to improve information dissemination.
V. RESPONSIBILITIES OF THE BOARD		
VA	Acts with due diligence, care	Drafting a Code of Corporate Governance could help build a national consensus on the role, duties, and functions of the board. Issuers could be required to “comply or explain” their adherence with the Code. The Center for Directors now in formation should work to quickly develop a basic Directors Manual and training curriculum for directors.
VB	Treat all shareholders fairly	Policymakers reviewing the draft company law should consider adding more explicit provisions on the fiduciary duties of directors. A “business judgment rule could be

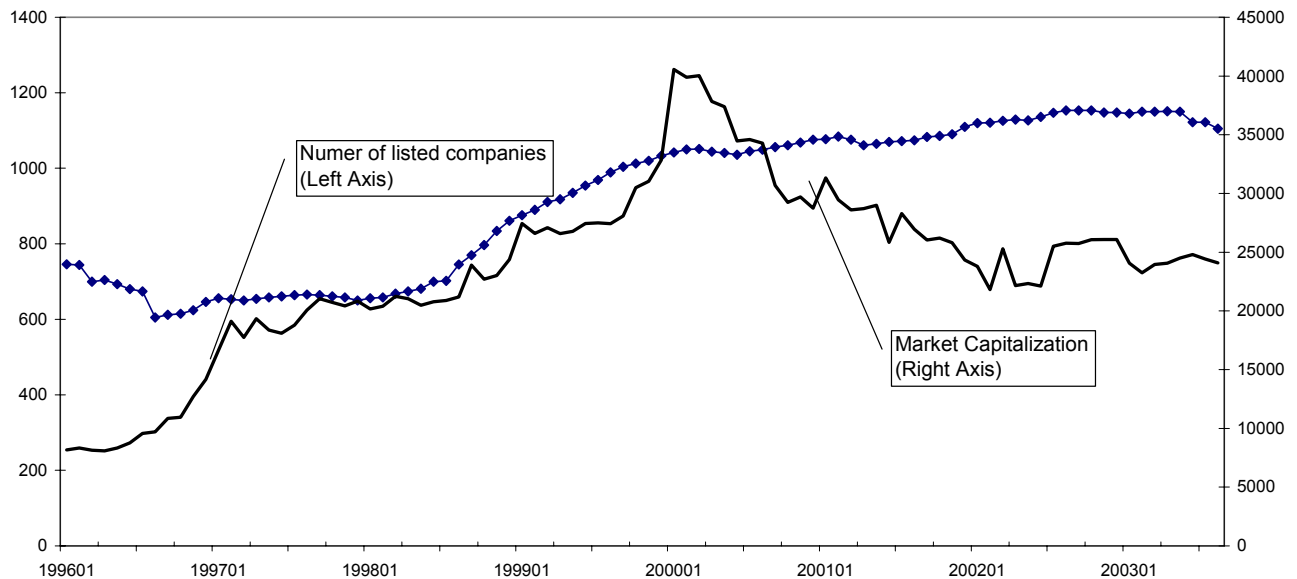
		introduced in order to protect board members from being held liable for good faith business decisions.
VC	Ensure compliance w/ law	A Code of Corporate Governance may be the best way to address stakeholder issues at the board level.
VD	The board should fulfill certain key functions	Board functionality that is consistent with international standards and the OECD Principles should be explicitly laid out in law or in a Code of Corporate Governance.
VE	The board should be able to exercise objective judgment	The groups reviewing the draft company law and preparing a Code of Corporate Governance for directors should consider introducing the concept of "independent director." The next revision of the listing rules could include requirements for independent nomination and audit committees, and an expansion of the role of the audit committee.
VF	Access to information	NA

ANNEX C: OVERVIEW OF THE EGYPTIAN CAPITAL MARKETS

The Egyptian equity markets have grown rapidly since the beginning of economic reforms in the early 1990s (see charts below and Tables 1 and 2 on the following page). At the end of 2002, market capitalization as a percent of GDP was 29 percent (USD 26.1 billion), up from 21 percent in 1996, but down from about 37 percent in 1999. By this measure, the Egyptian market was smaller than markets in Jordan, Bahrain, and Saudi Arabia, and was comparable to Morocco. In terms of absolute size, Egypt was the second largest in the Middle East and North African region, after Saudi Arabia. In 2003, Egypt's market performed well. The CASE 30 Index (in local currency terms) rose by almost 97.1 percent through the end of September 2003. The increase in USD terms was somewhat smaller; the MSCI Egypt Index (in USD terms) rose by 51.4 percent over the same period.

The Egyptian market is characterized by a large number of listed companies. Many companies have traditionally been listed because of the tax advantages associated with listing. Listed companies are eligible for a tax exemption equivalent to the three months' deposit rate paid by the Central Bank on paid-up capital. 1148 companies were listed at the end of 2002, up from 656 companies in 1992. However, the number of listed companies fell to 1079 by the end of September 2003, as the Cairo and Alexandria Stock Exchange (CASE) began to strictly enforce listing requirements. Up to 300 companies are expected to delist by the end of 2003, leaving approximately 800 listed companies.

**Egypt Capital Market Trends 1996 - 2003:
Listed Companies and Market Capitalization (USD)**



Source: S&P Emerging Markets Database

Traditionally, many listed companies have not traded during the year. For example, in 2002, only 574 companies were listed and traded during the year, and in any given month, an average of only 210 companies traded.¹ About 36 percent of market capitalization comes from the largest ten companies.² This figure would be lower if only actively traded issues were included; the listed company with the largest market capitalization is Telecom Egypt, which is 100 percent owned by the State. If only actively traded

¹Source: CMA Information Center, as reported in *Assessment of Corporate Governance in Egypt*, ECES Working Paper No. 82.

²Source: CASE Monthly Bulletin, data for end of July 2003.

**Table 1: Market Capitalization as a % of GDP
Selected Regional and Emerging Markets**

	1996	1997	1998	1999	2000	2001	2002
Egypt	20.9	27.5	29.7	36.9	28.9	24.7	29.0
Selected Regional Markets							
Bahrain				108.1	83.1	83.2	
Jordan	65.7	75.2	73.8	71.6	58.4	71.5	76.2
Lebanon				11.6	9.6	7.4	8.1
Morocco	23.8	36.4	43.8	38.8	32.7	26.8	23.1
Oman				27.4	17.4	13.1	19.9
Saudi Arabia			29.2	37.5	35.6	39.3	
Tunisia	21.8	12.3	11.4	12.9	14.5	11.5	10.1
Selected Emerging Markets							
Brazil	28.0	31.6	20.4	42.5	37.6	36.6	27.4
China	8.1	8.0	5.5	6.9	5.6	4.9	3.8
India	31.8	31.4	25.4	41.3	32.1	22.9	25.4
Mexico	32.1	39.1	21.8	32.1	21.6	20.2	16.2
Pakistan	16.8	17.6	8.7	11.9	10.8	8.4	16.9
Philippines	97.3	38.1	54.2	63.2	68.9	58.2	50.6
Turkey	7.2	14.3	11.9	58.2	26.8	15.2	9.8
Russia	20.6	67.8	10.3	39.3	19.5	52.5	67.9

