KINGDOM OF SAUDI ARABIA
Minister of Commerce

OBJECTIVES AND CONCEPTS

OF ACCOUNTING AND GENERAL

PRESENTAION AND DISCLOSURE STANDARD

TRANSALATED BY

AL-RASHED CERTIFIED PUBLIC ACCOUNTANTS

Translator's comments

This is a working translation prepared for the benefit of none Arabic speaking professionals, to provide them with general understanding of the document and enable them to provide their views and comments. The formal document is the one issued in Arabic by the Ministerial Resolution No. 692, dated 28.2.1406H (11.11.1985 A.D)

This document issued after receiving the concerned parties views and comments on the products of stage one and stage two of the profession development project issued in (1404H) (1984AD)(in Arabic).

OBJECTIVES AND CONCEPTS OF ACCOUNTING

PREFACE

The Ministry of Commerce in Saudi Arabia has been concerned with the development of the accounting and audit profession in the Kingdom in order for this profession to cope with the ongoing changes in the financial, commercial, and economic sectors and to meet the requirements of this profession which is deemed to be one of the crucial activities of the community.

After an extensive study, the Ministry has laid down the Objectives and Concepts of Accounting which form the conceptual framework for financial accounting and the basis for the preparation of standards of financial accounting. In light of these objectives and concepts, the General Presentation and Disclosure Standard has also been derived. This is considered to be the means that would verify that financial statements are up to the level which would give a fair view of the financial position of the enterprise, the results of its operations, and the changes in the sources and applications of its funds.

Ministerial Resolution No. 692, dated 28.2.1406H (11.11.1985 A.D) considered the Statements of Objectives and Concepts of Accounting and General Presentation and Disclosure Standard to be an official reference which guides all Certified Public Accountants licensed to operate in the Kingdom of Saudi Arabia.

The Ministry of Commerce has also conducted an analytical study to clarify the circumstances in which the referenced standards were prepared, together with a classified comparison with similar standards in one or more of the following countries:

- U.S.A.,
- Great Britain,
- West Germany, and
- Tunisia

This comparison was made with consideration of the nature of the subject, the circumstances of research and the feasibility of such comparison. Results of this study were attached to the text of said statements in order to apply these standards, clarify them and justify the reasons for their application.

MINISTER OF COMMERCE

FINANCIAL ACCOUNTING

1. Objectives of Financial Accounting
2. Concepts of Financial Accounting
3. General Presentation and Disclosure Standard
4. Appendices

1. Objectives of Financial Accounting

OBJECTIVES OF FINANCIAL ACCOUNTING

TABLE OF CONTENTS

1 INTRODUCTION

The objectives of financial accounting have been determined by way of the fundamental concepts dominating in Saudi Arabia and by way of defining the outputs of this financial accounting process. Therefore, in determining the objectives of financial accounting in this statement, the importance of financial statements has been emphasised because they represent the final product of financial accounting which is prepared for the information benefit of external parties who have an interest in the enterprise.

The main objective of this statement is manifested in the following main points: (para 51)

1.1 Assist areas concerned with the formulation of the standards of financial accounting and direct their efforts to prepare those standards within the framework of this established statement of objectives.

1.2 Assist chartered accountants and other areas concerned (eg the management of the enterprise) in arriving at the proper accounting procedures to handle the transactions for which financial accounting standards have not been issued.

1.3 Enhance the understanding of competent readers of the financial statements of the information contained therein and the limits of their application.

1.4 The objectives are not intended to be a recitation of information that should be included in the financial statements of a business enterprise in order for them to be useful to the intended users. Rather, they are intended to define in broad terms the primary function of the financial statements of business enterprises and the nature of the information that should be included therein. Since the primary function of the financial statements and the nature of the information that should be included therein depends on the information needs of the primary users of the financial statements, the statement of objectives also describes in broad terms the primary users and their information needs.

1.5 The limitations of the financial statements are not intended to be a recitation of the specific information that should not be included in the financial statements of a business enterprise. Different types of information about a business enterprise are sought by different parties for different purposes. It is not the function of financial accounting and/or the financial statements to provide every type of information sought about a business enterprise. The statement of limitations is intended to define in broad terms the functions that will not be satisfied by the financial statements of a business enterprise. This may be due to :

1.5.1 Conflict between the primary function of the financial statements and other functions that could have been satisfied through the statements; or

1.5.2. The inability of financial accounting, given the state of its development, to produce information that can satisfy the other functions.

2. SCOPE OF THE STATEMENT

2.1 This statement establishes the objectives and limitations of financial statements of business enterprises in Saudi Arabia. Financial statements are the principal means of communicating accounting information to those outside an enterprise. The financial statements now most frequently provided in Saudi Arabia are (a) Balance Sheet or Statement of Financial Position, (b) Profit and Loss or Statement of Income and (c) Statement of Sources and Application of Funds.
(para 52)

2.2 The objectives and limitations set forth in this statement apply to the financial statements of all business enterprises regardless of how they are legally organized or the nature of their operations. For example, the Statement establishes objectives for the financial statements of an enterprise whether it is conducted as a one man business, a partnership or a company with limited liability. Also, the statement establishes objectives for the financial statements of a business enterprise whether its activities are trading, constructing, manufacturing, service or financial in nature.

2.3 The objectives established in this statement apply to the financial statements of business enterprises as opposed to the financial statements of non business organisations. Business enterprises are organized for profit and include government - sponsored entities whose primary operating purposes are to provide goods or services at a profit equivalent.

2.4 The objectives and limitations in this statement apply to general purpose external financial statements of a business enterprise. General purpose external financial statements are those prepared by the management of a business enterprise on a periodic basis for the benefit of external parties who have an interest in the business enterprise. Accordingly, the statement does not apply to financial statements and/or presentations that management might prepare for its own internal use.

2.5 General purpose external financial statements are intended to provide information that is useful to external parties. However, because the information needs of external parties might be conflicting or might be beyond the scope of financial accounting information, the objectives in this statement are focussed on the common information needs of the primary external parties which can be satisfied by accounting information.

2.6 Although the statement does not prescribe specific financial accounting standards, it defines the objectives and limitations of general purpose external financial statements. These objectives and limitations provide a focus for the establishment of financial accounting standards in Saudi Arabia. Also, knowledge of the objectives and limitations of general purpose external financial statements in Saudi Arabia enables all who are affected by or interested in those statements to better understand the content and limitations of information provided by the statements, thereby furthering their ability to use the information effectively.

3. TEXT OF THE STATEMENT

3.1 THE PRIMARY EXTERNAL USERS AND THEIR COMMON INFORMATION NEEDS

The primary external users of general purpose financial statements are current and prospective equity investors, current and prospective lenders; and current and prospective suppliers who enter into long term supply agreements with the business enterprise. Although governmental agencies, in particular, the Zakat and Taxation Department and departments responsible for granting subsidies often use the information in financial statements for their purposes, they are excluded as primary external users because they can and do prescribe the form and content of the financial statements submitted to them for their specialized purposes. Accordingly they do not need to rely on information provided to other external users. Management is also excluded as an external user of general pur-

pose financial statements because managers including directors, can receive most of their financial information about the business enterprise they manage in other reports which can be specially tailored to their needs.
(para 53).

The primary use of financial statements, which is common to all of the primary external users of general purpose financial statements, is the making of business decisions. The making of a decision involves a choice among alternatives. If there are no alternatives there is no choice to be made and if no choice is required no decision needs to be made. The usual basis for choice is evaluation of alternatives. Such evaluation involves assessment of future outcomes associated with each alternative, and in business decisions, the economic consequences of those outcomes. The primary role of financial statements is to provide financial accounting information that can help, together with other information, the primary external users assess the future outcomes and the economic consequences associated with alternative choices facing them. In this context, the common information needs of the primary external users can be shown as follows:
(para 54)

3.1.1 CURRENT AND PROSPECTIVE INVESTORS

Choices facing current and prospective equity investors which involve a particular business enterprise are to sell or hold, or to buy or not buy an equity interest in the enterprise. A current investor facing the choice of selling or holding his equity interest in a business needs information that can help him assess the future outcome and the economic consequences associated with each alternative. The economic consequences associated with the choices of selling or holding an equity interest in a particular business enterprise normally take the form of cash flows to the current investor, i.e., cash flows from the sale and reinvestment of the funds or cash flows in the form of future distributions to him and future realizable value of his interest. The financial statements of the business enterprise in which an investor has an equity interest can not be expected to provide him with information about the economic consequences associated with the immediate sale of his interest – a quotation from a willing buyer is needed for that – nor information about the economic consequences associated with investing elsewhere – the financial statements of other business enterprises would be looked to for this. The role of the financial statements of a business enterprise in the evaluation of alternatives facing a current equity investor, must be related to the evaluation of the economic consequences from holding, i.e., not selling, an equity interest in the enterprise. To fulfill this role, the financial statements should provide a current equity investor with accounting information that can help him, together with other information, assess the prospects of cash flows to him from holding an equity interest in a business enterprise which, in turn, depends on the ability of the enterprise itself to generate favorable cash flows and the sufficiency of those flows.
(para 55)

A prospective investor facing the choice of buying or not buying an equity interest in a particular business enterprise needs information that can help him assess the future outcome and economic consequences associated with each alternative. Obviously, the financial statements of a particular business enterprise cannot be expected to provide him with information about the economic consequences associated with not buying an equity interest in that enterprise. The role of the financial statements of a particular business enterprise in the evaluation of alternatives facing a prospective equity investor must be related to the evaluation of economic consequences of buying an equity interest in the enterprise. The economic consequences of buying an equity interest in a business entrprise normally take the form of future cash flows to the prospective equity investor, i.e., future distributions to him and the future realizable value of his investment. The financial statements should

provide a prospective equity investor with accounting information that can help him, together with other information, assess the prospects of cash flows to him from buying an equity interest in a business enterprise which, in turn, depends on the ability of the enterprise itself to generate favorable cash flows and the sufficiency of those flows.
(para 56)

In addition to investment decisions, current equity investors make decisions when they vote at shareholders' meetings. The types of decisions they make include the reappointment of directors, confirmation of interim dividends and approval of the final dividend, appointment of the auditors, adoption of the final accounts and a variety of other issues that vary among companies and years. The reappointment of directors usually is the most important matter on which shareholders vote and for which financial statement information can be of substantial value. In view of the direct managerial responsibilities given to directors by law and the responsibility of the board of directors to appoint the senior officers of the enterprise, the major issue involved in the reappointment of the present directors is the performance of management. Shareholders need to appraise management's performance and the financial statements are useful to shareholders for this purpose.[1]

The evaluation of management performance is normally based on the objective of the evaluator. To shareholders,[2] the performance of management should, sooner or later, be reflected in increased cash flow to them. Shareholders invest cash in a business enterprise and expect to obtain sufficient cash in return to make the investment worthwhile. They should be directly concerned, when they evaluate management, with the ability of the enterprise to generate favorable cash flows and the sufficiency of those flows. Accordingly, the appraisal of management performance requires the same fundamental information as does the equity investment decisions.
(para 57)

3.1.2 CURRENT AND PROSPECTIVE LENDERS

Current and prospective lenders face a number of choices pertaining to a business enterprise for which financial statement information would be helpful. Current lenders have the choice of selling their claims, if they are negotiable; sometimes they are asked to renew their loan agreements, and they may also have the choice of enforcing certain provisions or restrictive covenants included in the original loan agreements. Prospective lenders have the choice of making or not making the loan or investing or not investing in debt securities. Prospective lenders may also have the choice of including any restrictive covenants in the loan agreements and also deciding on such basic features as liens, mortgages, rates of return, payment terms and maturity dates. Choices made by current and prospective lenders fall into two categories: (1) the basic decisions to lend or not, to sell or hold the debt security, and to renew or not renew the loan; (2) the secondary decisions involving security arrangements, rates of return, payment terms and maturity dates.
(para 58)

The two categories of choices faced by current and prospective lenders clearly involve assessing the enterprise's ability to pay. The greater the lender's doubt about repayment, the more restrictive covenants and security arrangements he is likely to insist upon and the higher the rate of return he

1. Even when the business enterprise is not organized as a corporation, its owners would have a need to evaluate the performance of professional managers who have been given the responsibility to manage the enterprise on their behalf. The need of non-corporate owners to evaluate the performance of management is similar to the need of shareholders.

2. See footnote No.1

requires to cover his risk. To be sure, the lender requires a great deal of information about the enterprise other than accounting information to help him make his decisions. However, to the extent that his information needs can be met by the enterprise's financial statements, this information should provide him with indications of the enterprise's ability to pay. Accordingly, current and prospective lenders should be directly concerned with the ability of the enterprise to generate favorable cash flows and the sufficiency of those flows which requires the same fundamental information. (para 59)

3.1.3 SUPPLIERS

Suppliers who extend credit to the business enterprise for a short period of time are like short-term lenders. Both groups need not to be very concerned about the enterprise's cash flows and ability to pay much beyond the few months of their credit terms. Decisions by both of these groups, to make the short-term loan or to grant the credit, are probably not based on financial statement information. However, a supplier who enters into a long-term agreement with the business enterprise involving a major portion of his output for several years has another concern aside from the creditor position. Such a supplier should be concerned about the viability of his relationship with the business enterprise. Even if the business enterprise pays cash on delivery, the supplier who gears up to provide the enterprise's needs on a continuing basis makes decisions which must be based, among other things, on the profitability of his relationship with the business enterprise for a long period. The supplier's decisions depend, among other things, on the enterprise's financial stability and prospects for continuing the type and volume of business on which the supply relationship depends. The business enterprise's financial statements might reasonably be looked to for evidence along this line. The supplier should be directly concerned with the enterprise's ability to pay its debts as they fall due, that is its solvency, the stability of the volume of operations as indicated by total sales of the category for which the supplier's output is used and the profitability of these operations. (para 60)

3.1.4 CUSTOMERS AND EMPLOYEES

Customers, especially permanent ones, and employees have a vested interest in the continuity of the enterprise as a source that would satisfy their needs for materials or services, in case of customers, or as a source of income, in case of employees. It is also obvious that the enterprise's ability to continue as a source of need satisfaction for both customers and employees depends primarily on its capacity to generate sufficient cash flow. This also requires fundamental information similar to that required by current and prospective investors and lenders. (para 61)

3.2 THE NATURE OF FINANCIAL STATEMENT INFORMATION

General purpose external financial statements are products of financial accounting. Accordingly, the ability of the financial statements to provide for the information needs of external users, and as a result, the objectives of those statements, is affected by the nature of the information that can be generated by financial accounting.

