



ACCOUNTING AND AUDITING STANDARDS IN LIBYA

H. Gin Chong^{*1}, Prairie View A&M University, USA
Nassr Saleh Mohamad Ahmad², Academy of Graduate Studies, Libya

Abstract: Despite the existence of Libyan accounting and auditing systems for more than half a century, there is a lack of literature available to the West. This is due to its social, political and economic situations in the past. This chapter provides an overview of the systems, explores the challenges faced by the profession and recommends the ways forward.

Keywords: accounting and auditing systems; accounting profession; Libya.

INTRODUCTION

Accounting is an important tool for a market and economic system, in particular in the Muslim societies (Zaid, 2000). In Libya, its accounting education has existed since the 1950s, but there is a lack of studies and understanding on the issues relating to the country's accounting and auditing systems. This is attributed to its social and political circumstances over the past decades. Key social factors that impacted upon this scenario include language barrier and conservatism in its cultures while political policies included isolations and sanctions imposed by the international bodies. Readiness of the current regime to open its door to the foreign investors and visitors has prompted for this study, in particular its accounting and auditing systems. The rest of the world, in particular the West, should be made aware that by implanting their own ideologies and systems in a foreign land without much considerations on its impact could

be a detriment in many situations. In many cases, a system may seem working in an environment, but this does not mean that it fits into all other situations, in particular for the case of accounting and auditing. The international accounting standards and auditing guidelines should be carefully reviewed and adapted before being adopted into the local systems. Sensitivities to the local environments are keys to succeed. All players, both within the local and from international, should hold continuing dialogues to ensure that the systems operate and fit into the local environments and meeting the expected needs. Using the Libyan business environment and accounting systems, this Chapter reports the evolution of accounting and auditing systems and education in the country. The extent of challenges faced by the regime and professional body is unparalleled and interesting. The situations and environments could serve as a showcase for all the emerging economies, as well as useful references for the international players.

^{1*} Prairie View A&M University, USA E-mail: hgchong@pvamu.edu

² Academy of Graduate Studies, Libya E-mail: nahmad@alacademia.org

LIBYAN CONTEXT

Libya is an emerging Arab state located in the north-central part of Africa with Islam as the official religion. Even though Arabic is the official language, English and Italian are the main languages for businesses and trades. The society is based on the core values of its religion, politics and social environments (Aghaia, 1997). In socio-cultural term, Libya is a highly collectivist society (Hofstede, 1980; 1984). A family web will normally extend to include the immediate and distant relatives through marriages, business networks and kinsmen (El-Fathaly and Palmer, 1980). The family individuals are expected to uphold the principles of unquestioning loyalty to the rules, traditions, values and beliefs in exchange for protections and supports. Aghaia (1996) recognises that close associations could bring collective fames or shames to the family, tribe and community as a whole. These webs pose huge pressures to the individuals to ensure that they uphold the highest conducts of integrity and honesty. Shames and fames of an individual could mean to the community and in some cases, the society as a whole. Accounting and auditing are not exact sciences and in many cases involved professional judgements. These may mean that these individuals are constantly exposed to liabilities, risk and possible litigations. However, in the collectivist society, chances of a person are being sued for negligence could be deemed unimaginable in view of close blood and family ties. Family members tend to keep dirt under the carpet rather than exposed them in the public. The added values of accounting information, audits and attestation services may, to a certain extent, questionable in the enclosed environment.