Source: S&P Emerging Markets Database (data from Table 2, below) and GDP (in USD) from World Bank World Development Indicators

**Table 2: Market Capitalization (USD billions)
Selected Regional and Emerging Markets**

Date	1996	1997	1998	1999	2000	2001	2002
Egypt	14.2	20.8	24.4	32.8	28.7	24.3	26.1
Selected Regional Markets							
Bahrain				7.2	6.6	6.6	6.9
Jordan	4.6	5.4	5.8	5.8	4.9	6.3	7.1
Lebanon				1.9	1.6	1.2	1.4
Morocco	8.7	12.2	15.7	13.7	10.9	9.1	8.6
Oman				4.3	3.5	2.6	4.0
Saudi Arabia			42.6	60.4	67.2	73.2	74.9
Tunisia	4.3	2.3	2.3	2.7	2.8	2.3	2.1
Selected Emerging Markets							
Brazil	217.0	255.5	160.9	228.0	226.2	186.2	123.8
China	65.9	72.0	51.9	68.2	60.4	56.3	47.6
India	122.6	128.5	105.2	184.6	148.1	110.4	131.0
Mexico	106.5	156.6	91.7	154.0	125.2	126.3	103.1
Pakistan	10.6	11.0	5.4	7.0	6.6	4.9	10.2
Philippines	80.6	31.4	35.3	48.1	51.6	41.5	39.0
Turkey	30.0	61.1	33.6	112.7	69.7	47.1	34.0
Russia	37.2	128.2	20.6	72.2	38.9	76.2	124.2

Source: S&P Emerging Markets Database

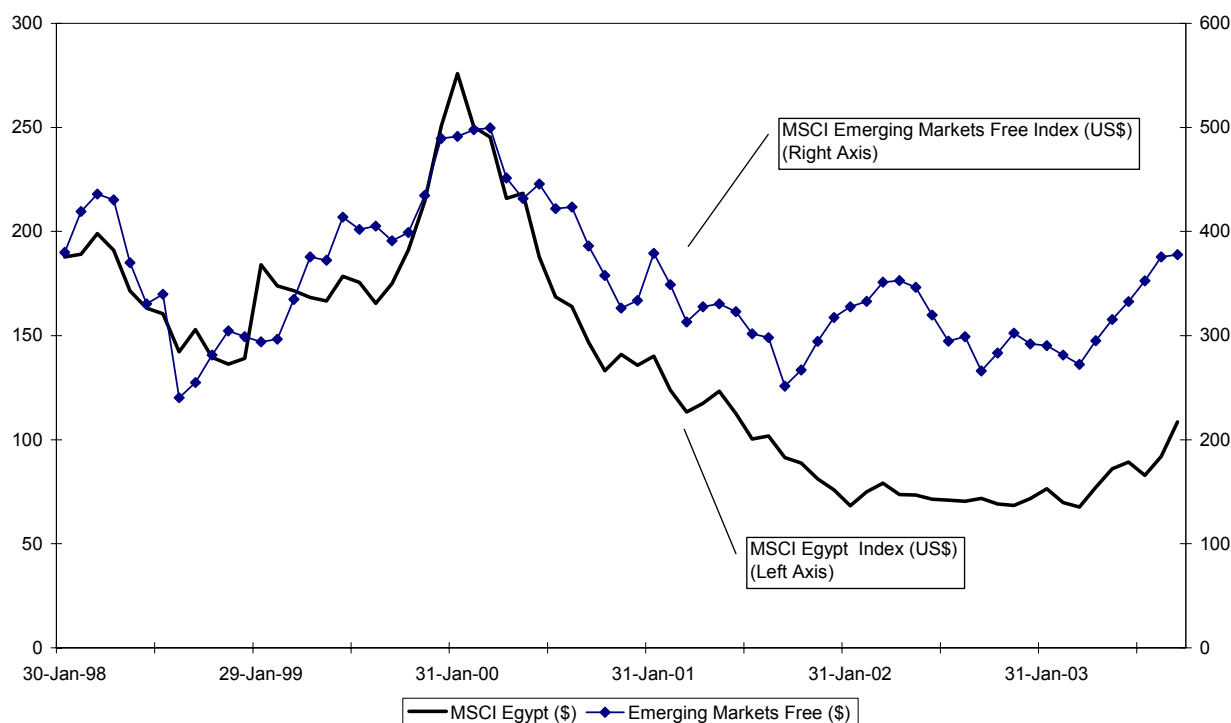
issues are included, the ten largest account for 13.3 percent of GDP. Nine companies are traded abroad through Global Depository Receipts (GDRs).

Market participants tend to divide listed companies into basically three types: about five-ten widely held blue chips (sometimes called the ‘GDR companies’), about 50 other large privatized public sector companies, and the remaining listed companies, mostly smaller and family-owned. Some of the companies often included in lists of shareholder-friendly companies include: Orascom Telecom, Orascom Construction Industries, Oriental Weavers, NSGB, MobiNil, CIB, MiBank, Eastern Tobacco, and Abu Zaabal Fertilizers.

Many listed companies originated from Egypt’s privatization program, which began in 1993, and reached its peak in the period 1996-1999. About 189 public sector enterprises were privatized through different methods through the middle of 2002, including 38 majority IPOs and 16 minority IPOs on the stock exchange. The state retains its share in many of the privatized companies, through a number of industry-based holding companies, under the authority of the Ministry of Public Enterprises.

Egypt’s market performance is generally correlated with other emerging markets. However, the bear market experienced by the Egyptian market since the beginning of 2000 (and other emerging and developed markets) was more severe in dollar terms. Most analysts explain this relative underperformance by the regional political troubles which began in September 2000, compounded by several devaluations of the Egyptian pound since 2001.

**Egypt Capital Market Trends 1996 - 2003:
Market Performance vs. Other Emerging Markets (in dollar terms)**



Listing Rules

Until 2002, CASE had three listing tiers: the “official schedule”; the “unofficial schedule 1”; and the “unofficial schedule 2.” Public enterprises were automatically listed on the official schedule, and foreign securities were listed on the unofficial schedules. The multiple schedule system was intended to encourage the listing of companies with special conditions (e.g. partially privatized, closed companies or

technology companies). However, there was no real difference in ownership structure, size, sector or cost of capital between the official and unofficial schedules, and the tax incentives and continuous disclosure requirements were the same. Because the rules were more stringent on the official schedule, 87 percent of companies chose the unofficial schedule.

Another feature of listed companies was that all issues were not considered to be issued to the “public” (so-called “public offering companies”), and many listed companies had not issued prospectuses.

CASE listing rules were updated in August 2002, and were implemented in practice in September 2003, after a one year grace period.³ The new rules required issuers to resubmit listing applications for the new tables. An “Official Schedule 2” has been added, to create a fourth tier. The names of the tables are fixed by the capital market law, and will become more indicative (e.g. “Main Market”) following the passage of an updated capital markets law.

Three criteria were added to the listing rules to begin the process of differentiating and “branding” listed issuers. The new criteria include profitability, minimum share capital, and most importantly, the number of shareholders (see table below).