Information contained in a particular set of general purpose financial statements pertains to an identifiable individual economic entity. The economic entity may be a single legal entity or it may be a holding company and its subsidiaries. The scope of financial statement information is limited, therefore, to a specifically identified entity. (para 62)

Only events that have already happened, that are subject to monetary measurement, and which affect the financial position of the business enterprise are usually recorded in the accounts. Financial statement information is, therefore, largely limited to the monetary effects of the events of the business enterprise that have already happened.

The financial position of the business enterprise is expressed in financial accounting in the form of an equation such as owners' equity = assets – liabilities. Each event affecting the financial position of the enterprise has effects on two or more items reflected in the equation. A central concern of financial accounting is the classification of those effects into capital and income effects. Accordingly, general purpose financial statement information is focussed on the entity's capital and income.
(para 63)

Financial information that is accumulated in a set of accounts of a particular entity is reported to interested parties at regular intervals during the life of the business enterprise. The most common reporting period in Saudi Arabia is a financial year.
(para 64)

The financial effects of events are measured in financial accounting on the basis that the enterprise has no intention or necessity to liquidate or curtail significantly the scale of operations. This has an important bearing on periodic financial statements. In so far as the business enterprise is a continuous stream of activities, the process of breaking the stream into periodic segments, for each of which financial statements are prepared, serves many real connections and tends to give the financial statements an aura of precision that is not justified. Financial statements, even under the most favorable circumstances, are tentative in character. The impression gained from them and the decisions resting upon them may have to be changed in the light of future events and should be tempered with a knowledge of this contingency.
(para 65)

Income from a particular transaction (or expenses associated with it) must sometimes be reported before (or after) the associated cash transaction in order to determine the income properly attributable to a period and the assets and liabilities at the end of that period. Accordingly, financial statements information is not limited to cash receipts and disbursements.
(para 66)

Financial accounting does not undertake to quantify and report many variables and events that might be of importance to external users when they make busines decisions. For example, financial accounting does not undertake to measure the value of a good reputation for product quality or services, or the social impact of the entity's operations, or the impact of the general economic conditions on the entity. Events not supported by documentary or other objective verifiable evidence are not generally recorded in the accounting records, unless this is clearly required for some other reason relating to the financial statements, for example, the need to disclose additional information that will make the statements not misleading. Accordingly, financial statements information is but one type of information that external users should utilize, together with other types of information, when they make decisions.
(para 67)

Financial accounting does not undertake to provide external users with assessments of the economic consequences of choices or alternatives facing them. The analytical work current or prospective investors and lenders need to undertake in connection with the evaluation of the economic consequences of different choices or alternatives facing them is not part of financial accounting. Financial accounting also provides information which is useful in the appraisal of management's performance, but such appraisals are not accounting functions. In general, the financial accounting

function of providing financial information must be distinguished from the use of financial information.
(para 68)

A business enterprise's success or failure depends on many factors including general economic conditions, demand for its products and services, supply conditions of its economic resources, management's ability to take advantage of opportunities and to cope with adverse conditions. Some of the factors affecting the enterprise's success or failure are often beyond the control of its management. Financial accounting usually can not and does not separate management performance from enterprise performance. Financial statement information is, therefore, limited for the purpose of asessing management performance apart from enterprise information.
(para 69)

3.3 OBJECTIVES OF GENERAL PURPOSE FINANCIAL STATEMENTS

On the basis of the previous analysis of the common needs of the users of financial statements, the objectives of the financial statements may be determined as follows:

3.3.1 PRESENTATION OF INFORMATION SUITABLE FOR THE NEEDS OF THE PRIMARY USERS

The primary objective of general purpose financial statements is to provide equity investors, lenders and others with similar information needs with accounting information that is useful in making investment and lending decisions involving the business enterprise. It is not an objective of financial statements to determine what those decisions should be. Specifically, current or prospective equity investors or lenders seek information that can help them assess the enterprise's ability in the future to generate sufficient favorable cash flow, that is, cash flow it can distribute to meet its obligations as they fall due and make distributions to its owners without curtailing the scale of its current operations.[3] A business enterprise's ability to generate sufficient favorable cash flow depends primarily on its ability to generate sufficient earnings from its operations and to convert those earnings into sufficient cash flow. Therefore, current and prospective equity investors and lenders seek information that can help them assess the business enterprise's ability to generate earnings in the future and convert those earnings into sufficient cash flow.
(para 70)

3.3.2 PERIODIC MEASUREMENT OF THE BUSINESS ENTERPRISE'S ABILITY TO GENERATE EARNINGS

The ability of a business enterprise to generate earnings in the future and to convert those earnings into sufficient cash flow depends on many variables including, but not limited to, general economic conditions now and in the future, current and future demand for its products or services, current and future conditions of supply, management ability to anticipate and take advantage of future opportunities as well as its ability to cope with adverse conditions, and the enterprise's current financial obligations. To be sure, assessing the impact of some of these variables on the enterprise's performance may require information that are outside the scope of the financial statements of a business enterprise. However, information about the historical ability of the business enterprise to generate sufficient earnings and convert those earnings into sufficient cash flow should be useful to current and prospective equity investors and lenders when they make their assessments about future enterprise performance. It should be noted that those assessments are not based on evaluation of enterprise performance.[4] Accordingly, the primary focus of the financial statements of a business

3. Investors and creditors in Saudi Arabia and other countries ordinarily invest in or lend to enterprises they expect to continue. Accordingly, they are interested in the cash flow an interprise can distribute while maintanining its scale of current operations.

4. This does not mean that the future can be predicted merely by extrapolating the past. Equity investors and lenders need to assess the possible or probable impact of variables that may cause change and form their own assessment about the future and its relation to the past.

enterprise should be on information about the enterprise's earnings and how they relate to its cash flow requirements. The most fundamental task of financial accounting, therefore, is the periodic measurement of enterprise income.
(para 71)

3.3.3 PRESENTATION OF INFORMATION FOR THE EVALUATION OF THE ENTERPRISE'S ABILITY TO GENERATE CASH FLOW

Periodic measurement of income and information disclosed about income in the financial statements of a business enterprise should, to the extent possible, be useful to current and prospective equity investors and lenders in assessing the potential cash flow to them from holding an equity interest or a loan position in the enterprise.

Periodic measurement of income based on accrual accounting is more useful to current and prospective equity investors and lenders in assessing the potential cash flow to them than periodic measurement of income that is based on cash receipts and disbursements. The typical business enterprise is a continuing process and income is a stream which must be broken up, for purposes of measurement and reporting, into convenient time-sections. The operations of a modern business enterprise are such that transactions, and events that affect its income stream during a period do not always coincide with the cash receipts and payments resulting from those transactions and events. Current and prospective equity investors and lenders are not only interested in transactions and events that had an effect on the enterprise's cash flow during the period, but also in those transactions, and events that will impact cash flow beyond the reporting period. Accordingly, periodic measurement of income based on accrual acccounting is essential to useful financial statements.

To be useful, information disclosed about income in the financial statements of a business enterprise should include the sources and components of that income and should differentiate beween recurring and non-recurring sources. Current and prospective equity investors and lenders are interested not only in how much income a business enterprise has generated in a particular period of time but also in information about the sources, components and incidents of that income. Information about the sources, components and incidents of income helps investors and lenders in forming their own expectations about the future and its relation to the past.
(para 72)

3.3.4 PRESENTATION OF INFORMATION ON THE ECONOMIC RESOURCES OF THE ENTERPRISE

Current and prospective equity investors and lenders usually seek to compare the enterprise's performance with others. These comparisons are almost always made in relative, not absolute terms, that is, income is usually related to the resources available to the enterprise before the comparisons are made. Accordingly, current and prospective equity investors and lenders are interested in information about the economic resources of the business enterprise as well as the sources of these resources, i.e., its assets, liabilities and owners' equity. Information about the enterprise's assets, liabilities and owners' equity provides a basis for current and prospective equity investors and lenders to evaluate information about the enterprise's income and its components during a particular period of time. Accordingly, the financial statements should include information peculiar to the enterprise's assets, liabilities and owners' equity.

Measurement of and information disclosed about the enterprise's assets, liabilities and owners' equity should, to the extent possible, be useful to current and prospective equity investors and lenders in

assessing the potential cash flows to them from holding an equity interest or a loan position in the enterpise. Current and prospective equity investors and lenders ordinarily perceive a business enterprise as a continuing stream of operations and activities investing cash in noncash resources to earn more cash. Accordingly, the measurement of and information disclosed about the enterprise's assets, liabilities and owners' equity should be consistent with that perception.[5]
(para 73)

3.3.4.1 Measurement of and information about a business enterprise's assets should differentiate between assets that are direct sources of cash and those that are not direct sources of cash. Assets that are direct sources of cash are money and claims to receive fixed amounts of money. Assets that are not direct sources of cash represent streams of future service potentials that are expected to be used by the business enterprise in its future operations and indirectly contribute to future cash flow. Measurement of and information about assets that are direct sources of cash should, to the extent possible, be geared toward providing indications of their direct cash inflow potential. Measurement of and information about assets that are not direct sources of cash should, to the extent possible, be geared toward providing indications of their service potential to the enterprise's operations.
(para 74)

3.3.4.2 A business enterprise's liabilities are almost always direct causes of cash payments by the enterprise. Accordingly, measurement of and information about liabilities should be, to the extent possible, geared toward providing indications of their direct cash outflow potential.
(para 75)

3.3.5 PRESENTATION OF INFORMATION ON THE SOURCES AND APPLICATIONS OF FUNDS

Current and prospective equity investors and lenders are directly interested in the ability of the business enterprise to pay its obligations as they fall due and make distributions to its owners without curtailing the scale of its current operations. Accordingly, the financial statements should provide information about the sources and utilization of the enterprise's cash and/or other liquid resources. Information about how an enterprise obtains and spends cash and/or other liquid resources, including the extent to which those resources are obtained from or spent in operations, about borrowing and repayment of borrowing and about cash received from and distributed to owners is useful in understanding the enterprise's operations and in assessing its ability to pay its obligations as they fall due and make distributions to its owners. Information contained in the financial statements should therefore cover the following:

1. Funds generated from or utilized in operations.

2. Funds obtained from borrowing or utilized in the repayment of loans.

3. Funds generated from new investments or distributed to owners.

4. Sources and applications of other funds.

5. The objectives of financial statements do not necessarily change if an enterprise shifts from expected operation to expected liquidation, but the information that is relevant to those objectives, including measurement of enterprise's assets, liabilities and owner's equity, may change.

3.4 LIMITATIONS OF GENERAL PURPOSE FINANCIAL STATEMENTS

General purpose financial statements that are prepared on a basis consistent with the objectives set forth in this statement should provide useful information to current and prospective equity investors and lenders and others who have similar information needs. However, such financial statements would have some obvious limitations.

3.4.1 General purpose financial statements are not intended to provide information that can be used, without adjustment, by the Zakat and Taxation Department to compute the zakat or tax obligation, or by other governmental agencies to compute the government subsidy due to a business enterprise. Tax and subsidy policies are usually motivated by social, economic, political and fiscal considerations which require accounting standards that may be different than those which would be consistent with the objectives of general purpose financial statements. However, with some adjustment, general purpose financial statements would fulfill the requirements of zakat, tax, and government subsidies.
(para 78)

3.4.2 General purpose financial statements are not intended to provide information about the progress of the business enterprise toward achieving non-monetary objectives such as human resources development, nor are they intended to provide information that can be used directly to assess the social costs of the enterprise operations.
(para 79)

3.4.3 General purpose financial statements are not intended to provide information that could be consolidated, without adjustment, into national accounts. General purpose financial statement information pertains to an identifiable business enterprise and does not provide a direct measure of the value added by the enterprise to the gross national product or other measures of its contribution at the macro level of the Saudi economy.
(para 80)

3.4.4. General purpose financial statements are not intended to provide information that can be used to evaluate overall management performance apart from the performance of the enterprise itself. However, information about the enterprise performance is useful in evaluating how management has discharged its stewardship responsibility to owners.
(para 81)

3.4.5 Because of the characteristics and limitations of the information that can be provided through the financial accounting process, general purpose financial statements are not intended to provide a direct measure of the business enterprise value either in liquidation, or as a going concern, or a direct measure of the risk associated with holding an equity interest or a loan position in the business enterprise.
(para 82) [Next paragraph is No. 233]

2. CONCEPTS OF FINANCIAL ACCOUNTING

TABLE OF CONTENTS

1. INTRODUCTION

To be consistent, financial accounting standards need to rest upon fundamental concepts. A concept is a fundamental term that is given meaning. A term is fundamental because repeated reference to it will be necessary, either explicitly or implicitly, when financial accounting standards are being established, interpreted or applied. For example, the term asset is fundamental because many of the financial accounting standards will deal with assets of the business enterprise and, therefore, repeated references to the meaning of an asset will be necessary when those standards are being established, interpreted or applied.