On 1 September 1969, Colonel Muammar Al Qathafi formed the Libyan Arabic

Republic by replacing the decades-long monarch system. The new regime has made a number of paradigm shifts including the restructuring of its economy, nationalisation of foreign companies, establishing public-owned companies to streamline and control services to the community, and demolishing the ideology of profit and wealth maximisation (Kilani, 1988). Since then, the country's GDP has shifted from relying solely on its agricultural output to hydrocarbon and oil and gas reserves. By the 1980s, oil and gas have contributed to 17.2% of its GDP (Secretariat of Planning, 1980, p.57). The sudden economic growth and expansion have brought along a huge gap on the supply and demand for its skilled human resources. To cope with this, the General People's Congress (GPC) (the highest legislative authority in the country) promulgated Law No. 5 (1997) to encourage foreign capital investments, implement de-nationalisation programme and accelerate its social and economic developments (Libyan Secretary of Justice, 1996). Private limited companies were encouraged to establish and joint ventures with their foreign counterparts to explore the resources and provide economic goods, services and needs for the communities. Economic boom has brought about an immediate demand for accounting and auditing personnel, education and training programmes and reliable accounting information systems. Accounting becomes an important tool to allocate resources, monitor social and economic development plans, to establish its pricing systems for products and services, and to establish and disseminate timely and accurate information for decision making. Unlike the Western world, accounting is not meant for establishing the bottom lines but ensuring availability of audit trails and sense of accountability throughout the process. The accounting information, generated by the finance departments, is normally used by

the federal and state agencies for planning, control and decision making on the federal and states' funds. The information is meant to substantiate evidence that the citizens are well fed and taken care of, and is not meant for other stakeholders like lenders and suppliers. After all, these stakeholders are part of the family of the country due to the closely-knitted society and culture.

The economic expansion has witnessed a huge demand for qualified accountants and reliable accounting information systems. By the end of 2002, the country has only 1369 qualified and partially qualified accountants (LAAA, 2002) to support its population of over 5.5 million (Central Bank of Libya, 2001). The regime has invested a huge volume of its resources on training students and boosting their interests to pursue for accounting and auditing education in higher education establishments. The journey remains long and hard, but the regime has adopted a step in the right direction to help boost the economic to a new height.

THE ACCOUNTING PROFESSION IN LIBYA

Since independence in 1952,¹ the country does not have a local accounting professional body that undertakes the responsibilities for training the accountants and accounting personnel. The country relies on its supplies from the accounting firms based in Italy, the USA and the UK (Bait-El-Mal *et al.*, 1973) and foreign agencies, for example, the Libyan Public Development and Stabilisation Agency, the Libyan American Reconstruction Commission, and the Libyan and American Joint Service. Reliance on foreign supplies means that foreign firms, in particular those from British and Americans, have brought along their accounting models and implant in Libya (Buzied, 1998). In a

short term, these non-Libyan agencies managed to fulfil the needs for meeting shortages of skilled personnel while implemented the accounting and auditing frameworks. Many of these frameworks may not be workable or in line with the local social, political and in particular religious backgrounds and values. Conflicts and confusions occurred due to discrepancies between the local and international practices. Despite this, the locals do not have the needed manpower and resources to review and revise these guidelines that are ready for adoption into the local environments. This is particularly acute in the 1960s, when large oil reservoirs have attracted more foreign investors and their accounting and auditing systems. Huge business activities and economic growth have put a huge pressure on regime and people to accept and adopt the foreign approach on business and entrepreneurship models. The principal-agent relationships become a phenomenon in the local context with particular stance toward meeting the increasing demands from the investors, creditors, business managers and government agencies for reliable, timely and accurate financial information and accounting services. The sudden transformation of decade-old practice on internal usage of financial information to meeting external stakeholders' demands, transparencies and accountability has caught the regime by surprise. The People's Revolution has prompted the country to take drastic actions by moving away from relying upon the foreign supplies, in particular from the UK and the USA, of professional accountants and expatriates by investing its resources on local trainings by the local universities and establishments of higher education. By the 1970s, supply of skilled accounting personnel has now come from University of Libya and Libyan graduates who reside abroad.

In the meantime, many local Libyan accounting firms were established. All these

have helped built the needed pools of skilled accounting human resources. However, there is a lack of an appropriate accounting framework that could firm the country's accounting standards and auditing approaches. Law No. 116 (1973) was enacted to govern the accounting and related areas in particular:

- to establish the LAAA
- to register all the qualified accountants
- to define the rights, duties and roles of the individuals and profession
- to determine how the accounting and auditing fees be charged
- to establish pension and contribution funds for the individuals and profession
- to determine the obligations of accountants and auditors
- to define the rules relating to code of conducts, and penalties, fines, suspensions and expulsions of members
- to design provisions that are deemed important to the profession and members.