Table 3: Summary of CASE Listing Requirements

	Description	Open / Closed	Free float requirement	# of Shareholders	Disclosure Requirements	Expected Number (mid 2004)
Official 1	Main market	Open (> 100 sh)	30%	> 150	Annual, quarterly	100
Official 2	Public sector companies	Any # of shareholders)	Any	Any	Annual, quarterly	50
Unofficial 1	Closed companies w/ 10% free float	Closed (< 100 shareholders)	10%	50<100	Annual, quarterly	50
Unofficial 2	Closed companies	Closed (< 100 shareholders)	Any	<50	Annual	600
OTC “T”	OTC – using CASE systems	Generally closed Currently includes two open companies (delisted from Main Market or not otherwise meeting Official 1 requirements)	Any	Any	Annual	22,000
OTC “D”	OTC – interdealer					

The new rules introduced a number of significant changes:

³The Board of Directors of CASE decided on September 2, 2003 to impose penalties on listed companies that did not conform to the new listing rules, beginning August 1, 2003.

- ❑ The rules move larger companies towards the Official schedule, and smaller companies towards the unofficial schedules.
- ❑ Importantly, disclosure requirements are now based on the number of shareholders. Companies with more than 100 shareholders have stricter disclosure standards, and must file annual and quarterly reports. The new rules thus begin the move towards a real differentiation between “public” and “private” issues (sometimes also called open and closed companies in Egypt).
- ❑ An audit committee is now mandatory for listed companies. As of October 2003, 60 companies had disclosed the existence of an audit committee.
- ❑ Official Table 2 was separate out those securities issued by public sector companies which cannot meet the requirements of Official Table 1. These securities must remain listed, according to the Capital Markets Law.
- ❑ Companies must publish their listing applications on the Internet and in the Stock Exchange daily bulletin.
- ❑ CASE adopted a system of “listing agents” to make it easier for companies to complete listing procedures.

Most importantly, CASE has renewed its commitment to enforce the listing rules, which will result in a decrease in the number of listed companies over the next few months. By the end of September 2003, 99 companies had been delisted for failing to observe the new listing rules (including non-payment of listing fees), and a total of 300 mostly small and very closely held companies may be delisted over the next several months. As of the end of September 2003, 61 companies were listed on Official 1, 29 on Official 2, 27 on Unofficial 1, and 246 were listed on Unofficial 2. Seven hundred sixteen companies had temporary status, and their applications were under review.

Ownership

Available data on company ownership in Egypt suggests a number of observations:

- ❑ Many Egyptian listed companies are held by relatively few shareholders. Because of the tax laws that encourage listing, many small companies that would not be listed in most jurisdictions remain listed in Egypt. As shown in the table below, 551 companies registered with MCSD have fewer than 50 shareholders.

Table 4: Number of Companies by Number of Shareholders

Number of shareholders	Number of Companies
Less than 5	111
6 – 50	440
51-100	55
101-1000	112
More than 1000	197
Total	915

Source: MCSD, data as of 10/8/2003. Data are for all companies registered with MCSD.

- Ownership is highly concentrated. According to a recent survey (using year 2000 data), average free float of the top 90 listed companies was 20 percent.⁴

Table 5: Average Ownership Structure in Egyptian Listed Firms

Type of Ownership	Average of 90 listed companies
Private Sector	
Private Banks & Insurance Companies	4
Mutual Funds	3
Other Private Institutions	20
ESA (employee ownership)	2
Management/Founders	15
Private Individuals (free float)	20
Total Private Sector	64
Public Sector	
Law 203 Holding Company	18
Public sector banks & insurance companies	11
Other public sector institutions	6
Total Public Sector	35

Source: See footnote below. Data for top 90 listed companies for the year 2000. Totals do not add to 100 percent due to rounding.

- The State continues to play a major role in the ownership of many listed companies. Based on the table above, 35 percent of the average large listed company is held directly by the State or by a public sector institution. Based on data from the 2001 corporate governance ROSC, of the 50 most active companies that comprised the CASE index, 25 were privatized companies (including majority IPOs, minority IPOs and sales to strategic / “anchor” investors. The government remained the majority shareholder in 16 listed companies, and retained stakes in 25 additional companies privatized through public flotation. In such cases, board and management structures often remained identical to pre-privatization. In March 2003 the government announced its intention to sell its remaining stakes in listed firms.⁵ This announcement had a positive effect on their market trading value.
- Employee shareholdings of 5-10 percent are common in privatized firms.
- Group structures are relatively uncommon. Based on data from the 2001 ROSC, of the 50 most active companies that comprised the CASE index, 11 companies had controlling shareholders, (including two which were state holding companies). Four companies formed part of a well-known group which directly or indirectly included six listed companies and a number of closed companies. The groups were characterized by pyramid structures and cross shareholdings.
- Foreign investment and domestic institutional investors are relatively small. In 2002, investment percentage reached 17 percent for individuals (15 percent nationals and 2 percent foreigners), 78 percent for enterprises (64 percent national and 14 percent foreign) and 5 percent for investment

⁴Dr. Shahira Abdel Shahid, *Does Ownership Structure Affect Firm Value? Evidence from the Egyptian Stock Market*, January 2003, published by Cairo and Alexandria Stock Exchange (see web site).

⁵ *Assessment of Corporate Governance in Egypt*, ECES Working Paper No. 82.

funds (1 percent national and 4 percent foreign).⁶ Pension funds and insurance companies invested only a small portion of their assets in shares. In the case of private pension funds this percentage was 2.5 percent of approximately LE 10 billion (USD 2.6 billion) in 2000.

⁶ *Assessment of Corporate Governance in Egypt*, ECES Working Paper No. 82.

ANNEX D: CAPITAL MARKET INSTITUTIONS

Capital Market Authority

The Capital Market Authority (CMA) is the securities market regulator, subject to the supervision of the Minister of Foreign Trade. However, it is considered to be an independent agency.

The CMA is governed by a board of directors. Two of the seven board members (the chairman and the deputy chairman) are appointed by Presidential Decree for a period of three renewable years. The others are appointed by the Prime Minister for a period of two renewable years.

CMA's budget is derived from fee income. It employs 250 people, whose salaries are in line with comparable private sector positions. CMA has wide administrative sanction powers, including warnings, delistings, suspending and revoking licenses, imposing monetary penalties, canceling transactions (even after settlement, if there has been an illegal act), conducting inspections, and suspending shareholder decisions. CMA can request the prosecutor general to initiate proceedings. Allegations that brokers did not properly follow client instructions constitute the majority of complaints.

Enforcement Actions

The Capital Market Authority is responsible for the enforcement of the Capital Market Law, the supervision of capital market development, and the regulation and monitoring of market activities. The CMA is perceived by market participants to be an active enforcer of rules and regulations, and the following statistics are intended to provide some indications of enforcement emphases and activities.