Financial accounting is a measurement and communication process. Measurement and communication may take many forms. Different measurement and communication forms require different standards. The basic form of the measurement and communication process that is appropriate for Saudi Arabia should be identified before financial accounting standards are established.

The fundamental concepts of financial accounting define the basic features of financial accounting in Saudi Arabia.

2. SCOPE OF THE STATEMENT

This statement defines the basic elements of financial statements of business enterprises, the concepts that should govern the measurement of those elements and the criteria that should be used to evaluate the usefulness of the information to be disclosed in the financial statements. These concepts determine the basic features of financial accounting. Although the statement does not establish specific financial accounting standards for business enterprises, it will be used together with the Statement of Objectives and Limitations of Financial Statements of Business Enterprises as a basis for establishing those standards.
(para 233)

3. CONTENTS OF FINANCIAL STATEMENTS

3.1 BASIC ELEMENTS OF FINANCIAL STATEMENTS

3.1.1 INTRODUCTION

Financial statements are the means by which the information accumulated and processed in financial accounting is periodically communicated to external parties. Information reported in the financial statements is of two basic types:

1) "Stocks" which relate to a point in time; and
2) "Flows" which relate to a period of time.

"Stocks" refer to information about the financial position of the business enterprise at a particular point of time. The Statement of Financial Position (the Balance Sheet) is the main vehicle for communicating this information. Assets, liabilities and owners' equity are the basic elements that depict the financial position of the business enterprise at a particular point of time.

"Flows" refer to information about the changes in the financial position of the business enterprise during a period of time. They include:
(para 234)

i) Information about the results of the enterprise's operations for a period of time. The Statement of Income (Profit and Loss Account) is the main vehicle for communicating this information. Revenues, expenses, gains, losses and net income (net loss) are the basic elements that depict the results of the enterprise's operation for a period of time;
(para 235)

ii) Information about the enterprise's owners' equity changes for a period of time. The Statement of Changes in Owners Equity is the main vehicle communicating this information. Net income (net loss), investments by and distributions to owners are the basic elements that depict changes in the enterprise's owners' equity for a period of time; and
(para 236)

iii) Information about the enterprise's sources and utilization of cash or other liquid resources for a period of time. The Statement of Sources and Applications of Funds is the main vehicle for communicating this information. Changes in assets, liabilities and owners' equity that affect cash or other liquid resources are reflected as sources or utilization of funds in the Statement of Sources and Application of Funds.

The basic elements of the financial statements of a business enterprise are, therefore, assets, liabilities, owners' equity, revenues, expenses, gains, losses, net income (net loss), investments by owners and distributions to owners. These ten elements are of two types. The first type is financial position elements and includes the first three. The second type is changes in financial position elements and include the last seven. The two types of elements are fundamentally related in that assets, liabilities and owners'equity are changed by elements of the other type and in that an increase (decrease) in an asset can not occur without a corresponding decrease (increase) in another asset or a corresponding increase (decrease) in a liability or owners' equity. The results of the financial accounting process are expressed in a set of fundamentally related financial statements which articulate with each other and rest upon the same underlying data.
(para 237)

3.1.2 DEFINITIONS OF THE BASIC ELEMENTS OF FINANCIAL STATEMENTS

A practical definition of any of the basic elements of the financial statements must provide a basis for distinguishing between items which fall within a specified category and those which do not. A definition of asset, for example, must enable an accountant to decide whether a specified item proposed for inclusion in the asset category meets the characteristics of all those items which are to be called assets. The definitions of the basic elements of the financial statements are a significant first step in determining the content of financial statements. They screen out items that lack one or more characteristics of assets, liabilities, revenues, expenses, gains, losses or other elements of financial statements. The definitions are not intended to provide criteria as to when the elements of financial statements should be recognized or what property of these elements should be measured. The recognition criteria and the property of the elements that should be measured are defined by the measurement concepts. Below are the definitions of the basic elements of financial statements:
(para 238)

1. ASSETS

An asset is any item capable of providing future services or benefits, the rights to which have been acquired by the enterprise as a result of past transactions or events and which is presently measurable in monetary terms with acceptable reliability, provided that it is not directly associated with an immeasurable obligation.
(para 239)

The previous definition indicates that an asset regardless of its form has the following five essential characteristics:
(para 240)

i) Service or benefit potential, that is, it embodies the capacity, singularly or in combination with other assets, to provide future services or benefits which contribute directly or indirectly to future net cash inflows;[1]

ii) Association with the business enterprise, that is, the business enterprise can obtain the benefits or services that the item embodies;

iii) Past transaction or event, that is, the transaction or event giving rise to the enterprise's right to obtain the benefits or services has already occurred;

iv) Measurability, that is, some property of the item which has a demonstrable relationship to its service or benefit potential is subject to measurement in monetary terms with acceptable reliability;

v) Measurability of any directly associated obligation, that is, any obligation that is incurred by the entity to obtain the right to the asset is subject to measurement in monetary terms with acceptable reliability. "Executory" contracts (which are substantially unperformed by both parties) typically involve valuable rights to service or benefit potential and burdensome obligations. The usefulness of including such rights among the enterprise's assets would be seriously limited unless the related obligations are measurable and, therefore, are also included among liabilities.

2. LIABILITIES

A liability is a present obligation of the business enterprise to transfer assets or provide services to other entities in the future as a result of past transactions or events and which is presently measurable in monetary terms with acceptable reliability, provided that it is not directly associated with an immeasurable, but valuable, right.
(Para 241)

The previous definition indicates that a liability regardless of its form has the following six essential characteristics:

i) A present obligation, that is, a liability embodies a present duty or a responsibility to one or more other entities;

ii) Conveyance or disposition of assets in the future, that is, the present duty or the responsibility requires settlement by transfer or use of assets in the future at a specified or determinable date, on occurrence of a specified event, or on demand;

1 This characteristic is probably the most difficult to assess. Uncertainty about business and economic outcomes often could, whether or not a particular item that might be an asset with the capacity to provide future benefits to the enterprise, preclude recognition as an asset. The kinds of items that may be recognized as expenses or losses rather than assets because of uncertainty are some in which management's intent in initating certain events is clearly to acquire or enhance future benefits available to the enterprise. For example, business enterprises engage in development activities, develop markets, train employees, engage in preoperating activities and the similar cases in which it is difficult to assess the future benefits. The uncertainty not about the intent to increase future benefits but about whether and, if so, to what extent they succeed in doing so.

iii) Association with the enterprise, that is, the duty or responsibility has to be satisfied by the particular enterprise with little or no discretion;

iv) Past transaction or event, that is, the transaction or event obligating the business enterprise has already happened;

demonstrable

v) Measurability, that is, some property of the obligation which has a demonstratable relationship to the future transfer or disposition of assets is subject to measurement in monetary terms with acceptable reliability; and

vi) Measurability of any directly associated valuable rights, that is, any rights to future benefits obtained by the enterprise as a result of the transaction or event which provides the basis for the liability is subject to measurement in monetary terms with acceptable reliability.
(Para 242)

3. OWNERS' EQUITY

Owners' equity is the residual interest in the assets of the enterprise that remains after deducting its liabilities. Owners' equity always equals net assets (assets-liabilities) that is why it is a residual interest. Equity in a business enterprise stems from ownership rights and involves a relation between the enterprise and its owners (as owners) rather than as employees, suppliers, lenders, customers or in some other non-owner role.
(para 243)

4. REVENUES

Revenues of a business enterprise are increases of its assets or decreases of its liabilities or a combination of both during a specific period of time from selling or producing goods, allowing other entities to use enterprise assets, rendering services or other profit-directed activities that constitute the enterprise's ongoing major operations.
(para 244)

The previous definition indicates that revenues have the following characteristics:

i) The increases in assets or decreases in liabilities that represent revenues result from profit-directed activities as opposed to increases in assets that result from investment by owners, other capital contributions to net assets from nonequity sources, additional borrowing, receipt of assets purchased or as opposed to decreases in liabilities that result from settlement of debt by means other than delivering goods or rendering services or allowing others to use enterprise assets;

ii) The profit-directed activities that result in the revenues constitute the ongoing major operations of the enterprise as opposed to incidental or peripheral transactions of the enterprise with other entities and other events and circumstances affecting it. The distinction between the ongoing major operations of the enterprise and its incidental or peripheral transactions with other entities and other events and circumstances affecting it depends to a significant extent on the nature of the enterprise, its operations and its other activities. Ongoing major operations for one kind of business enterprise may be incidental or peripheral to another. The distinction requires judgement but it is very important. The primary purpose behind the distinction is to make the information about an enterprise's income, its components and incidents as useful as possible to the external users of the financial statements. The distinction provides the basis for differentiating between revenues and gains which is another component of the enterprise's income.

iii) Revenues represent increases in assets or decreases in liabilities and accordingly, the new assets or the settled liabilities should meet the characteristics of assets or liabilities as specified before; and

iv) The increases in assets or decreases in liabilities is associated with a specified period of time.
(para 245)

5. EXPENSES

Expenses are the expiration of assets or the incurrence of liabilities (or a combination of both) during a specific period of time resulting from selling or producing goods, allowing other entities to use enterprise assets, rendering services or other profit-directed activities that constitute the enterprise's ongoing major operations.
(para 246)

The previous definition indicates that expenses have the following characteristics:

i) The decreases in assets or increases in liabilities that represent expenses result from profit-directed activities of the enterprise as opposed to decreases in assets that result from distributions to owners, other retirements of owners' equity, expenditures to buy assets, settlement of debt or as opposed to increases in liabilities that result from additional borrowing or from buying assets;

ii) The profit-directed activities that result in the expiration of assets or the incurrence of liabilities constitute the ongoing major operations of the enterprise as opposed to incidental or peripheral transactions with other entities or other events and circumstances affecting the enterprise;

iii) Expenses represent decreases in assets or increases in liabilities and accordingly, the assets that expire or the new liabilities must meet the characteristics of assets or liabilities noted before; and

iv) The decreases in assets or the increases in liabilities are associated with a specific period of time.
(para 247)

6. GAINS AND LOSSES

Gains are increases in owners' equity (net assets) resulting from peripheral or incidental transactions of the business enterprise with other entities and other events and circumstances affecting it during a specific period except those that result from revenues or investments by owners or other capital contributions to net assets from nonequity sources.
(para 248)

Losses are decreases in owners' equity (net assets) resulting from peripheral or incidental transactions of the enterprise with other entities and other events and circumstances affecting it during a specific period except those that result from expenses or distributions to owners. (para 249)

The previous definitions indicate that gains and losses have some common characteristics. The common characteristics of gains and losses are:

i) They affect owners' equity (net assets), gains increase it and losses decrease it;

ii) They result from peripheral or incidental transactions of the enterprise with other entities and other events and circumstances affecting it as opposed to its ongoing major operations. This characteristic differentiates gains from revenues and losses from expenses;

iii) They do not result from transactions or transfers between the enterprise and its owners as owners or from other capital contributions to net assets from nonequity sources; and

iv) They are associated with a specific period of time.
(para 250)

Notwithstanding the common characteristics of gains and losses, not all gains and losses result from the same causes. Some gains and losses result from exchanges between the enterprise and other entities, for example, gains and losses from the sale of productive assets that are not held for sale in the normal course of business. Other gains or losses result from one sided transactions, that is, nonreciprocal transfers between the enterprise and other entities, for example, from operating subsidies and from assessment of penalties by a governmental agency. Still, other gains and losses result from holding assets or liabilities while their value changes, for example, from changes in foreign exchange rates. And still other losses result from involuntary conversions of assets, for example, loss of assets due to theft, destruction of assets due to fire or an act of God such as flood.
(para 251)

7. NET INCOME (NET LOSS)

Net income (net loss) of the business enterprise for a specific period of time is the increase (decrease) in owners' equity, i.e., net assets, during the period resulting from its revenues, expenses, gains and losses which are associated with that period. It includes all changes in net assets during a period except those resulting from investment by or distribution to owners or those resulting from other capital contributions to net assets from nonequity sources.
(para 252)

The previous definition indicates the following characteristics of net income (net loss):

i) Net income (net loss) is the result of all ongoing major operations of the enterprise; its peripheral or incidental transactions with other entities and other events and circumstances affecting it, which give rise to revenues, expenses, gains or losses that are associated with the specific period of time for which income is being measured;

ii) Net income (net loss) does not result from transfers between the business enterprise and its owners as owners or from capital contributions to net assets from nonequity sources; and

iii) Net income (net loss) is a residual measure, that is, it is measured indirectly. It is the difference between revenues, gains, expenses and losses.
(para 253)

The basic components of net income (net loss) are revenues, expenses, gains and losses. However, these components may be combined in different ways to obtain useful intermediate measures of the enterprise's performance during a specific period of time. Example of such intermediate measures are gross profit, income from continuing operations and operating income. Those intermediate measures are, in effect, sub-totals of net income (net loss).
(para 254)

8. INVESTMENT BY AND DISTRIBUTIONS TO OWNERS

Investment by owners are increases in the net assets of the business enterprise resulting from transfers of assets to it from other entities, the performance of services for it by other entities, or the settlement of its liabilities by other entities to obtain or increase equity interests in the enterprise.
(para 255)

Distributions to owners are decreases in the net assets of the business enterprise resulting from transferring assets, rendering services or incurring liabilities by the enterprise to its owners to reduce or terminate their equity interest in the enterprise.
(para 256)

The previous definitions indicate the following characteristics for investments by and distributions to owners:

i) They represent one sided transactions between the business enterprise and its owners as owners, that is, nonreciprocal transfers between the enterprise and its owners as opposed to exchanges with owners;

ii) Investments by and distributions to owners involve the transfer of assets or liabilities, to or from the enterprise and accordingly, the assets or liabilities that are being transferred must meet the criteria for assets and liabilities specified previously; and

iii) Investment by and distributions to owners do not result in gains or losses to the enterprise.
(para 257)

3.2 CONCEPT OF EVENTS, TRANSACTIONS AND CIRCUMSTANCES

3.2.1 INTRODUCTION

Changes in the entity's assets, liabilities and owners' equity are caused by events, transactions and circumstances affecting it. Measurement in financial accounting involves the recognition of events affecting the entity's assets and liabilities, determining the amounts of changes in those assets and liabilities and expressing those amounts in monetary units. Events, transactions and circumstances that change the entity's assets, liabilities and owners' equity are the basis for the basic elements of the entity's results of operations—revenues, expenses, gains, losses and net income—and other changes in its financial position with which financial accounting is concerned.
(para 258)

3.2.2 DEFINITION OF EVENTS, TRANSACTIONS AND CIRCUMSTANCES

Events are happenings of consequences to the entity. Events may be classified in many ways. From the standpoint of financial accounting, events are either external or internal. External events are happenings that involve interaction between the entity and other entities or its environment. Internal events are happenings that occur within the entity, that is, events in which only the entity participates.
(para 259)

A) EXTERNAL EVENTS

External events that affect the entity's assets and liabilities may take the form of transactions, casualties or circumstances.
(para 260)

A.1 Transactions

A transaction involves an actual transfer of an asset or a liability between the entity and other entities.