With this, the LAAA was established in June 1975. It is responsible for:

- organising and improving the conditions of the accounting profession, and raising the standards of accountants and auditors professionally, academically, culturally and politically
- organising and requiring its members participating in conferences and seminars related to accounting and auditing, and keeping abreast with new events, scientific periodicals, and lectures
- establishing a retirement pension fund for its members
- increasing cooperation between its members and protecting their rights

- taking appropriate actions against those members who violate the rules, traditions and ethics of the profession.

Apart from the LAAA, the State Accounting Bureau (SAB) helps support and develop the accounting profession. The SAB was established in 1955 by Law No. 31 responsible to audit the public funds and accounts prepared by the federal and state agencies. To ensure its independence, the SAB is responsible for and reporting directly to the whole Ministries' Council of Libya under the Audit Bureau Law (1966), Libyan Government 1966 (in Arabic). In 1975, Law No. 79 was enacted to ensure independence of the SAB by requiring it to report all its audit findings directly to the Revolutionary Command Council (RCC).² In Article No. 1 of the SAB Law (1973), the Bureau stipulates that:

- it is an independent agent affiliated to the RCC
- its purpose is to apply effective control over the public funds.

By 1977, RCC has transferred all its authorities to the GPC, and in view of the change over, the SAB is now responsible for and reporting directly to the GPC. In 1988, Law No. 7 was passed to combine the SAB and Central Institute for General Administration Control to form the Institute for Public Follow-Up (IPFU). IPFU was officially formed in 1996 and take charge of all audits of the financial results of state's agencies, departments and corporations that receive more than more than 25% of its capital. Audits become the mechanism to ensure these public agencies comply with the accounting standards, financial regulations and guidelines issued by the respective secretariats (ministries), implement and review their internal control systems, and meet the set social and economic goals. Discrepancies and misstatements of information were

reflected in the audit reports and stern legal actions taken on those culprits.

As the IPC has grown in its capacity, capability and resources, the regime requires it to conduct the audits of the financial statements of foreign companies and those local companies having joint ventures with the foreign companies. This is to ensure that these organisations are operating within the stipulated laws and regulations. However, no specific audit guideline exists to help support the audit procedures and approaches. Acute supply of skilled accounting and auditing personnel, and the sheer volume of audit assignments have caused serious delays in publishing the audit findings and reports. Consequently, the IPC out sourced its services to the private firms of accountants. This has, in turn, increased the demand cycle for qualified accountants and skilled personnel, thereby makes the situation becomes critical.

On the supply of accountants, Article 3 allows a person be admitted as a member of the LAAA if he or she:

- a Libyan
- has completed a bachelor's degree programme majoring in accounting
- active in political and civil rights
- possesses a good conduct, reputation and respects
- has a minimum of post five-year accounting experiences attached to an accounting firm after completing the bachelor's degree.

The Article 3 also allow a person to be an accountant or auditor if the individual:

- 1 holds a doctorate degree in accounting or auditing or taxation or costing from

an Arab university, or any recognised international institution

- 2 a member of the AICPA (USA)
- 3 has gained at least five years of relevant accounting work experiences after completion of an undergraduate programme. The relevant work experience is received from:
 - the treasury department
 - IPC office
 - audit firm or inland revenue department
 - accounting departments of a financial or public institution
 - being an accounting faculty of a national university
 - a job that is deemed appropriate to satisfy the work experiences requirements of the Minister of Treasury
- 4 a ACCA or CIMA member with at least post three year work experiences.