- ❑ 21 issuers and holding companies were referred by the CMA to the Public Attorney at the Financial and Commercial Prosecution Department. These companies had violated the laws and regulations in a number of different areas, including releasing financial statements that containing false information, submitting forged banking certificates, manipulating the share price at the stock exchange by releasing false information, and other violations which they refused to address.
- ❑ Similar referrals were made in the cases of three auditors. They violated the law in several areas, including incorporations, capital increase, forged banking certificates, and falsification of information in financial statements.
- ❑ After reviewing the financial statements and audit reports filed by listed companies, the CMA noted certain accounting and auditing malpractices and disclosures issues used by some companies either to present untrue picture of their financial positions and operations' results or merely because of lack of understanding of applicable accounting standards. Hence, the financial statements of those companies were not fairly presented. According to Article 6 of the CML, CMA notified these companies and asked them to amend their financial statements to reflect a true picture of their financial positions.
 - A notification letter was sent to 175 companies for not submitting their financial statements, the companies responded and did submit their financial statements.
 - 300 companies responded to CMA's review remarks regarding their financial statements.
 - 3 companies republished their financial statements upon the CMA's request

This following table presents some case studies of disclosure content review actions taken by the CMA against issuers.

Table 6: Case Studies of Disclosure Content Review by the CMA

Violation	Enforcement Action Taken
<i>Enforcement actions related to violations involving publication and disclosure of financial statement</i>	
1. A holding company violated Article 6 of the Capital Market Law and the listing rules concerning publication of its financial statements.	This company was asked repeatedly by the CMA to publish the financial statements.
The company then responded to the CMA's request, but the financial statement included some legal violations related to assets valuation and submitting forged banking certificates.	CMA suspended the trading on the company's stock and referred the case to the Public Attorney at the Financial and Commercial Prosecution Dept.
2. A securities company did not disclose or publish its financial statements and manipulated the share price at the stock exchange by releasing false information.	CMA suspended the trading on the company's stock. The company responded to CMA's request and disclosed the information and published the CMA's remarks at the newspapers. Then the suspension was removed.
The minority shareholders then appealed against the published financial statements accusing it to include false information.	CMA decided to suspend the Annual General Meeting's (AGM)'s resolutions and referred the case to the Public Attorney at the Financial and Commercial Prosecution Department.
<i>Enforcement actions related to overstatement of revenues</i>	
Although the collection of the accounts receivable from its credit sales was minimal, an educational services company recognized, in revenue, the total amount of these sales on an accrual basis. According to the Egyptian Accounting Standards, only the collected and, reasonably assured, collectable amounts should be recognized in revenue. The company also recognized the full amount of its installment sales in the revenue of the period in which sales took place. The installment-selling price includes the cash sale price and the interest revenue for the installment sale. The interest revenue should have been recognized in the future years when installments are collected or become due for collection. As a result of the above practices, the profit for the ending accounting period was overstated to L.E. 182.9 million at the expense of the following accounting periods.	The CMA requested the company to restate its financial statements in accordance with the requirements of the accounting standards. The company agreed and restated its financial statements for that period to report L.E. 115.4 million in loss.
<i>Enforcement actions related to capitalizing and deferring current expenses to subsequent periods</i>	
1. A manufacturing company failed to recognize the total amount of foreign exchange loss from revaluation of the outstanding balance of a long-term loan, dominated in a foreign currency, at the exchange rate as of the date of the balance sheet. Instead, the company recognized in its income statement only foreign exchange loss related to revaluation of the current portion of that loan. This was in violation of the Egyptian Accounting Standard No. 13, which requires revaluation of the total outstanding balance of loans in foreign currencies.	At the CMA's request, the company restated its financial statements and recognized additional L.E. 19 million in foreign exchange loss.
2. A manufacturing company failed to charge its income statement with L.E. 1.5 million in rent expense for a plot of land, which resulted in overstating its profits.	At the CMA's request, the company restated its financial statements to affect this charge.
<i>Enforcement actions related to failure to recognize permanent decline in the value of long term and intangible assets</i>	
1. An educational services company failed to recognize the ongoing decline in the value of its long-term	At the CMA's request, the company restated its financial statements in accordance with the applicable accounting

Violation	Enforcement Action Taken
investment amounting to L.E. 59 million.	standards.
<i>Enforcement actions related to recognition of unreal expenses on the income statement</i>	
1. A securities company obtained a loan of L.E. 66.9 million for which it was charged with L.E. 7 million in interest. The loan was used by one of its staff for a personal benefit. The company charged that employee with the amount of the loan, but failed to charge him the interest for that loan.	The CMA referred this case to the legal authorities and forced the company to charge the employee interest.
2. A manufacturing company obtained a loan of L.E. 379 million at an interest rate of 13 percent and used this loan to finance construction of an asset for a tax-exempted affiliated company. The company charged the interest incurred for the loan to the income statement to reduce its taxable income (tax evasion).	At the CMA's request, the company disclosed this fact in the notes to its financial statements. When it was disclosed, the minority shareholders opposed the majority decision to approve the company's financial statements at the AGM, because this practice resulted in an understatement of profits and dividends. Following a complaint filed by minority shareholders, the CMA stopped the AGM's decision. This case is currently reviewed by the court.
<i>Enforcement actions related to valuation, classification and presentation of items on the financial statements</i>	
1. A securities company recorded as a long term investment an amount of L.E. 79K representing the accumulated loss that should have been deducted from the shareholders' equity on the balance sheet. Another securities company recorded its accumulated loss amounting to L.E.698K as a current asset instead of deducting this amount from the shareholders' equity. These practices resulted in overstatement of assets and shareholders' equity in both companies in a way misleading to users of the financial statements.	The CMA requested these companies to correctly classify the accumulated losses on their financial statements.
2. To manipulate its financial leverage, a manufacturing company classified a payable account due to its shareholders at L.E. 105.8 million as an equity account rather than as a liability account on its balance sheet.	The CMA requested the company to correct this classification on its financial statements.
3. A manufacturing company reclassified its long term investments amounting to L.E. 33.9 million as current investments with the purpose of overstating its working capital and "window dressing" its financial position.	The CMA requested the company to correct this classification on its financial statements.
4. A shipping service company understated both of its current assets and current liabilities by offsetting L.E. 6.5 million of accounts receivable against current liabilities. Although this offset did not affect the value of its working capital or equity, it unduly overstated the company's current ratio (current assets/current liabilities) and understated its financial leverage (liabilities/equity).	The CMA requested the company to comply with the correct classification of these items on its financial statements.
5. A securities company offset items of cash inflows against items of cash outflows on its cash flows statement. This was in violation of the Egyptian and International Accounting Standards, which require separating cash flows related to operation, investment, and financing activities.	The CMA -requested the company to comply with the accounting; standards in presenting its cash flows statement.
6. A manufacturing company offset the debit balance of L.E. 7.3 million in "cash on hand and with bank" account against the credit balance in "bank overdraft," account which resulted in understatement of both its current assets and liabilities. This practice unduly	The CMA requested the company to correct the classification on its financial statements.