Transactions may be two sided or one sided but they always involve transfers of assets or liabilities to or from the entity. Two sided transactions are called exchanges. One sided transactions are called nonreciprocal transfers.

Exchanges are reciprocal transfers of assets or liabilities between the entity and other entities in which the entity either sacrifices or settles other liabilities.
(para 261)

Nonreciprocal transfers are transfers in one direction of assets or liabilities, either from the entity to other entities or from other entities to the entity. Nonreciprocal transfers may be between the entity and its owners (as owners) or may be between the entity and entities other than owners.

Investments by and distributions to owners (as owners) are nonreciprocal transfers between the entity and its owners. The entity does not sacrifice any of its assets or incur any liability in exchange for owners investments, and it receives nothing of value to itself in exchange for the assets it distributes to its owners.

Nonreciprocal transfers between the entity and entities other than owners are one sided transactions in which the entity either:

i) Sacrifices assets or incurs liabilities without obtaining other assets or discharging other liabilities; or

ii) Receives assets or discharges liabilities without sacrificing other assets or obtaining other liabilities.

Examples of the first type are the contribution of assets by the entity to a charitable organization, imposition of taxes or fines or theft and examples of the second type are the receipt of subsidies, receipt of capital contributions from nonequity sources.

A.2 Casualties

Casualties are sudden, unanticipated expirations in the entity's assets not caused by other entities. Examples are fire, floods and other events usually termed acts of God. (para 262)

A.3 Circumstances

Some external events do not involve current transfer of assets and/or liabilities between the entity and other entities. Yet, they affect the entity. Such external events create favorable or unfavorable circumstances affecting the entity. The effect may be current or potential. Favorable or unfavorable circumstances which have a current effect on the entity are a present condition or a set of present conditions involving current gains or losses to the entity. Examples of such circumstances are increases or decreases in market price or the change in the economic utility of the entity's assets.[2]
(para 263)

Favorable or unfavorable circumstances which have a potential effect on the entity are a present condition or a set of present conditions involving an uncertainty as to possible gain or loss to the entity which will ultimately be resolved when one or more future events occur or fail to occur.[2] Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a new liability. A present condition of a set of present conditions involving an uncertainty as to possible gain to the entity is a "gain contingency". A present condition or a set of present conditions involving an uncertainty as to possible loss to the entity is a "loss contingency". Examples of gain contingencies which may result in the acquisition of assets or gains are claims against others for breach of agreements, claims for reimbursements under condemnation proceedings and claims for price redetermination upward under construction or similar contracts. Examples of loss contingencies which may result in the incurrence of liabilities, or losses or impairment of assets are pending or threatened litigations, assessments or possible assessments of additional taxes, guarantees of indebtedness of others, and uncertainty about the collectibility of the entity's receivables.
(para 264)

B) INTERNAL EVENTS

Internal events are happenings that occur within the entity, that is, events in which only the entity participates. Internal events encompass all the acitivities involved in the process of transforming assets and other resources into products (goods or services). Transforming assets and other resources into products could take many forms and is not limited to manufacturing operations. It includes, for example, commercial, mining, transportation, exploration, agriculture and service operations. Internal events encompass all of the activities that are intended to result in a product with an exchange value higher than the cost of the resources used to make it available for exchange.
(para 265)

2. The fact that a present condition or a set of present conditions may involve current or potential gains or losses to the entity does not mean that such gains or losses should be recognized. Recognition criteria for events, transactions and circumstances are defined by the recognition concept.

3.3 MEASUREMENT CONCEPTS

3.3.1 INTRODUCTION

Measurement in financial accounting involves the determination of the amounts of the basic elements of financial statements of a particular business enterprise. The measurement concepts define certain assumptions underlying the measurement process and the basic characteristics of the measurement process itself. They include: the entity concept; the going concern concept; the measurement unit concept; the periodic reporting concept; the recognition concept; the measurement basis concept; and the matching concept.
(para 266)

3.3.2 THE ENTITY CONCEPT

The business enterprise is conceived of as an economic entity in its own right, separate and distinct from the parties who furnish its assets. The business enterprise accounts and its financial statements are those of the entity rather than those of the proprietor, partners, stockholders or other parties or groups concerned. Accordingly, the enterprise's assets are the entity's assets rather than the proprietors', partners' or stockholders' assets. The enterprise's liabilities are claims against the entity's assets rather than claims against the proprietors', partners' or stockholders' assets. The business enterprise's revenues and expenses are changes in the entity's assets and liabilities rather than changes in the proprietors', partners' or stockholders' assets and liabilities. The business enterprise's gains and losses are changes in the entity's net assets rather than changes in the proprietors', partners' or stockholders' net assets. Net income is that of the entity rather than that of the proprietors, partners or stockholders until such time as transfer to the owners has been effected.
(para 267)

That the entity concept is important for unincorporated as well as incorporated business enterprises should be emphasized. Even if the enterprise is not a company, and usually powerless to hold legal title to assets, financial accounting must regard assets dedicated to the business enterprise as being the entity's assets. Considerations of both management and equity call for the reporting of the enterprise income, in the first instance, as the entity income even if no formal legal action is needed to secure transfer to individual possession.
(para 268)

Recognition of the business enterprise as an economic entity in its own right in financial accounting does not eliminate the problem of discerning the boundaries of the enterprise in certain cases. Except for joint ventures, the business enterprise organized in accordance with the Saudi Company Law is deemed as a juristic person i.e., a separate legal entity, from the date of incorporation (see Article 13 of the Company Law). However, the legal entity may not always coincide with the economic entity. The entity concept defines the business enterprise as an economic rather than a legal entity. In general, an economic entity is any business undertaking with a single management in control of its activities. In some instances, a number of distinct legal entities may be controlled by a single management as to justify treatment of the group, as one economic entity.
(para 269)

3.3.3 THE GOING CONCERN CONCEPT

The business enterprise, i.e., the economic entity, is assumed to have continuity of life. In the absence of persuasive evidence to the contrary, the economic entity is assumed to have a remaining life greater than that of its limited life assets. This means, in particular, that the Statement of Finan-

cial Position and the Statement of Income assume no intention or necessity to liquidate the entity or curtail significantly the scale of its operations.
(para 270)

The going concern concept has an important bearing on financial accounting and the financial statements of a business enterprise. In so far as the business enterprise is conceived of as a continuous stream of activities, it is the task of financial accounting to make the most relevant and significant measurements possible of the continuous flow of the business enterprise acitivities. Under this concept, the most relevant and significant measurements of the continuous flow of the business enterprise activities are those pertaining to allocating its efforts and accomplishments as between the present and future and placing those efforts and accomplishments in contrast. The process of allocating the continuous flow of the business enterprise activities between the present and future severs many real connections and tends to give an aura of precision to financial statement information which in substantial measure depends on the course of future events. The financial statements of a period, even under the most favorable circumstances, are tentative in character. The complete picture of the business enterprise is never entirely discernable prior to final liquidation. Accordingly, the decisions resting upon the financial statements may have to be changed in the light of future events and the statements should be prepared with this consideration in mind. The net income figure, its components, the statement of the financial position figures and the related disclosures should not suggest a finality that is far from real.
(para 271)

By means of the Statement of Income a section of the continuous flow of the enterprise's efforts and accomplishments is presented as an exhibit of the enterprise's performance and management's effectiveness in handling its available resources during a period of time. To serve this purpose well, the Statement of Income should be prepared as a series of connected reports. That is, the Statement of Income should not neglect to recognize all peripheral and incidental losses and gains, as those elements undoubtedly serve to modify the long-run income stream. By means of the Statement of the Financial Position, a picture as of a moment of time of the enterprise's assets which are reasonably associated with its future activities and the present claims against those assets is presented.
(para 272)

3.3.4 THE PERIODIC REPORTING CONCEPT

Information that is accumulated in a set of accounts for a particular entity is reported to interested parties at regular intervals during the life of that entity. In other words, the life of the entity is broken into reporting periods to provide interested parties with test readings by which they can evaluate the entity's performance. The most common reporting period in Saudi Arabia is a year, calendar or fiscal. A principal task of financial accounting, therefore, is the assignment of the entity's continuous stream of activities to specific reporting periods.
(para 273)

The principal alternative to the accounting period as a unit by which to measure and report performance is the project or completed venture which may cover varying lengths of time. For typical trading and manufacturing establishments and for most other lines of business in Saudi Arabia, the period is clearly superior, from the standpoint of expediency to the project or venture, as the focus of measurement and reporting the entity's performance. Regular accounting periods, however established or defined, are consistent and, therefore, promote comparability.
(para 274)

3.3.5 THE MEASUREMENT UNIT CONCEPT

The measurement of assets, liabilities, owners' equity, revenues, expenses, gains, losses and net income must be made in a common denominator. The monetary unit is the common denominator in which measurement in financial accounting is expressed. The monetary unit in Saudi Arabia is the Saudi Riyal. In the absence of significant changes in its general purchasing power, the Saudi Riyal is assumed to be stable as a measuring unit.
(para 275)

Stating assets, liabilities, owners' equity and changes in them in terms of a common denominator is prerequisite to performing the operations necessary to measure the entity's financial position and its periodic net income. Defining the unit of measure in terms of money may present problems because of decreases (inflation) or increases (deflation) in the general purchasing power of the money over time. If moderate inflation or deflation were to persist for several years or if substantial inflation or deflation were to occur over short periods, the general purchasing power of the Saudi Riyals used to express the amounts of different elements of the financial statements might be different. For example, the general purchasing power of the Saudi Riyals in which expenses are expressed might be different from the general purchasing power of the Saudi Riyals in which revenues are expressed; or the general purchasing power of the Saudi Riyals in which certain assets are expressed might be different from the general purchasing power of the Saudi Riyals in which other assets are expressed. Significant differences in the general purchasing power of the Saudi Riyal over time hampers comparability of the entity's performance between years as well as between the entity and other entities for the same year.
(para 276)

The basic effect of the measurement unit concept is that moderate changes in the purchasing power of the Saudi Riyal that persist for several years or substantial changes in its purchasing power that occur over short periods will require restating the financial statements for changes in the purchasing power of the Riyal.
(para 277)

3.3.6 THE RECOGNITION CONCEPT

Financial accounting is concerned with the measurement of the amounts of change in the entity's assets and/or liabilities. Changes in the entity's assets and liabilities are classified as revenues, expenses, gains, losses, investment by and distributions to owners and other changes in its financial position. Changes in the entity's assets and liabilities are caused by external or internal events. Before a change in the entity's assets and/or liabilities is measured and classified, the event causing it should be subject to recognition in the accounting records. The recognition concept defines the broad criteria for the recognition of external and internal events that affect the entity.
(para 278)

The effects of external and internal events on the entity's assets and liabilities should be recognized and reported in the time periods to which they relate in accordance with the criteria set forth in the following paragraphs rather than when cash is received or paid.
(para 279)

A) RECOGNITION OF EXTERNAL EVENTS

External events have been classified as transactions, that is, events involving transfers of assets or liabilities between the entity and other entities; casualties involving sudden unan-

ticipated expirations of the entity's assets, and favorable and unfavorable circumstances involving current or potential gains or losses to the entity.
(para 280)

Transactions have been classified as exchanges or nonreciprocal transfers. Nonreciprocal transfers have been classified as those between the entity and its owners and those between the entity and entities other than owners. Favorable and unfavorable circumstances have been classified as those involving current gains or losses to the entity and contingencies. Contingencies have been classified as gain contingencies or loss contingencies.
(para 281)

According to this classification, recognition will be as follows:

1) Exchanges between the entity and other entities should be recognized in the accounting records when the transfer of assets or liabilities takes place or when services are rendered or assets are used.

2) Nonreciprocal transfers to or from owners (as owners) should be recognized when the transfer of assets or liabilities takes place.

3) Nonreciprocal transfers to or from entities other than owners should be recognized when assets are acquired, when assets are disposed of or their loss is discovered (for example, in the case of theft), or when liabilities are incurred or discovered (for example, in the case of penalty imposed on the entity).

4) Casualties involving the entity should be recognized when the sudden, unanticipated expiration of the entity's assets occurs or is discovered.

5) Damage or destruction of the entity's assets caused by other entities should be recognized when the damage or destruction occurs or is discovered.