For a graduate whose major is in accounting can practise as an assistant accountant even though the person does not possess any relevant prior work experiences. Once an individual has clocked in two years of working experiences with a firm of accountants, the individual is deemed qualify to practice and allowed:

- to certify the accounts and balance sheets of the sole proprietorships and partnerships
- to audit and certify accounts of individuals and corporations with share capital of not exceeding 20,000 L.D. (US\$32,800) or annual net income of not exceeding 5,000 L.D. (US\$8,200)
- to audit and certify accounts of individuals and corporations with turnover not exceeding 10,000 L.D. (US\$16,400).

For those with a master's degree majoring in accounting they are exempted from practical experiences as long as the programme is four years or more. For a partnership, the accounting firms are required to apply for its licence from the LAAA. Firms are allowed to offer for both the audit and non-audit services. The non-audit services include preparing the financial reports, providing tax advice, involving in the bankruptcy processes, providing management consultancies, and designing and installing accounting systems. However, due to shortage of skilled and qualified accountants, most of these qualified personnel focus their attentions on providing auditing services and preparing the financial reports. Many other non audit services remain unexploited (Buzied, 1998).

Once a person is admitted as a full member of the LAAA, the individual is not required to participate or attend any seminars or courses which credit toward the continuing professional education and trainings. Accounting firms are not under any obligation to provide further trainings for their existing staff or train the next generation of accountants. Supplies of these skilled human resources remain acute. Annisette (2000) argues that "professional education, examination and certification play important roles in demarcating and defining the boundaries of a profession both in terms of its membership and in terms of its knowledge-base" (p.654). The continuing inflows of foreign businesses and trades, and accounting principles and rules, the country remains lacks on the needed pools of human resources to help set formal accounting standards and frameworks to present and interpret the financial information, in particular on how the international standards and guidelines should be incorporated and integrated into the local context (Bait-El-Mal *et al.*, 1973; Buzied, 1998; Kilani, 1988). This has posed major challenges to the readers and users

who attempt to interpret and compare the financial performance and results (Ahmad and Gao, 2004, p.372).

AUDITING SYSTEMS

The country has modelled its auditing profession with those of the USA and the UK over the past five decades (Bait-El-Mal *et al.*, 1973; Kilani, 1988; Mahmud, 1997). The local auditing profession is exposed to three distinctive influences. These are the legal imperatives, quasi-legal professional requirements of the nationally recognised professional body and socio-cultural imperatives of family, tribe and community. The legal imperatives originated from Law No. 116 (1973) which means a member who does not comply with the bylaws of the profession may face the possibility of being suspended, expelled or imprisoned. Hush penalties intends to deter the members from violating the professional codes of conducts while live up with the highest possible level of integrity and standards (LAAA, Article 53). However, the LAAA is allowed to enforce suspension of an individual member for a maximum of three years. For cases relating to expulsion or imprisonments, the LAAA requires approval from the RCC and to show evidence for the decisions. This puts LAAA on the defence rather than the individual default members. LAAA members are prohibited to advertise for their services or to subcontract the audit assignments. This makes the audit profession in a relatively dormant situation as lack of publicity would mean that the stakeholders are being educated on or aware of the actual services provided by the profession. Prior to 2006, the LAAA does not have its own professional codes of conduct but from 2006 onwards, the LAAA adopted the AICPA's professional code of ethics in its entirety. This approach intends to bridge its local code with those of the West.

Since Libya is a highly collectivist society (Hofstede, 1980; 1984) due to its close-knit inter-locking family environment. The family webs have posed huge challenges to the individual auditors when exercising their professional codes of conducts and retaining independence. Express adverse and qualified audit opinions will be classified as an outcast in the community, expelled and refrained from receiving further supports and protections. The dilemma becomes deepened if the outcast decides to take further litigation against the fraudsters. The individuals will be requested to leave the community, and not allowed to return to the community or accepted by another neighbouring communities. Strong external pressure has constantly impounded upon the auditors to refrain from expressing qualified or adverse opinions, and be prepared to compromise their positions to fit into the society's norms. As far as the issue on independence is concerned, an auditor is required:

- by Law number 116 (Independence of auditors) to take the oath of being fair, independent by fact and appearance, integrity and honesty before the RCC
- to first seek advice from the RCC in regard to matters pertaining to clients who failed to settle for the audit fees before taking legal actions. The RCC will appoint a lawyer or other experts to assess the situation before deciding whether to allow the case to proceed in the public hearing
- by Article 25 to refrain from holding any ministerial position or accepting a job position that could deem conflict with the individual's position as an auditor.