Violation	Enforcement Action Taken
enhanced the current ratio and the financial leverage of the company.	
7. Some companies failed to present the comparative figures on its financial statements, limiting the usefulness of these financial statements and the ability of their users to define the general trends and development in the company's business.	The CMA requested these companies to present the comparative figures in their financial statements.
8. A telecommunication company increased its capital by L.E.800 million based on a false bank certificate.	The CMA referred the case to the legal authorities and forced the company to deposit the cash amount for the capital increase.
9. A financial investment company overstated its assets in the amount of L.E. 252 million in intangible assets that generate no future benefit and should be charged to the income statement. The company also incorrectly double recorded some assets in the amount of L.E. 116 million in an "assets under construction" account and in the amount of L.E. 207 million in a "long-term investments" account.	The CMA referred this case to the legal authorities."
<i>Enforcement actions related to notes to the financial statements</i>	
1. A manufacturing company obtained a loan and incurred interest expense for this loan. The loan was not used in the company's business and, instead, was used to finance the business of related parties. The company failed to disclose this transaction and to charge those parties with interest incurred for that loan.	At the CMA's request, the company disclosed this transaction in notes to the financial statements.
2. A manufacturing company failed to disclose the terms of a transaction with a related party to buy assets totaling L.E. 254 million. 3. Some companies failed to provide adequate disclosure in the notes to the financial statements about their fixed assets, additions to and disposals from these assets during the reporting period. They also failed to disclose the restrictions on ownership of such assets (e.g. assets' mortgage) for loans obtained from banks. 4. Some companies failed to disclose their investments in affiliated and subsidiary companies, the percentage of their ownership in each company, the accounting policy followed in the valuation of such investments and changes in the value of these investments during the reporting period. 5. Some companies failed to disclose their tax status, tax returns examined but not approved by the Tax Department, tax returns not yet examined, and the adequacy of the tax provisions.	At the request of the CMA, these companies provided the required disclosure.

Minority Shareholder Protection (Article 10)

The CMA has specific powers to protect minority shareholders. The Capital Markets Law created a special protection for minority shareholders. Shareholders who represent 5 percent or more of share capital are entitled to raise a complaint to the board of directors of the Capital Market Authority. CMA has the power to suspend resolutions of the AGM that are considered to unfairly favor a given group of shareholders, or cause harm to them, or unfairly bring about a benefit to members of the board or others. CMA has in fact acted as a special court for shareholder disputes.

To suspend a decision, the CMA board must be convinced of the seriousness of the request for suspension. Judgment is based on the presence of one of two factors:

- 1- If the nature of the decision made by the AGM, which is requested to be suspended, will entail benefits for the majority shareholders, or for any of the board members or for any of the company staff members.
- 2- If the nature of the decision will be detrimental to minority shareholders, provided that they do not own less than 5 percent of the capital shares. Ownership of 5 percent of the shares does not necessarily have to be by one shareholder alone, but can be the total sum of shares owned collectively by several shareholders, provided that the total does not fall below 5 percent.

Prior to 2002, the parties concerned were required to submit to arbitration, to request annulment of these suspended decisions, within a period of 15 days as of the date of the issuance of the decision of the CMA board. Without any further action, a suspension decision issued by the Authority was nullified, and the AGM decision was removed of all constraints. If the Arbitration Board ruled to annul these suspended decisions, they became null and void.

However, in January 2002, the Supreme Constitutional Court issued a ruling canceling the mandatory arbitration provisions in the capital markets law (specifically Articles 52 to 69), but at the same time also canceled the second paragraph of Article 10, removing the 15 day suspension period. Until a new law on arbitration is ruled valid by the Court, the decision of the CMA board suspending the decisions of AGMs is final, unless the decision is appealed to the courts.

Majority shareholders against whose interests the CMA board has issued a decision are entitled to submit an appeal to an internal Appeals Committee. The Appeals Committee (established according to Article 50 of the Capital Markets Law) is an internal five-member body, which includes a senior official of the CMA (appointed by the Chairman), an expert appointed by the Minister of Foreign Trade, two judges appointed by the Chairman of the State Council (courts), and the deputy Chairman of the State Council.

If the Appeals Committee overturns a ruling of the CMA board concerning suspension of an AGM decision, then the decision of the Appeals Committee is final. However, if the Appeals Committee issues a decision rejecting the grievance of the majority and upholding the disputed decision of the CMA board, then majority shareholders have no other alternative but to resort to the courts.

Table 7: CMA Suspension of Shareholder Resolutions

	Total applications by shareholders to the CMA	Number approved (resolutions suspended)	Number denied (no action taken by CMA)	Percent of applications approved
1995 – 2002	29	20	9	69.0%
2002 – October 2003	14	9	5	64.3%
Total	43	29	14	67.4%

Since 1995, shareholders have petitioned the CMA 43 times, and the CMA board has ruled in favor of the petitioning shareholders 29 times (or in just over 67 percent of applications). Of the nine shareholder meeting resolutions that have been suspended by the CMA since 2002, four were appealed. The CMA appeal committee rejected all four appeals, but all 4 were then successfully appealed to the administrative court.

Every shareholder also has the right to file a complaint with the relevant administrative agency (e.g. the Companies Department) regarding any violation of the law. At the request of shareholders, CMA and the Companies Department can carry out company inspections, and attend the AGM to ensure that

administrative procedures are followed correctly and that decisions do not unfairly favor one group of shareholders over another.

Cairo and Alexandria Stock Exchange (CASE)

Cairo and Alexandria Stock Exchanges (CASE), a quasi self-regulatory authority by virtue of law, is managed by an elected board of directors under the supervision of the Capital Market Authority (CMA). The board comprises eleven members: the chairman is appointed by the Council of Ministers, six members represent stock exchange brokers, two members represent banks, one member is appointed by the Central Bank of Egypt, and one member is from the CMA. The Capital Market Authority has the right to object to the decisions issued by CASE's board of directors. CASE is responsible for supervising commitment to registration rules, but has no authority for investigation and inquiries. CASE may impose sanctions that include downgrading listing status, trade suspensions, delisting, and (since the recent changes to the listing rules) monetary penalties.

The stock exchanges were established in 1883 and 1903 respectively and reached their historic peak in the 1940's when, together, they constituted the fifth largest market in the world. After several decades of low market activity, the exchanges started growing again in 1992, spurred by economic reforms, privatization and changes in the regulatory environment.

The CASE trading system has evolved through three different stages since 1992. Prior to 1994, an open outcry system was in operation. The CMA then developed an automated order-driven trading system, which was used from 1994 till May 2001. To upgrade its trading platform to keep pace with anticipated growth, the Exchange went through a second phase of automation and procured the EFA trading system, modified to meet CASE trading rules and requirements. The new automated order-driven system trading system became operational in May 2001.

CASE has 114 members (October 2003) consisting of licensed brokerage firms that meet CASE membership requirements.

According to the trading rules of the Stock Exchange, the CMA supervises the share price fluctuations, which must remain within a 5 percent increase or decrease on a daily basis. The Ministry of Foreign Trade issued a decree in 2002 (Decree No. 441 July 2002), which removed this price limitation from the most active shares (17 issues as of October 2003). Price limitations are expected to eventually be removed from all remaining shares. There are no price limitations on bonds except for convertible bonds, which are subject to the current 5 percent band.