6) Favourable circumstances involving current gains to the entity should not be recognized when they occur.[3] Instead, their effects should be recognized at the time of later exchanges or transfers. Although such favorable circumstances create current gains to the entity, for example, the increase in the market prices of its assets, such gains are not recognizable. They do not reflect or measure the progress of operating activity; they are not the result of any transaction or any act of conversion; they make available no additional liquid resources which may be used to meet obligations or make disbursements to owners; and they have little or no legal standing as gains.

7) Unfavourable circumstances involving current losses to the entity should not be recognized when they occur unless they are indicative of a permanent loss, that is, the recorded amounts of assets will not be recovered in the normal course of business.

8) Gain contingencies should not be recognized until they are confirmed by future recognizable events.[4]

3. This does not mean that such gains should not be disclosed. Indeed, if material, they should be disclosed provided that they meet the characteristics of useful information discussed under the quality of information concepts in this statement.

4. See footnote number 3.

9) Loss contingencies should be recognized if available information indicates that it is probable that one or more future events will occur confirming that an asset had been impaired or a liability had been incurred and the amount of the loss can be reasonably estimated.[5]
(para 282)

B) RECOGNITION OF INTERNAL EVENTS

Internal events refer to happenings that occur within an entity which affect its assets. Internal events encompass all the activities involved in the process of combining and transforming assets and other resources into products (goods or services). Internal events are intended to add utility to assets, that is, existing assets are combined and transformed into products that are intended to have more value than the original assets used. Utility added to assets by internal events should not be recognized until it is confirmed by later exchanges. However, changes in assets caused by internal events should be recognized when they occur. Changes in assets caused by internal events should be recognized by regrouping the recorded amounts for those assets to reflect the status of their transformation into products or services.
(para 283)

3.3.7 THE MEASUREMENT BASIS CONCEPT

The measurement basis concept is concerned with the determination of the monetary effects of recognizable external and internal events. It defines the basis for determining the amounts that should be recorded and reported as a result of recognizable external and internal events. Because the assets and liabilities and changes in them are inseparably connected, measuring the assets and liabilities and measuring changes in them are two aspects of the same problem. Accordingly, the measurement basis concept is stated in terms of the measurement of assets and liabilities. But, it is also applicable to changes in assets or liabilities whether those changes are classified as revenues, expenses, gains, losses or other changes in the entity's financial position.
(para 284)

Assets and liabilities are either monetary or nonmonetary. A monetary asset is money or a claim to receive a sum of money the amount of which is fixed or determinable without reference to future specific prices of specific goods or services. A monetary liability is an obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. Monetary assets include cash, trade debtors, notes and other debt securities owned. Monetary liabilities will require the conveyance of monetary assets, usually cash. All assets and liabilities that are not monetary are nonmonetary. Obligations calling for services or goods in quantities that are fixed or determinable without reference to changes in prices; and obligations to pay cash in amounts dependent on future prices of specific goods or services are nonmonetary liabilities. Nonmonetary assets include goods held primarily for sale or assets held primarily for direct use in operations of the entity; shares owned; intangibles; prepayments; and claims to cash in amounts dependent on future prices of specific goods or services.
(para 285)

The monetary-nonmonetary distinction is significant to the external users of the financial statements. Monetary assets and liabilities are directly and more definitely tied to the times and amounts of future cash flows. Nonmonetary assets and liabilities are indirectly and less definitely tied

5. This does not mean that loss contingencies which can not be recognized in accordance with this criteria should not be disclosed.

to the times and amounts of future cash flows. Whereas measurement of monetary assets and liabilities should be geared toward providing indications of their direct cash flow potential, measurement of nonmonetary items should be geared toward providing indications of their indirect cash flow potential.

A) ACQUIRING ASSETS

The basis for measuring and initially recording acquired assets should be their fair value on the date of acquisition, that is, their acquisition cost. Applying this basis to the acquisition of an asset depends on the nature of the transaction:

i) An asset acquired by exchanging cash should be measured and initially recorded at the amount of the cash disbursed;

ii) An asset acquired by exchanging a nonmonetary asset should be measured and initially recorded at the fair value of the nonmonetary asset given up;

iii) An asset acquired by incurring a liability should be measured and initially recorded at the present value of the amount to be paid;

iv) An asset acquired by issuing shares (or equity interests) of the acquiring entity should be measured and initially recorded at the fair value of the asset[6], that is, shares issued (or the increase in owners' equity because of investment by owners) should be measured and recorded at the fair value of the consideration received for the stock;

v) A nonmonetary asset received by the entity in a nonreciprocal transfer from nonowners should be measured and initially recorded at its fair value.
(para 287)

B) MEASUREMENT OF AN ASSET VALUE AFTER ACQUISITION

The nature of an asset, and not the manner of its acquisition, determines the entity's subsequent measurement of its recorded amount. Assets are classified as monetary or nonmonetary.
(para 288)

1. **Measurement of monetary assets after acquisition**

The basis for measuring and reporting recorded monetary assets should be the present value of the amounts expected to be collected. In the case of cash, this should be its face amount. In the case of short-term claims to cash, this should be their face amounts reduced by an estimate of the amounts considered to be uncollectible. In the case of long-term claims to cash, this should be the amounts expected to be collected discounted to the present time based on the cost of money established in the transactions that resulted in the acquisition of those assets.
(para 289)

6. An asset acquired may be entire entity. The acquisition of an entire entity should be differentiated from similar transactions which have the effect of uniting the ownership interests of two entities without disbursing resources of either entity. It should also be differentiated from transfers of net assets and exchanges of shares between entities under common control. These types of transactions are not considered acquisitions. Rather, they are considered changes in the legal forms of the entities involved.

2. Measurement of nonmonetary assets after acquisition

The basis for measuring and reporting recorded nonmonetary assets should be their historical costs after adjustment for decline in their service potential because of use or because of unfavorable circumstances, damage or destruction. This basis of measurement is applicable whether the nonmonetary asset is held for sale in its present form, held for use or held as an investment to yield income and/or appreciation. Historical cost represents, at acquisition date, a minimum judgement by management of the value of the nonmonetary asset's contribution to the entity's future cash flows. Historical cost of a nonmonetary asset, not its current sale price or current replacement cost[7], is the relevant measure of its service potential because the entity's own management—not just other buyers and sellers—participated in the establishment of the price that determined the asset's historical cost.[8] To be sure, external parties might be interested in information about the current sale value or the current replacement cost of the entity's nonmonetary assets. Such an interest does not justify substituting a measurement basis based on prices established by other buyers and sellers for a measurement basis based on prices that the entity had participated in establishing.[9]
(para 290)

3. Asset disposition measured

The basis for measuring and recording disposition of assets should be their acquisition costs as adjusted for amortization and other recognized changes in acquisition costs (the recorded amounts for the assets). Applying this basis to the disposition of an asset does not depend on the nature of the transaction. Accordingly decreases in assets as a result of disposition should be measured by the recorded amounts of the disposed assets whether the disposition is effected through an exchange, a nonreciprocal transfer to owners[10] or to entities other than owners.
(para 291)

7. A current market price may be an exit price or an entry price. Exit prices are prices in the market in which the entity would sell a nonmonetary asset. Entry prices are prices in the market in which the entity would buy a non-monetary asset. A current sale price is a current exit price. Current replacement cost is a current entry price. The entity may or may not be involved in establishing exit and entry prices. The entity was involved in establishing exit and entry prices for the nonmonetary assets it has sold or purchased. Historical cost is an entry price that the entity was involved in establishing on acquisition date. Current replacement costs and current sale prices are entry and exit prices which the entity is not involved in establishing for the nonmonetary assets which it currently holds. These prices represent current judgements by other buyers and sellers of the service potential of nonmonetary assets similar to those that the entity holds. These judgements affect the entity's nonmonetary assets' contribution to its future cash flow if it were to buy or sell nonmonetary assets at those prices.

8. The Saudi Riyal in which historical cost is expressed may have to be adjusted because of significant changes in its purchasing power. Adjusting the Riyals in which the historical cost is expressed does not change the measurement basis of nonmonetary assets. The measurement basis is still historical cost. However, the number of Saudi Riyals representing the historical cost amount is more or less than at date of acquisition because of inflation or deflation.

9. This does not mean that the interest which external parties might have in information about the current sale value or the current replacement cost of nonmonetary assets should be ignored. If such information meets the criteria of useful information set forth under the quality of information concepts, it should be disclosed.

10. The distribution of nonmonetary assets to owners in lieu of cash to satisfy dividend requirements is not a nonreciprocal transfer to owners. The declaration of dividends creates a liability that should be measured on the basis of the amounts to be paid. The creation of the liability for dividends is a nonreciprocal transfer to owners. The distribution of nonmonetary assets in lieu of cash is a settlement of the dividend liability. A gain or loss should be recognized if the recorded amount of the non-monetary asset that will be distributed is different from the amount of the dividend liability.

C) MEASUREMENT OF INCURRING LIABILITIES

The basis for measuring and initially recording incurred liabilities should be the present value of the amounts to be paid. Applying this basis to the incurrence of a liability depends on the nature of the transaction:

i) A liability incurred in exchange for cash should be measured and initially recorded at the amount of cash received;

ii) A liability incurred in exchange for a nonmonetary asset should be measured and initially recorded at the present value of the amounts to be paid or the fair value of the non-monetary asset received whichever is more clearly evident;

iii) A liability incurred as a result of a nonreciprocal transfer to entities other than owners, for example, imposition of taxes or fines, should be measured and initially recorded at the amounts to be paid; and

iv) A liability incurred as a result of a nonreciprocal transfer to owners, for example, dividends payable, should be measured and initially recorded at the amounts to be paid. (para 292)

D) MEASUREMENT OF LIABILITIES AFTER THEY HAVE BEEN INCURRED

The nature of a liability and not the manner in which it had been incurred determines the entity's subsequent measurement of its recorded amounts. Liabilities are classified as either monetary or nonmonetary.
(para 293)

1. **Measurement of monetary liabilities after they have been incurred**

The basis for measuring and reporting recorded monetary liabilities should be the present value of the amounts expected to be paid. In the case of short term liabilities, this should be the face amount of liability, that is, the amounts expected to be paid without discounting. In the case of long-term liabilities, this should be the amounts expected to be paid discounted to the present time based on the cost of money established in the transactions that resulted in the incurrence of those liabilities.
(para 294)

2. **Measurement of nonmonetary liabilities after they have been incurred**

The basis for measuring and reporting recorded nonmonetary liabilities should be the original prices established by the entity in the transactions that resulted in the incurrence of those liabilities.
(para 295)

3. **Settlement of liabilities measured.**

The basis for measuring and recording the settlement of liabilities that is, liability decrease, should be their recorded amounts. Applying this basis to the settlement of a liability does not depend on the nature of the transaction. Accordingly, decreases in

liabilities should be measured by the recorded amounts of the settled liabilities whether the settlement is effected through an exchange, a nonreciprocal transfer to owners or entities other than owners.
(para 296)

E. MEASUREMENT OF THE EFFECT OF INTERNAL EVENTS ON THE RECORDED AMOUNTS OF ASSETS

Internal events transform and combine assets and other resources into an output of product which may be either goods or services. Internal events in this sense are not restricted to manufacturing activities, but include other activities such as merchandising, transportation, warehousing, holding goods or other assets and leasing or rental of owned assets. The output of product resulting from internal events is intended to have added utility. Utility created by internal events should not be measured at the time the internal events occur. Instead, previously recorded amounts of assets (their acquisition or historical cost) that are totally or partially consumed by internal events should be shifted or allocated between asset categories or between activities or periods during which the internal events take place. Therefore, the acquisition or historical cost of assets that are totally or partially consumed by internal events are assembled by products or time intervals, not because, as regrouped, they express new values, but because they express part of the total effort made to bring about revenues, that is, costs of future revenues. Once revenues are recognized the related costs should be matched with those revenues to measure the utility added by internal events represented by those costs. Some costs, like manufacturing overhead which can be traced to a product, should be allocated directly to a product; but other costs, like administrative overhead, which can not be traced to a product, should be allocated only to time periods, that is to say, against total revenues recognized for the period.
(para 297)

3.3.8 THE MATCHING CONCEPT

Matching is the process of recognizing, measuring and relating revenues, expenses, gains and losses of an entity for an accounting period. This is the process through which the entity's net income (net loss) for an accounting period is determined. Net income (net loss) for an accounting period is the residual amount after expenses and losses have been matched with revenues and gains. The matching process should be accomplished by separately recognizing and measuring revenues and gains and separately recognizing and measuring expenses and losses. When these are summarized and the algebraic sum is determined, it represents net income (net loss).
(para 298)

A) REVENUE RECOGNITION

Revenues represent a flow of assets into the entity (or decreases in liabilities) from delivering or producing goods, rendering services, permitting others to use entity's assets or other activities that constitute its primary central ongoing operations. The primary business operations of an entity refer to those activities in which its resources are utilized (for example, the manufacture and sale of a product) in contrast to transactions which may be unavoidable but which, nevertheless, are only incidental to the primary function of the entity (for example, the disposal of a piece of equipment). Primary business operations are characterized by their repetitive nature in contrast to those activities which occur infrequently and are considered to be nonrecurring or peripheral.
(para 299)

Revenue recognition is concerned with selecting the point of time at which revenues are to be recognized. It is generally acknowledged that revenues are earned gradually and continuously by the entire process of business activity, not just at a single point of time such as the moment of sale or the accomplishment of delivery to a customer. It is also generally acknowledged that as a practical matter the amount of revenues earned by the entire process of business activity may not be determinable until that process is terminated by a sale or delivery. Accordingly, revenue should be recognized at a specific point in the earning process. Since revenues represent increases in assets or decreases in liabilities, the point in time at which revenues are recognized is also the point in time at which the related increases in assets or decreases in liabilities should be recognized. Therefore, revenues should be recognized when two conditions are met:
(para 300)

i) The earnings process is complete or virtually complete; and

ii) An exchange has taken place.