There are interesting issues whereby the auditors are refrained to expose the situations in public not unless these disputes could not been discussed and dissolved within the

community. The community spirit should receive priority than the individual's grievance. However, the auditors are expected to exercise their professional due care and conducts under Law 116 Articles 49 and 557. These Articles spell out that the auditors are the agents for the stockholders and should ensure that they are performing their duties with highest care and integrity.

Based on questionnaire surveys conducted by Ritchie and Khorwatt (2007) on 164 practicing auditors on their perceptions on audit risks, inherent risks and control risks, they conclude that:

- the respondents have different perceptions on understanding and differences between inherent risks and control risks
- most auditors are fully familiar with the different sources of risk and their likely impact on the audit risks as a whole.

These reflect the auditors' awareness and understanding of the auditees' business environment, nature of activities and levels of risk that they are being exposed to. Closeness in the community spirit plays an important role on understanding and predicting the risk level and exposures, and the Libyan auditors' level of behaviour and understanding of audit risk assessments are comparable with their UK and US counterparts. These reflect the efforts and commendations on roles played by the LAAA over the past decades.

CONCLUSIONS AND WAY FORWARD

This huge unexplored emerging economy has made giant leaps in its progress in accounting and auditing systems over the past decades. Despite the acute problem on shortage of skilled and qualified accounting personnel, the country has recruited

qualified and experienced professionals to help set the foundation for its frameworks and systems. In the current stage, the systems remain crude and fundamental, and there are huge tasks ahead to meet the continuing demands for better and efficient accounting information and control systems. The close-knitted community spirit plays an important part of the development and the authority should not ignore this crucial factor when incorporating the international practices and guidelines into the local environment. These issues include:

- The need to establish a reliable accounting and auditing frameworks that are useful to meet the internal and external demands. The frameworks should be comparable to those of the international, in particular other Islamic countries and have incorporated the local values, norms and beliefs.
- The LAAA should review its professional codes of conducts to ensure independence, integrity, honesty and accountability of its members. Members are required to attend and take part in the continuing professional training and education and to attain the minimum mandatory credit hours to maintain the memberships. Members who fail to uphold the rules and constitutions of the professional body should be subject to serious penalties.
- To meet the supply, the regime needs to ensure all the national universities to have accounting and business programmes. The curriculum should reflect the practical aspects and useful for the students to appreciate and understand the real world expectations and challenges.

There is a need for the regime to open its doors to the world and allowing the international dialogs to take place. Students and

faculty exchanges help promote the understanding of business ethics, entrepreneurship, stakeholders' expectations, audit risk and litigations and professional codes of conducts in other parts of the world. Libya is an emerging economy that is constantly facing challenges and is a suitable laboratory for further research to be conducted.

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NOTES

¹ Before the country's independence, the colonisers (Turkish from 1551 to 1911, Italian from 1911 to 1943, and Britain and France from 1943 to 1952) were responsible for running the country's affairs and implemented their laws.

² The general broad function of the SAB, as stated in the Law No. 79 of 1975, is to exercise effective control over public resources. In order to undertake its responsibilities, the SAB performs four main tasks: (1) post-audit of government revenues; (2) post-audit of government expenditures; (3) pre-audit of government obligations; and (4) reporting of audit findings. Particularly, according to part 2, Article 18, of the Law No. 79 of 1975, the SAB is responsible for the examining and auditing of the accounts of the state, organisations and public agencies. Also, the SAB is responsible for auditing government-owned companies and any account or entity assigned for government audit by the RCC.