CASE has also established a wholly-owned information dissemination subsidiary (Egypt For Information Dissemination, or EGID). EGID was established in June 1999, and began exclusively transmitting CASE data to all both locally and international clients at the beginning of 2002. EGID is working to make all information on CASE listed companies available to all users using all available delivery channels and methods to suit the needs of the different interested parties.

As of October 2003, a variety of information was available on the EGID website (<http://www.egidegypt.com>). Available information includes free float, ownership structure, financial statements, and dividend payments.

Misr Clearing, Settlement and Central Depository Company (MCSD)

Misr Clearing, Settlement and Central Depository Company (MCSD) is Egypt's central depository and is responsible for the clearing and settlement of CASE-executed transactions. MCSD was originally established according to the provisions of the Capital Market Law No. 95 for the year 1992. In 1994, CMA approved the establishment of MCSD as a self-regulatory entity subject to CMA's supervision. MCSD is responsible for enforcing Central Depository Law No. 93 for the year 2000. Members of MCSD

include banks and financial institutions that carry out brokerage or custodial activities, and issuers of securities. The MCSD has a total staff of 420.

MCSD's ownership structure includes CASE (35 percent), banks (50 percent) and brokers (15 percent). By law, shareholders are limited to 5 percent ownership.

MCSD acts as a central registry, and beneficial ownership is maintained in real time. Although the law allows the establishment of nominees and holding shares through nominee accounts, all custodians and shareholders now use the client accounting / sub-accounting framework to maintain ownership records. All shareholders must access the depository through one of the 16 custodian banks. However, the MCSD provides some information services (including account statements and trade confirmations) directly to clients. Should nominees be established, as described below, a custodian is the registered owner, and only the custodian can vote on behalf of the beneficial owners. The MCSD would then periodically request the identity of the beneficial owners from all nominees.

MCSD was designed so that clients would access accounts through custodians. However, of 1,932,388 total clients (as of October 8, 2003), 1,634,084 clients hold accounts directly with MCSD and have not established a relationship with a custodian.

The Central Depository Law and the listing rules of CASE require companies to register their shares in the MCSD to remain listed. As a result, the number of registered companies has been steadily increasing over the past few years. The total number of registered companies reached 870 companies at the end of 2002 (of which 860 were listed) and 927 companies by the end of August 2003. Although this remains less than the number of listed companies, many of the unregistered companies are expected to be delisted by CASE in the next few months.

As a result of this registration (and resulting immobilization of the old physical certificates) the proportion of trading taking place in book entry form has steadily increased. Book-entry trading reached 99.6 percent of total trading in 2002. In contrast, at the beginning of 2001 almost 62 percent of all the shares were in physical form.

Clearing and settlement is carried out on the basis of delivery versus payment. When securities are on deposit at MCSD, securities are delivered to the buyer in book-entry form, and cash is added to the settlement account of the selling broker¹. Trade settlement for the 17 securities (as of October 2003) with no price restrictions are made on the second day after trading (T+2). Trade settlement for securities in the central depository are made on T+3, and settlement for other securities (not on deposit) using physical share certificates is made on T+4.

A Settlement Guarantee Fund was established in January 2000 with capital provided by member brokers, proportional to the volume of their trading on CASE. The Fund is run as a self-regulatory organization under the supervision of the CMA. The Fund's main function is to protect the investor against non-commercial risks and to guarantee the settlement in case either of a failure to deliver cash or securities. Since the inception of the SGF, the number of unsettled transactions has been greatly reduced. The main role of the Fund is to buy shares on behalf of the defaulting party (in case the selling broker does not deliver the shares) or pay cash (in case the buying broker defaults in payment). The size of the fund is currently LE 30 million and is adjusted every three months according to a specific formula related to the brokers' turnover.

¹Custodians are responsible for the management and depositing the accounts of securities' traders. In addition to MCSD, there are 16 banks that provide depository services; the five largest are the National Bank of Egypt, the Commercial International Bank, Citibank, American Express and HSBC.

The MCSD is currently working to implement securities lending and borrowing functionality. Before the Central Depository Law was issued, all the clearing and settlement operations were made according to ISSA-G30 recommendations with the exception of three subjects: the active payment system with geographical spread, securities lending and borrowing, and registration of all the companies in the central depository (MCSD). The latter two issues were addressed by the Central Depository Law. However, the regulations that organize the implementation of lending operations have not yet been issued.

MCSD also handles the payment of all dividends, interest, and other payments from corporate actions. Shareholders can place a standing order to transfer dividends to a bank account, can delegate dividend collection to a custodian, or can request home delivery by check (or in cash for amounts less than 10,000 LE). Alternatively, shareholders can visit one of 44 bank branches (covering most of Egypt) to collect payments in cash in minutes. MCSD staff are available in each location to electronically process the payments.

The Associations of Capital Sector of the General Authority for Investment and Free Zones (GAFI)

The Associations of Capital Sector of the General Authority for Investment and Free Zones (GAFI) (referred to in this assessment as the Companies Department) supervises the enforcement and implementation of Law 159. It has 186 employees. In 2001, this organization was moved from the jurisdiction of the Ministry of Foreign Trade, and became subject to the General Authority for Investment and Free Zones (GAFI).² The organization can reject applications for the establishment of companies and for ratification of an extraordinary general meeting's (EGM's) decisions to liquidate a company. GAFI also supervises incorporated under the Investment Law (Law No. 8).

The Companies Department approves and maintains on file a number of company documents, including company charters, the minutes of board meetings, minutes of shareholders meetings (which are made public). The Department attends shareholder meetings (sometimes together with the CMA), especially those where there is reason to expect complaints.

Under the Law, the Department has the power to send inspectors, and call a general meeting.

The Ministry of Public Enterprises

The Ministry of Public Enterprises and its affiliated Holding Companies are responsible for partially and fully-state owned companies incorporated under the Public Business Sector Law (No. 203 of 1991). Law 203 established and defined 314 public sector companies slated for privatization. These companies were established as "Affiliated Companies" under 17 Holding Companies. Once private ownership in an affiliated company reaches 51 percent, it becomes subject to the provisions of the regular Company Law (Law 159).

Egyptian Capital Market Association

The Egyptian Capital Market Association (ECMA) was established in 1996 as a professional association of securities market participants. At the end of 2002, it had 138 members, including 89 individuals and 49 institutions. It acts as a trade association to provide input to the CMA and the other supervisory bodies to advocate industry positions during the drafting of capital market regulations and laws. ECMA organizes training courses for employees, convenes seminars to raise public awareness, and resolves disputes that may arise between its members or between them and other parties.

² Decision No. 415/2001

Egyptian Association for Investment Management

Founded in 2001, members of the Association include banks, insurance companies and asset managers. Through training courses and workshops, it acts to build member efficiency and to improve the quality of the services provided to investors. It also certifies portfolio managers to ensure performance quality and qualification.