Clearly the earnings of revenues is the most important single factor in the recognition of revenues. There is no set of circumstances in which the recognition of revenues before they have been earned would be acceptable. For example, payments are sometimes received in advance—as in the case of payments for professional services in advance. Such advance collections should not be recognized as revenues, however, until they have been earned by rendering the services. The exchange required as a second condition for revenue recognition determines the time at which to recognize revenue. Accordingly, revenues should be recorded when products are sold, services are provided or entity's assets are used by others.
(para 301)

B) MEASUREMENT OF REVENUES

Revenues should be measured at the price established in the exchanges, that is, by the amount of the increase in the entity's assets or decrease in its liabilities resulting from delivering products, providing services, or allowing others to use assets without consideration of any simultaneously related reductions in assets or increases in liabilities. For example, when sales are made on account, the amount of revenues should be measured by the amount of the increase in accounts receivable, which should equal the prices established in the sale transaction. The reduction in the amount of inventory and other past, present and future costs attributable to the sales transactions should not enter into the revenue measurement.
(para 302)

C) EXPENSE RECOGNITION

Expenses reflect the flow of assets (represented by their acquisition or historical costs) out of the entity as a result of the expiration of resources utilized in the creation of revenues. If the economic services embodied in a group of assets are invested in another group of assets; there has been no expiration; there has merely been a transformation in the form in which those economic services are stored for future benefit. Hence, the creation of a product by the utilization of materials, labor and facilities does not constitute an expiration of resources; it is a transformation into a new form represented by that product. When the product is sold, its usefulness to the entity will indeed have expired. At that time, an expense is incurred.
(para 303)

Expense recognition is concerned with selecting the point of time at which expenses should be recognized. Expenses should be identified either with specific revenues or with specific periods of time. The recognition of revenues, therefore, dictates that certain expenses closely associated with those revenues be recognized at the same time. Obvious examples are the cost of goods sold and salesmen's commission. These should be recognized as expenses at the same time that the sales are recognized as revenues. Other expenses have no direct relationship to revenues but do have a direct relationship to the period during which revenues are recognized. The trading establishment building in which sales are made does not depreciate with each individual sale, but it does depreciate over the period of time during which sales are made. The wages of supervisory personnel do not increase with each individual sale, but they may be directly identified with periods of time during which sales revenues are created. Expenses that have no direct relationship to revenues but do have a direct relationship to the periods during which revenues are recognized fall, therefore, in two categories:
(para 304)

i) Those that represent allocation of the acquisition or historical cost of assets that benefit more than one period; and

ii) Those that represent costs incurred during the period to obtain benefits that are exhausted in the same period.

When more than one period receive benefits from a single asset, expense recognition should be based on an allocation of the acquisition or historical cost of that asset to the periods benefited. Estimates will often be necessary in allocating the costs of such assets to the periods benefited. When costs are incurred during the period to obtain benefits that are exhausted in the same period, the cost should be recognized as an expense immediately.

To summarize, expenses should be recognized based on one of these criteria:
(para 305)

i) Direct association with revenues recognized during the period; or

ii) Allocation of cost between periods benefited; or

iii) Immediate recognition.

EXPENSE MEASUREMENT

Expenses should be measured by the amount of the decrease in assets or the increase in liabilities resulting from the rendering of goods or service or from permitting others to use the entity's assets without consideration of the revenues which occur simultaneously. For example, if the creation of revenues is culminated in the form of sales made on account, expenses are measured by the amount of decreases in inventory, cash and other assets and the amount of increases in wages payable and other liabilities attributable to the sales transactions. The concurrent increase in trade accounts receivable does not enter into the measurement of expenses.
(para 306)

The measurement basis for expenses which are recognized by direct association with revenues recognized during the period should be the acquisition or historical cost of the assets whose cost is

being allocated to the periods benefited. The measurement basis for expenses recognized based on immediate recognition should be the acquisition prices of the benefits acquired.
(para 307)

E) GAINS AND LOSSES

Gains are any increases in net assets other than those resulting from the entity's primary operations and those resulting from additional investments by owners or capital contributions to net assets from nonequity sources. The recognition criteria set forth under the recognition concept limit recognizable gains to those that result from events that involve transfer of assets or liabilities. Accordingly, gains should be recognized only when the transfer of assets or liabilities takes place. Recognizable gains may result from an exchange. Examples of such gains are the sale of fixed assets at an amount in excess of their unexpired historical costs and the settlement of liabilities for a consideration less than the amount at which such liabilities are recorded in the accounts of the entity. Recognizable gains may also result from nonreciprocal transfers with entities other than owners. Examples of such gains are the forgiveness of liabilities owed.
(para 308)

Losses are any decreases in net assets other than those resulting from distribution to owners or those resulting from the creation of revenues. The recognition criteria set forth under the recognition concept limit recognizable losses to those that result from:
(para 309)

i) Exchanges—such losses should be recognized when the exchanges have taken place;

ii) Nonreciprocal transfers—such losses should be recognized when the transfers have taken place;

iii) Theft or damage to the entity's assets by others—such losses should be recognized when discovered;

iv) Casualties—such losses should be recognized when the casualty occurs or is discovered;

v) Unfavorable circumstances which have a current effect on the entity—such losses should be recognized when the unfavorable circumstances indicate that the recorded amounts for the affected assets are permanently impaired; and

vi) Probable loss contingencies—such losses should be recognized when available information indicates that one or more future events are likely to occur confirming the loss or impairment of an asset or the incurrence of a liability provided that the amount of loss can be reasonably estimated.

3.4 THE QUALITY OF ACCOUNTING CONCEPTS

3.4.1 INTRODUCTION

The quality of information concepts define the characteristics or the criteria of useful accounting information. These characteristics or criteria should assist those responsible for establishing accounting standards, as well as, those responsible for the preparation of financial statements in evaluating

financial information produced by alternative accounting methods and in differentiating between necessary and unnecessary disclosures. The usefulness of financial information must be evaluated in relation to the objectives of presenting financial statements which are focussed on helping current and prospective equity investors, lenders and others make decisions involving the entity.
(para 310)

The decision making objective of presenting financial statements leads to the overriding criterion by which alternative accounting methods or disclosure choices can be evaluated. Given a choice from among alternative accounting methods or given a number of disclosure choices, the method that should be chosen or the disclosure that should be made is the one that produces the information that is most useful for decision making by current and prospective equity investors, lenders and others who have similar information needs.
(para 311)

To say that a choice from among alternative accounting methods or disclosure alternatives should be based on the usefulness of the resulting information for decision making is not sufficient guidance to those who have to make the choice. The specific characteristics that would make the information useful for decision making need to be discerned and defined. These characteristics are:

A) Relevance
B) Reliability
C) Neutrality
D) Comparability
E) Timeliness
F) Understandability
G) Materiality
H) Optimal disclosure

3.4.2 RELEVANCE

Relevance refers to the existence of the close relationship between the financial accounting information and the purposes for which this information is prepared.

To be useful, financial accounting information should be relevant to one or more decisions of users of that information. On this basis, one can give a specific meaning of relevant financial accounting information.
(para 313)

INFORMATION WHICH MEETS THE OTHER CRITERIA OF USEFUL INFORMATION IS RELEVANT TO A DECISION IF IT HELPS THE DECISION MAKER EVALUATE AN OUTCOME FROM ONE OF THE COURSES OF ACTION UNDER CONSIDERATION.

Current and prospective equity investors and lenders have many courses of action under consideration. Some of these courses of action involve a particular entity but others do not. Obviously financial accounting information can only be relevant to evaluating an outcome of a course of action that involves the entity about which the information is presented. Financial accounting information of a particular entity can not and should not be expected to be relevant to evaluating an outcome of the course of action that does not involve that entity. For example, the financial statements of the entity in which an investor has an equity interest can not be expected to provide him with information about the outcome from the immediate sale of his interest—a quotation from a willing buyer is needed for that—or information about the outcome from investing elsewhere—the financial statements of

other entities should be looked to for this. For this reason, the STATEMENT OF OBJECTIVES OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES concludes that the role of the financial statements of a particular entity in the evaluation of outcomes of different courses of action under consideration by current and prospective equity investors and lenders must be related to the evaluation of the outcome from holding an equity interest or a loan position in the entity, (see discussion and analysis noted before). On this basis one can give a more specific meaning of relevant financial accounting information:
(para 314)

INFORMATION ABOUT A PARTICULAR ENTITY WHICH MEETS THE OTHER CRITERIA OF USEFUL INFORMATION IS RELEVANT IF IT HELPS CURRENT AND PROSPECTIVE EQUITY INVESTORS AND LENDERS EVALUATE THE OUTCOME FROM HOLDING AN EQUITY INTEREST OR A LOAN POSITION IN THAT ENTITY.
(para 315)

3.4.3 RELIABILITY

Users of financial accounting information prefer that such information has a high degree of reliability. Reliability is the characteristic which permits users to depend upon information with confidence. Reliable financial accounting information reflects two qualities as follows:
(para 316)

i) The information is an accurate representation of what it purports to represent.

That is, there is close "correspondence" between such information and reality. Appraising a measurement method in terms of this quality, that is, the degree to which information produced by the method corresponds with reality, can not be done in general. Specific circumstance must be known before one can say whether a given measurement method can be considered sufficiently reliable in the case at hand. Reliability in this sense does not imply precision of the information in the financial statements because financial accounting involves approximation and judgement. Rather, it means that based on all the specific circumstances surrounding a particular transaction or event, the method chosen to measure and/or disclose its effects produces information that reflects the substance of the event or transaction.
(para 317)

ii) The information is verifiable

Verifiable financial accounting information provides results that can be substantially duplicated by independent measures using the same measurement and/or disclosure methods. To "verify" financial accounting information means to substantiate the information. This implies that the person verifying the information will, among other things, reapply the same measurement and/or disclosure methods that were used by the person who prepared the information and reaches substantially the same conclusion. Measurement and disclosure, however, can not be completely objective. The process of measuring and disclosing financial information can never become completely scientific, because its factual materials can never be determined with complete and conclusive objectivity. Business does not lend itself to laboratory analysis and its activities do not follow mathematical formulae. Hence, accounting information is not always conclusively objective or completely verifiable. Nevertheless, the usefulness of accounting information is enhanced if it is verifiable, that is, if the measurement and/or disclosure methods used provide results that can be substantially corroborated by independent measurers.
(para 318)

To summarize, reliability means that the measurement and/or disclosure methods selected to produce and present the information are appropriate to the specific circumstances and have been applied in a manner that can be substantially replicated by independent measurers. As a result, the information presented is an accurate representation of the underlying events and does not contain material errors or distortions. There is another aspect to reliability, that is, neutrality or freedom from bias. However, because of its importance it is discussed as a separate characteristic of useful financial accounting information.
(para 319)

3.4.4 NEUTRALITY

Neutrality is meant as a positive term for the absence of bias. It clearly overlaps reliability because biased information is unreliable. Neutral financial accounting information is directed toward the common needs of external users and is independent of presumptions about particular needs of specific users of the information. Neutral financial accounting information is evenhanded information and, therefore, is free from bias towards predetermined results.

Neutrality imposes on those who establish accounting standards or those who prepare financial statements a responsibility to make evenhanded choices among alternative measurement and/or disclosure methods motivated only by the relevance and reliability of the chosen methods without regard to predetermined results. It also imposes on those who prepare financial statements to apply measurement methods which require estimates in an evenhanded manner.
Neutrality, therefore, requires that:
(para 320)

i) Choice from among alternative measurement and/or disclosure methods is based only on assessment of the relevance and reliability of the information produced by the alternative methods; and

ii) In applying measurement and/or disclosure methods which require estimates, management will not deliberately understate or overstate the required estimates in order to achieve certain predetermined results.
(para 321)

3.4.5 COMPARABILITY

Comparable financial accounting information allows external users to identify real similarities and differences in the business entity's performance in relation to the performance of other entities for the same period or in relation to its own performance in prior years. Real similarities and differences result from similarities and differences of the events and circumstances affecting different entities or those affecting the same entity over time. Real similarities and differences do not result from similarities and differences of the measurement and/or disclosure methods. The usefulness of financial accounting information is, therefore, enhanced by the choice and application of similar measurement and/or disclosure methods to similar events (but not, of course, by treating significantly different events as if they were similar). While there is some overlap between comparability, reliability and relevance, the many aspects of comparability are so important in providing useful financial accounting information to external users that a separate consideration seems to be warranted. There are two aspects of comparability that are significant to the usefulness of financial accounting information. These are:

i) Interperiod comparability of financial accounting information relating to the same entity, that is, consistency. Interperiod comparability exists when the following conditions are met:

1) Intraline comparability, that is, the several items which are aggregated for presentation as one amount should be comparable and the same items should be aggregated as one amount from one period to another;

2) Monetary unit comparability, that is, the monetary units reported in any one articulated set of financial statements for a given period should be substantially identical to those reported in a set of financial statements for another period. This suggests that when significant changes in the purchasing power of the Saudi Riyal occurs, the monetary units reported on financial statements of different periods for the same entity should be adjusted before effective comparison between periods can be achieved;

3) Formal comparability, that is, the presentations from one period to another are in the same form;

4) Comparability of the lengths of the reporting periods, regular reporting periods for any one entity facilitate comparisons over time provided that the reporting periods are of equal length;

5) Management and disclosure method comparability, that is the accounting methods used are not changed from one period to another or, if they are changed, the effects of the changes are disclosed; and

6) Dislosure of changes in circumstances or in the nature of the underlying events between periods.
(para 323)

ii) Interentity comparability, that is comparability between entities, especially between entities within the same line of business. Comparability between entities requires that the following conditions are met:

1) The six conditions required for interperiod comparability;

2) Eliminations of alternative measurement and disclosure methods that can be used to measure and disclose the effects of events that are similar in substance; and

3) Disclosure of measurement and disclosure methods used by different entities.