The Egyptian Accountants and Auditors Association

The Egyptian Society of Accountants and Auditors (the Society) is an association of chartered accountants that develops educational and professional standards for its approximately 1,200 members. It was established in 1946. About 700 members are actively involved in auditing practice. The Society is a member of the International Federation of Accountants (IFAC). The Society does not function as a self-regulating body and does not ensure compliance with rules of professional conduct. Members are admitted when they meet one of the following requirements: (a) membership in the Institute of Chartered Accountants in England and Wales, or another acceptable foreign professional body (provided they pass the Society's examinations on Egyptian tax law and Egyptian company law); (b) doctoral degree in accounting with three years of experience in practice; (c) at least three years of full-time work experience in the office of a practicing Society member, and successful completion of the Society's two-part examination.

ANNEX E: LEGAL FRAMEWORK

The Egyptian legal system is largely influenced by the French Civil Code. However, the laws governing capital market performance, such as the Central Depository Law and the Capital Market Law, are based on Anglo-American law. The following major laws regulate capital market performance:

Law	Description	Future Plans
<p>The Law on Joint Stock Companies, Limited by Shares Companies and Limited Liability Companies (No. 159 of 1981) or the “Company Law.”</p> <p>The Investment Guarantees and Incentives law (No. 8 of 1997).</p>	<p>Company Law 159 establishes the basic company forms.</p> <p>Law No. 8 was designed to boost investments in various economic sectors and specific industrial zones through income tax exemptions of 5, 10, 20 years or permanently in tax-free zones. In all other respects, companies established under this law use Law 159.</p>	<p>The government intends to develop a new company law to replace the current laws and dispersed provisions and to place all companies of different types in Egypt under a unified, modernized regulatory system.</p> <p>A draft law has been in preparation since 1998.</p>
<p>Capital Market Law (No. 95 of 1992) and its executive regulations.</p>	<p>The Capital Market Law regulates the capital market, provides the legal framework for the Cairo and Alexandria Stock Exchange, and regulates the incorporation and operations of market participants.</p>	<p>The Capital Market Law was redrafted for submission to the People’s Assembly. The current position of the government is that most of the changes in the draft law could be introduced by executive regulation in the existing law and through the CASE listing rules. Therefore, the introduction of the draft capital markets law has been given lower priority.</p>
<p>The Central Depository and Registry Law (No. 93 for the year 2000) and its executive regulations.</p>	<p>The Central Depository and Registry Law establishes the MCSA and provides the rules for shareholder recordkeeping, custody, and clearance and settlement. The law went into effect after its executive regulations were issued by the Minister of Foreign Trade (No. 906) in November 2001.</p>	<p>No revisions planned.</p>
<p>Accounting Practice Law (Law 133 of 1951).</p>	<p>The Accounting Law governs professional accountants and auditors, particularly in the private sector. Governs registration / licensing of accountants and auditors, provides a broad framework for bookkeeping and financial reporting, and authorizes the Ministry of Finance to develop a standardized chart of accounts and detailed instructions on the accounting treatments and reporting formats.</p>	<p>Law considered to be outdated by most practitioners.</p>

Company forms

Company forms included under the various company laws in Egypt include joint stock companies, limited liability companies, limited by shares companies and partnerships. The joint stock companies is by far the most common company form for listed and larger companies. In December 2002 there were about 29,000 companies in Egypt, including 22,000 joint stock companies, 280 limited by shares companies and 7,000 limited liability companies.¹ The share capital of a joint stock company is divided into tradable shares of equal value. Shareholder liability is limited to invested capital. Only joint stock companies and limited by shares companies can be listed.

The Capital Market Law 95 of 1992 (CML) defines “publicly offered” companies. Companies that wish to issue shares to the public must issue a prospectus that is approved by the Capital Market Authority. However, because the exchange’s previous listing policy goal of increasing the number of listed companies, many companies listed on the exchange are private, and have not issued prospectuses.

Companies offering shares to the public must file an application with CMA for review in order to ensure the company’s compliance with requirements. Once the application is accepted, the company may publish and distribute the prospectus, thus initiating public offering proceedings. A summary of the prospectus must be published in two morning newspapers and state where the prospectus can be obtained.

The legal framework allows for multiple share classes, provided that, within a given class, shareholders are treated equally. There are two general classes of shares: common and preferred.

- ❑ Common shares are either registered (also called “nominal”) or bearer shares. Bearer shares were introduced by the Capital Market Law Executive Regulations. Bearer share capital must not exceed 25 percent of total share capital and must be fully paid-up. Owners of bearer shares may attend the AGM, if their shares are deposited at a bank, the company or MCS D, but they are not allowed to vote. However, bearer shares are reported by the MCS D to be very rare, and are absent among widely-held listed companies.
- ❑ Preferred shares may have privileges in terms of voting, receive a fixed percentage of dividends to be paid before other dividends, or have priority in liquidation. Cumulative preferred shares exist. In most cases voting rights are capped at two votes per share (via Companies Department internal policy), but there is no legal limit. Preferred shares may be issued if the company statutes permit and if approved by an EGM. Non-voting preferred shares do not exist in Egypt. Preferred shares are relatively rare: ordinary shares represented 99.7 percent of the total market capitalization at the end of October 2003, and none were issued by actively traded companies.²

Insider Trading and Tender Rules

Insider trading is not specifically addressed in the law, although general provisions of the CML 95 can be used to pursue cases.³ Insider trading is considered a priority by the CMA and CASE, although most cases are resolved informally (often by reversing suspicious trades) rather than civil or criminal cases.

¹ CASE Monthly Bulletin, January 2003 and Report of the Ministry of Foreign Trade on Egypt’s Stock Market Performance during 2002, as quoted in *Assessment of Corporate Governance in Egypt*, ECES Working Paper No. 82.

² CASE Monthly Bulletin, July 2003.

³ Article 64 of CML 95 states that “any person who divulges a secret, which is in his possession by virtue of his duties under government by the provisions of this law, or has benefited him, his spouse and his children, from insider information of his work, or who used material misstatement, or omitted any material information in reports, submitted by him, to the extent that it affects the results contained in such reports” is punishable by law. Penalties include fines in the amount of L.E. 20,000-50,000 (USD 5,000-13,000) and/or prison terms of two years.

The new listing rules contain a number of enhancements designed to reduce insider self-dealing and increase transparency of insider deals. Board members, executives, and others with access to internal information must inform CASE and CMA 24 hours before making any trades.

Table 8: Insider Trading Provisions of the New Listing Rules

Article Four: A list of the names of board members and 5 percent shareholders, and their relatives up to the second degree, shall be attached to the listing application.

Article Nineteen: The company shall notify the stock exchange of its internal policies regarding the trading of company shares by board members, directors or employees in the period of two weeks before or three days after the release of material or information that may have a substantial effect on the stock price. The company shall also notify the stock exchange of its intentions to buy treasury stock; the stock exchange will then publish the transaction data on the trading board at the purchase date.

Article Twenty Five: With regard to matters under negotiations, the company may indicate that in writing and specify the persons having information related to these negotiations. If the company views that such information has spread, it shall immediately notify the stock exchange. Those having access to confidential information shall not trade in the company's securities during that period until such information becomes available to the public. The company shall notify the stock exchange with any data it requires, especially those related to names of persons having access to the information in question.

Article Twenty Eight: the company's board members, officers or persons who have access to information that is not available to the public and that affects the price of the company's securities are prohibited from selling or purchasing the securities related to this information without prejudice to any other related controls or other laws or rules.