3.4.6 TIMELINESS

Financial accounting information should be available to external parties when it is needed. If information is not available when it is needed or becomes available so long after the reported events that it has no impact on future action, the information loses its usefulness. Timeliness alone can not make the information useful but a lack of timeliness reduces or eliminates the usefulness the information might have had. There are two aspects of timeliness:
(para 324)

A) Frequency of reporting, that is, the length of the shortest reporting period. It is possible to report too frequently or too infrequently. If the reporting period is too short, the Statement of Income may be too heavily influenced by random or seasonal variations in the entity's activities, with the result that the information is misleading or at least not worth the user's time. But if the reporting period is too long, the user is required to wait too long before obtaining and using the information included in the financial statements. By then it might be too late for the information to make a difference in the user's assessments of the outcome of different courses of action under consideration.

B) The lag between the end of the reporting period and the date the financial statements are issued. A long lag between the end of the reporting period and the date the financial statements are issued reduces the usefulness of the information.
(para 325)

Optimal frequency and minimal lag are, therefore, important criteria of useful accounting information. They apply primarily to the reporting function rather than to the accumulation and measurement of financial accounting data.
(para 326)

3.4.7 UNDERSTANDABILITY

Information can not be useful to external users who can not understand it. Understandability depends on the extent and nature of the data contained in the financial statements, the way the data is presented as well as the background and abilities of external users. Accordingly, the strengths and limitations of financial statement readers should not be overlooked by those who establish financial accounting standards and those who prepare financial statements if there is serious interest in communicating with external users.
(para 327)

This characteristic of useful accounting information requires careful attention by those who establish financial accounting standards as well as by those who prepare financial statements. Those who establish financial accounting standards need to always keep in mind that standards are not established for the benefit of those who prepare financial statements. Rather, standards are established for the benefit of those who need to rely on the financial statement to revaluate the outcome of alternative courses of action under consideration. Accordingly, the strengths and limitations of financial statement readers should be as important a consideration as anything else when establishing standards. Those who prepare financial statements need to always keep in mind that the statements are not prepared for the benefit of other accountants. Rather, they are prepared for the benefit of external users who have limited, if any, knowledge of financial accounting.
(para 328)

Accordingly, the strengths and limitations of those users should be kept in mind when designing financial statements and writing the notes accompanying them. The use of classifications that are meaningful to the users (not just to the accountant), information headings, juxtaposition of related data and presentations of net figures which the users typically want to know, contribute to the understandability of financial accounting information.

3.4.8 MATERIALITY AND OPTIMAL DISCLOSURE

Those two concepts are interrelated and relate also to the concepts of relevance and reliability. Materiality and optimal disclosure are interrelated because if the information is material it should be disclosed and at the same time, information that is not disclosed is presumed to be immaterial. (para 329)

Materiality and optimal disclosure relate to relevance because irrelevant information is considered immaterial and, therefore, should not be disclosed.
(para 330)

Materiality and optimal disclosure also relate to reliability because to be reliable the financial statements should, among other things disclose all material relevant information. Financial accounting as a process of measurement and communication, frequently involves judgements. In making these judgements, considerations of materiality play an essential part. Materiality in financial accounting is a state of relative importance. Importance may depend on quantitative or qualitative characteristics or a combination of both. In general, an item must be regarded as material if its omission, non-disclosure or misstatement would result in distortion of the information being presented in the financial statements, and thereby influence users of the statements when making evaluations or decisions.

Materiality calls for consideration as to who are or are likely to be the users of the particular financial statements, and as to the information needs of those users.The Statement of Objectives of Financial Statements defines the primary users as well as their information needs. In this context, an item should be considered material if its omission, nondisclosure or misstatement would result in distortion of the information being presented in financial statements and thereby influence current or prospective equity investors' or lenders' assessment of the outcome from holding an equity interest or a loan position in the business enterprise; or influence current equity investors' evaluation of management performance. In deciding whether an item is material, its nature and its amount should both be taken into account. Ordinarily, the nature and the amount of an item should be evaluated together, although in particular circumstances, either alone may have to be recognized as the decisive factor. Characteristics of an item having primarily qualitative significance, that is, characteristics related to the nature of the item, are:
(para 331)

i) The inherent importance of the transaction, event or circumstances that the item reflects (unusual, unexpected, improper, in violation of contract or statute; and
(para 332)

ii) The inherent importance of the item as an indicator of the probable course of future events (new activities, major changes in old ones or suggestive of changes in business practice or activities).

Characteristics of an item having primarily quantitative significance, that is, the amount of an item and its magnitude, are:
(para 333)

i) The magnitude of the item (smaller or larger) relative to normal expectations;

ii) The magnitude of the item relative to an appropriate base (for example, Statement of Income items in relation to operating income for the current year or the average operating income for the last five years, including the current year; or Statement of Financial Position items in relation to owners' equity or in relation to the appropriate statement grouping such as current assets, noncurrent assets, current liabilities, noncurrent liabilities).

Optimal disclosure contributes to the usefulness of financial accounting information. The financial statements should disclose that which is necessary to make them not misleading but the disclosure should stress the matters which should be stressed (relevant and material matters).
(para 334)

There are two aspects of optimal disclosure: optimal aggregation and optimal written descriptions and explanations. With respect to optimal aggregation, the financial statements should provide sufficient details to meet the users' need for information about various categories of assets, liabilities, owners' equity, revenues, expenses, gains, losses, sources and application of funds. Too much details, however, can contribute to confusion, especially if the user is required to study many lines of data that are not helpful in order to find the few that are needed. Furthermore, as excessive detail can cause the user to overlook the significant data, immaterial items should not be separately stated.
(para 335)

With respect to optimal written descriptions and explanations, the headings, captions and amounts must be supplemented by enough additional descriptions and explanations so that their meaning is clear but not by so much information that important matters are buried in a mass of trivia. Notes accompanying the financial statements are always necessary to explain the approach taken by management or the limitations of the statements. Such notes may be either too long or too skimpy for optimal disclosure, depending partly on the background of the primary users of the financial statements.
(para 336)

Whatever the circumstances, those who establish financial accounting standards and those who prepare financial statements must aim at optimal disclosure as a significant step towards providing useful information.
(Next paragraph is No. 578)

THE GENERAL PRESENTATION AND DISCLOSURE STANDARD
TABLE OF CONTENTS

1. INTRODUCTION

This Standard sets forth the general presentation and disclosure requirements of financial statements including consolidated and development stage company financial statements. It also prescribes the accounting treatment for accounting changes and contingencies. Finally, it prescribes the requirements with respect to the disclosure of the identity of the reporting entity, nature of its business, identity of its financial statements, its accounting policies, accounting changes, contingencies, commitments and subsequent events.
(para 578)*

The standard has been divided into four primary branches: the first one is devoted to the general presentation, the second one is concerned with the general disclosure, while the third branch is designed for the general presentation and disclosure requirements of consolidated financial statements and finally the fourth one is concerned with the general presentation and disclosure requirements of development stage business enterprises.
(para 579)

It should be noted that the standard should be studied in the light of the explanatory foreword and the proposed statement of the objectives of financial accounting in the Kingdom of Saudi Arabia and also the proposed Statement of the Concepts of Financial Accounting.
(para 580)

2. SCOPE OF THE STANDARD

This standard is applicable to the financial statements of business enterprises regardless of the legal form of the reporting entity or the nature of its business activities. In addition, the standard encompasses specific materiality considerations which should be taken into account when determining whether the items or components or groups should be disclosed in the same financial statements. These considerations are not applicable to the other subjects of the standards of general presentation and disclosure.
(para 581)

3. TEXT OF THE STANDARD

Following is the text of the general presentation and disclosure requirements:

3.1 GENERAL PRESENTATION

The standard of general presentation sets forth the presentation requirements of combined and individual financial statements. Following is a detailed description of these requirements:
(para 582)

* The paragraphs are the same as in the analytical study for easy reference.The numbers of the above paragraphs are mentioned in the preface of the analytical study.

3.1.1 GENERAL REQUIREMENTS

A) COMPLETE SET OF FINANCIAL STATEMENTS

A complete set of financial statements is composed of the following:

- Statement of Financial Position
- Statement of Income (Loss)
- Statement of Changes in Owners' Equity or alternatively, a Statement of Retained Earnings and disclosure of changes in other categories of owners' equity.
- Statement of Sources and Applications of Funds.

These statements and related notes is the minimum presentation required to present the financial position, results of operations and sources and applications of funds.
(para 583)

B) ORDER OF PRESENTATION OF FINANCIAL STATEMENTS

The financial statements should be presented in the following sequence:

- The Statement of Financial Position
- The Statement of Income (Loss)
- The Statement of Retained Earnings (Accumulated Deficit)
  or
  The Statement of Changes in Owners' Equity
- The Statement of Sources and Applications of Funds
- Notes to the Financial Statements

(para 584)

C) MATERIALITY CONSIDERATIONS

An item should be considered material if its omission, nondisclosure or misstatement would result in distortion of, or some other short-coming in the information being presented in the financial statements, and thereby influence users of the statements when making evaluations or decisions. In deciding whether an item is material, its nature and its amount should both be taken into account. Ordinarily, the nature and the amount of an item should be evaluated together, although in particular circumstances either alone may have to be recognized as the decisive factor.
(para 585)

When considering the type of the item or class or component for the purpose of determining whether it should be disclosed as a separate item or class or component in the financial statements or in the related notes, the following considerations should be taken into account.

1) The nature of the item or the component or class (for example: cash, inventory, accounts receivable, notes receivable, investments by equity owners, distributed dividends, sales, real estate investment revenue, revenue from investments in other companies, gains on sale of fixed assets, losses, salaries, wages, advertisement expenses, leases, cost of goods sold, etc.)

2) Bases of accounting measurement or conditions of accounting recognition of the item or component or class (for example: the expected realizable value, the historical cost after depreciation, first in first out, the moving average, date of the exchange transaction which has resulted in revenue, etc.)

3) Degree of reliability in the accounting measurement (for example, estimated liabilities, unestimated liabilities, estimated revenue, unestimated revenue, estimated expenses, unestimated expenses, etc.)

4) The ability of management to determine the size of the item or component or class (for example, variable expenses, fixed expenses, semi fixed expenses, expenses which are subject to the estimation of management such as the expenses of researches and advertisement, unexpected expense, etc.)

5) The importance of the item or component or class for the decisions made by users based on the financial statements.
(para 586)

When considering the amount of an item, it should be compared with an appropriate base amount. The following base amounts should be used:

a) Statement of Income items should be compared with the net income for the current year or the average net income for the last five years (including the current year), whichever is the more relevant measure of net income having regard to the trend of the business over that period.

b) Statement of Financial Position should be compared with the lower of:

i) Total owners' equity (net assets); or

ii) The appropriate Balance Sheet class total, for example, current assets, non-current assets, current liabilities, non-current liabilities.

c) Where an item is subject to comparison with the base amounts in both (a) and (b) above, the more stringent test should prevail.

d) Statement of sources and applications of funds items should be compared with the lower of:

i) Net increase or decrease in funds for the period; or

ii) Cash or working capital (depending on the definition of funds) at the end of the period.

The following guidelines should be applied when considering the materiality of the amount of an item:

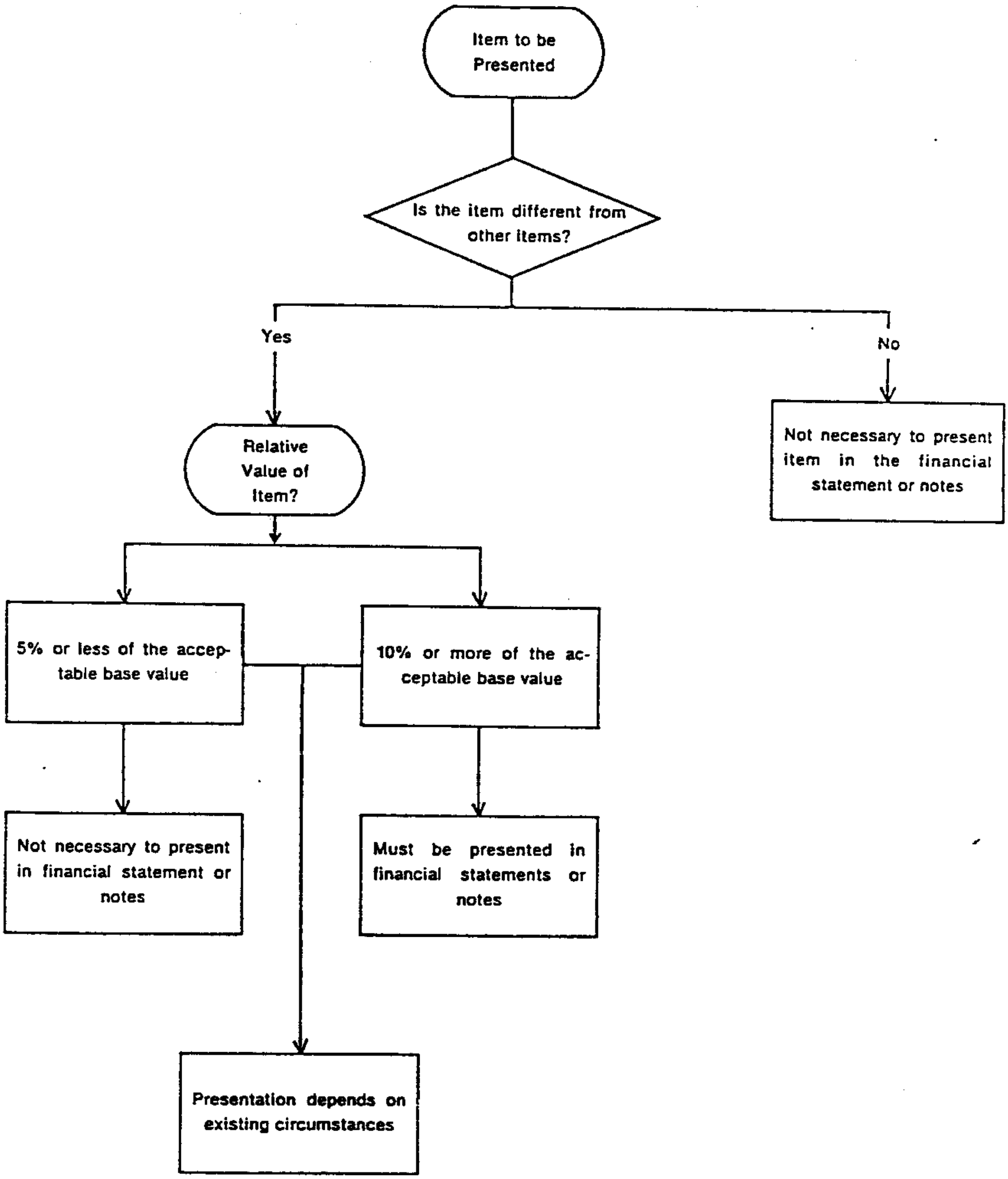
a) An amount which is equal to or greater than 10 per cent of the appropriate base amount, should be presumed to be material unless there is evidence to the contrary.
(para 587)

b) An amount which is equal to or less than 5 per cent of the appropriate base amount, should be presumed to be immaterial unless there is evidence to the contrary..