Article Twenty Nine: The internal control procedures shall ensure that all information regarding the sale or purchase of the company's securities is disclosed to the CMA within 24 hours of that information becoming known to board members and officers.

ANNEX F: ACCOUNTING AND AUDITING

Accounting Standards and Compliance

The Government and the profession have taken significant steps to close the gap between Egyptian Accounting Standards and International Accounting Standards. Except for lease accounting, Egyptian Accounting Standards were developed in conformity with the IAS. The legal requirements concerning leases do not recognize finance leases and the application of accounting treatments required under the relevant international standard. Ministerial Decree 503/1997 mandates the use of IAS in the absence of Egyptian Accounting Standards, but actual accounting practice is hampered in this regard by inadequate knowledge of current pronouncements of the International Accounting Standards Board and lack of appropriate implementation guidelines.

The Capital Market Authority is working to improve compliance with accounting standards. The CMA reports a number of actions taken to improve compliance with financial reporting rules (see “Enforcement Actions” table above).

The Accounting and Auditing ROSC (2002) reviewed 2001 financial statements of 30 top-listed companies and interviewed experienced corporate accountants, practicing auditors, finance executives, investment analysts, academics, and regulators to assess divergences from existing accounting standards (see Table below). Data published in the accounting and auditing ROSC reviews the financial statements of listed companies and takes a number of actions when deviations are detected.

Compliance with Accounting Standards: A Survey in the Accounting and Auditing ROSC

Disclosures. Some companies avoid full disclosure of information in the published financial statements, ignoring the disclosure requirements set by the applicable accounting standards.

Statement of changes in equity. Contrary to the applicable standard, the financial statements of many companies do not include a statement of changes in equity.

Segment reporting. Very few companies comply with all requirements on segment reporting. Where segment information is presented, there is a tendency to avoid disclosure of key information, such as revenues and expenses of segments.

Related-party transactions. Required disclosures are rarely fully provided. The financial statements of many companies that seem to have related parties do not disclose information on either the existence of related parties or related-party transactions.

Impairment of assets. Egyptian companies do not follow IAS requirements on undertaking impairment tests of tangible and intangible assets on the balance sheet date. In fact, many accountants and auditors in Egypt are not aware of the requirements on impairment tests and related accounting treatments.

Foreign currency exchange gains and losses. Some companies do not adhere to the requirement that foreign currency exchange gains and losses arising from balance sheet date revaluations should be shown in the income statement. Some companies show currency exchange gains under a special account in the liability section of the balance sheet. Some companies capitalize the currency exchange losses as part of fixed assets, even if all the necessary conditions for such capitalization are not met.

Inventory valuation. Very few companies follow all the requirements related to measuring and disclosing inventory at the lower figure of either cost or market value. It is common practice to understate the figure for loss due to obsolete and slow-moving inventory.

Consolidated financial statements. Many companies do not consolidate all the subsidiaries and special-purpose entities in accordance with the IAS requirements and related standard interpretation. During review of 30 sets of published financial statements, it was found that several companies that should have prepared consolidated financial statements failed to do so.

Assets pledged as securities. In many cases, it is a practice not to disclose in the financial statements, assets pledged for securing loans.

Leases. All finance leases are treated as operating leases although this contradicts IAS; local standards allow this practice because it meets legal requirements regarding leasing.

Risk exposures and loan loss provisions. Banks and other lending institutions usually do not present the analysis of risk exposures required under IAS in the financial statements. Inadequate loan loss provisions distort reported profits of financially troubled financial institutions.

Classifications of current assets and current liabilities. Egyptian Accounting Standards require presentation of working capital calculations on the face of the balance sheet. To avoid the appearance of negative working capital, some companies resort to incorrect balance-sheet classification of current and noncurrent items.

Financial instruments. The requirements in IAS32, Financial Instruments: Disclosure and Presentation, and IAS39, Financial Instruments: Recognition and Measurement are not fully observed in preparing the financial statements of corporations and financial institutions.

Timeliness of the financial statements. Companies are required by law to present their annual financial statements within three months of the fiscal year-end. In addition, listed companies must present their financial statements 45 days after the end of each quarter. However, many companies fail to meet these requirements.

Distorted earnings per share and understated operating costs. Company Law and Tax Law grant employees the right to receive extra financial benefits in the year when profit is distributed. Total benefits should not exceed whichever figure is lower—10 percent of reported profit or annual employee salaries of the company. These payments to employees are not included in the income statement and are required to be shown as distribution of profit after calculation of company's net income. As a result, the earnings per share calculation based on a company's reported net income provides a distorted picture of earnings per share; also, the operating costs shown on the face of the income statement are too low.

Deferred tax. In most cases, financial statements fail to account for deferred tax. Most companies provide a disclosure note stating that, due to the prevailing tax environment, the amount of deferred tax is not practical to measure.

Events after the balance sheet date. Companies usually do not disclose information on events after the balance-sheet date. Noncompliance with the relevant Egyptian Accounting Standard can be found even in the case of many companies that present financial statements three to four months after the balance sheet date.

The Egyptian Accountants and Auditors Association, in cooperation with the Ministry of Finance, the Commercials' Syndicate, CMA and the Central Auditing Agency have prepared a draft law to regulate practice of the accounting and auditing profession in Egypt, as an amendment of the current Law No. 133/1951. The draft law was discussed at the State Council and was referred to the government in preparation for forwarding it to the People's Assembly for approval.

The most important articles that would be introduced in the new proposed Law include:

1. An article that insures that no person is to be licensed to audit corporate financial statements unless s/he passes two exams designed to test competence in understanding and applying accounting and auditing standards. The first exam is held after three years of practicing the profession as a trainee, and allows successful candidates to audit partnerships and sole proprietorships. After practicing for other five years, a certified accountant may sit for another exam to test his/her ability to audit joint stock companies (corporations). The previous law did not require testing the capabilities of auditors.

2. An article is added to allow firms ("accounting companies") to be appointed as auditors. The previous law allowed only individuals to audit financial statements, and accounting companies were not allowed to perform this function.

3. The proposed law establishes a Supreme Council for Accounting and Auditing to enhance professional capabilities, performance and competence. The council is also responsible to review and update accounting and auditing standards.

4. The proposed law includes an article to establish an Accounting Oversight Board to monitor, inspect and review auditors' work and to assess auditors' independence and compliance with auditing standards. The Oversight Board is entitled to impose penalties on non-complying auditors.

Under Article 5, a majority of the Board's members will be non-auditors, with two members representing each of following entities: the Capital Market Authority (CMA), the Central Auditing Bureau (CAB), and the Supreme Counsel for Accounting and Auditing (SCAR). Membership on this Committee will be for three years and could be renewed for other similar periods.

5. The proposed law requires that auditors are not allowed to provide consultation services to the companies they audit unless they receive approval from the Oversight Board. This is made to guarantee the independence and integrity of auditors.

Liability for auditors is increased under the new law. Under Article 46, the auditor will be liable against the company s/he audits its financial statements, as well as to third parties, to compensate for any damage resulted from his/her work which should be carried out with due care, in accordance with professional standards and practices.