c) The materiality of an amount which lies between 5 per cent and 10 per cent of the appropriate base amount, is a matter of judgement, depending upon the circumstances.

Although the above guidelines are of necessity somewhat arbitrary, it is considered that their application will help to reduce the possibility of widely divergent judgements when decisions on materiality are made.

The following diagram summarizes the major factors that must be taken into consideration in determining whether it is necessary to present a certain item in the financial statements or the attached notes:
(para 588)


Item to be Presented
Is the item different from other items?
Yes
No
Not necessary to present item in the financial statement or notes
Relative Value of Item?
5% or less of the acceptable base value
10% or more of the acceptable base value
Not necessary to present in financial statement or notes
Must be presented in financial statements or notes
Presentation depends on existing circumstances

D) GENERAL PRINCIPLES FOR THE PRESENTATION IN THE FINANCIAL STATEMENTS:

The following general principles must be taken into consideration with respect to presentation in the Financial Statements:

1) Financial Statements should be prepared in such a form and use such terminology and classification of items that significant information is readily understandable. Items not significant in themselves should be grouped with such other items as most closely approximate their nature. To eliminate unnecessary detail it is preferable to express all amounts in the financial statements to the nearest Riyal or, depending on the magnitude of the amounts involved, to the nearest thousand Riyals.
(para 589)

2) Financial statements are generally more meaningful when they are presented in comparative form with those of the preceding comparable period(s). When comparative statements are presented, the notes to the financial statements should contain information for all the periods presented to the extent currently relevant. If changes have occurred in the manner or on the basis of presenting items from one period to another, such changes should be disclosed and explained in accordance with the requirements of this standard.
(para 590)

3) Each financial statement must be titled descriptively including the name of the reporting entity and its form (joint stock company, limited liability company, partnership, etc.) and the date(s) as of which or the period(s) for which the financial statement is presented.
(para 591)

4) Notes to the financial statements should be captioned, and the captions should adequately describe the matter contained. Notes should be numbered and the financial statements should contain specific references thereto. In addition, each financial statement should include a reference stating that the accompanying notes are an integral part of the financial statements.

3.1.2 GENERAL PRESENTATION REQUIREMENTS OF INDIVIDUAL FINANCIAL STATEMENTS

A) PRESENTATION IN THE STATEMENT OF FINANCIAL POSITION

1. The Statement of Financial Position should include and properly describe all assets, liabilities and classes of owners' equity. Assets and liabilities in the Statement of Financial Position should not be offset unless a legal right of setoff exists.
(para 592)

2. Assets should be presented in the Statement ofFinancial Positionin accordance with the following order:

i) Current assets;
ii) Investments and financial assets;
iii) Fixed assets; and
iv) Intangible assets.
(para 593)

3. Liabilities should be presented in the Statement of Financial Position in the following order:

   i) Current liabilities; and
   ii) Noncurrent liabilities.
   (para 594)

4. Owners' equity should be presented in the Statement of Financial Position in the following order:

   i) Paid-in capital;

   ii) Donated capital;

   iii) Reserves and/or appropriated retained earnings; and

   iv) Unappropriated retained earnings.
   (para 595)

5. Assets and liabilities should be classified into current and noncurrent.[2] Current assets should include cash and those assets ordinarily realizable in cash or sold or consumed within one year from the date of the Statement of Financial Position[3] or during the course of operations cycle whichever is longer.
(para 596)

6. Current assets should be segregated as between the main classes based on their nature in the Statement of Financial Position, e.g. cash, temporary investments, accounts and notes receivable, inventories and prepaid expenses. Material items within each class should be segregated as between monetary and nonmonetary on the face of the Statement of Financial Position or in the related notes. In addition, material items within a class that are subject to different measurement basis should be segregated.
(para 597)

7. The total of the current assets should be shown on the face of the Statement of Financial Position.
(para 598)

8. Noncurrent assets should be displayed on the face of the Statement of Financial Position based on their general nature under the following captions: fixed assets; investments and financial assets; intangible assets.
(para 599)

9. Noncurrent assets displayed under each caption should be segregated as between the main classes based on their specific nature, e.g., land, buildings, office furniture and

2. For certain types of business (e.g., leasing, banking, real estate, finance, building operations, warehouses and companies in the development stage), the current classifications may be of little significance, and may not be practically determinable. In those cases an unclassified Statement of Financial Position should be presented.

3. Even though not actually set aside in special accounts, funds that are clearly to be used in the future for the liquidation of long-term debt or for similar purposes should also be excluded from current assets. However, where such funds are considered to offset maturing debt which has properly been classified as a current liability, they should be included within the current asset classification.

equipment under the fixed asset caption. Within each class, material monetary assets should be segregated from nonmonetary assets[4] and assets subject to different measurement bases. Segregation between the items of noncurrent assets displayed under each separate caption is made either on the face of the Statement of Financial Position or in the related notes.
(para 600)

10. Asset valuation allowances (e.g., accumulated depreciation) should be deducted from the assets to which they relate.
(para 601)

11. Current liabilities should include amounts payable within one year from the date of the Statement of Financial Position or during the operating cycle, whichever is longer.
(para 602)

12. Obligations, otherwise classified as current liabilities, should be excluded from the current liability classification to the extent that contractual arrangements have been made for settlement from other than current assets before the issuance of financial statements. Examples would be: (a) a maturing short-term loan where contractual arrangements have been made for long-term refinancing and (b) trade accounts where contractual arrangements have been made for settlement by the issue of share capital.
(para 603)

13. Current liabilities should be segregated as between the main classes, on the face of the Statement of Financial Position under separate captions according to their type e.g., bank loans, suppliers and accrued expenses, loans payable, dividends payable, deferred revenues and current payments on long term debt.
(para 604)

14. The total of the current liabilities should be shown on the face of the Statement of Financial Position.
(para 605)

15. Noncurrent liabilities should be segregated as between the main classes, e.g., long term debt and other noncurrent liabilities.
(para 606)

16. Amounts owing on loans from directors, officers and shareholders or owners, amounts owing to subsidiaries not consolidated, whether on account of a loan or otherwise, and amounts owing to parent and other affiliated companies, whether on account of a loan or otherwise, should be shown separately on the face of the Statement of Financial Position or in the related notes.
(para 607)

17. The liabilities that are secured by a mortgage should be stated separately on the face of the Statement of Financial Position or in the related notes and the assets used as a mortgage or security for these liabilities should be disclosed.
(para 608)

4. See definition of monetary and nonmonetary assets, in the Statement of "Concepts of Financial Accounting".

18. Owners' equity (net assets) should be segregated as between the following main classes:

i) Paid-in capital (e.g. capital stock in the case of a joint stock company) should include investments by owners for which equity interests have been granted by the reporting entity and are outstanding. Items included in this class of owners' equity should be displayed separately based on the different rights associated with different equity interests.

ii) Donated capital should include capital contributions received by the reporting entity from nonequity sources.

iii) Reserves and/or appropriated retained earnings should include accumulated earnings of the reporting entity that have been set aside because of the requirements of the company law or otherwise. Items included in this class of owners' equity should be displayed separately based on the reasons for the reserve or the appropriation of retained earnings.

iv) Unappropriated retained earnings should include accumulated retained earnings of the reporting entity that are available without any restriction for distribution to its owners.
(para 609)

B) PRESENTATION IN THE STATEMENT OF INCOME

1) The results of operations of the reporting entity should be presented in the Statement of Income in a multi-step format showing appropriate intermediate components of net income. Specifically, the Statement of Income should display the following separate components of net income where applicable:

i) The results of continuing operations;

ii) The results of discontinued operations including any related gain or loss from the disposal of a segment of a business; and

iii) Extraordinary items, that is, gains or losses resulting from casualties and/or involuntary expiration of usage period of assets for reasons not related to operations.
(para 610)

2) The results of continuing operations should separately display the following:

i) The results of the ongoing major operations of the reporting entity for which financial statements are prepared; and, where applicable;

ii) The results of the peripheral or incidental transactions of the entity with other entities and other events and circumstances affecting it other than:

1. Results of discontinued operations, and.
2. Extraordinary gains and losses.

The ongoing major operations of the reporting entity refer to its main line(s) of business that is (are) the major source(s) of its revenues as opposed to its peripheral or incidental transactions with other entities and other events and circumstances affecting it. Ex-

amples of the results of peripheral transactions with other entities that should be displayed separately as part of the results of continuing operations are: income from rental operation of a steel manufacturer and dividends received on shares owned by a dairy producer. Examples of the results of incidental transactions with other entities that should be displayed separately as part of the results of continuing operations are: gains (losses) on sale of assets not held for sale in the normal course of business and revenues from the sale of by-products (e.g., sale of animal feed by a dairy producer and sale of scrap material by a construction contractor). Examples of the results of other events and circumstances[5] that relate to the operations of the reporting entity and, therefore, should be displayed separately as part of the results of continuing operations are: loss due to the impairment of value of inventories; fines imposed by the government because of delay in the completion of a project; a loss due to a judgement against the entity because of breach of an agreement with a customer or supplier and a loss contingency[6] resulting from an unsettled claim regarding product liability.
(para 611)

3) The results of operations of a discontinued segment of a business should be displayed separately on the face of the Statement of Income and any recognizable gain or loss from the disposal of a segment of a business should be reported in conjunction with the related results of discontinued operations. For purpose of applying this standard, a segment of a business is defined as a component of the reporting entity whose activities represent a separate major line of business. A segment may be in the form of a subsidiary, a division, or a department or in some cases a joint venture or other nonsubsidy investee, provided that its assets, results of operations, and activities can be clearly distinguished,physically and operationally and for financial reporting purposes, from the other assets, results of operations, and activities of the entity. A segment of a business should be considered discontinued, for purpose of presentation of the results of operations, when it has been sold, abandoned, spun off, or otherwise disposed of, or when it is still operating but is the subject of a formal plan to dispose of it.
(para 612)

4) Extraordinary items refer to material gains or losses due to casualties and involuntary expiration of assets that is not related to operations and do not represent the disposal of a segment of a business. Extraordinary items should be displayed as a separate component of net income on the face of the Statement of Income following the display of the results of continuing operations and, where applicable, the results of discontinued operations.

Casualties refer to sudden, unanticipated expirations of the entity's assets not caused by the other entities. Examples are fires, floods, earthquakes and other similar events usually termed acts of God.

An involuntary expiration of assets that is not related to operations is the sudden, unanticipated damage, destruction or disappearance of assets caused by other entities. Examples are theft and expropriation.
(para 613)

5. Events and circumstances are defined in the proposed Statement of Concepts of Financial Accounting for Business Enterprises.

6. Loss contingency is defined in the proposed Statement of Concepts of Financial Accounting for Business Enterprises.

5) Any governmental operating subsidy should be displayed separately on the face of the Statement of Income following the presentation of the results of operations before the operating subsidy.
(para 614)

6) The following items, where applicable, should be presented separately in the following order on the face of the Statement of Income as part of the results of continuing operations:

i) Net sales (or revenues) from major operations;

ii) Cost of sales (or revenues);

iii) Gross profit (i.e., the difference between net sales and cost of sales);

iv) Operating expenses related to major operations and including selling, general and administrative expenses;

v) Income from major operations (i.e., the difference between gross profit and operating expenses);

vi) individual material elements of other income or gains and losses[7] (or in the aggregate if individual elements are not material) resulting from the peripheral or incidental transactions of the entity and other events and circumstances affecting it other than extraordinary items;

vii) Income (loss) from continuing operations (i.e., the total of all of the above items or components).
(para 615)

7) Income (loss) from continuing operations should be followed, where applicable, by a presentation of discontinued operations in the following manner:

Income from continuing operations		SR xxxx
Discontinued operations (NOTE)		
Income (loss) from operations of discontinued division x	SR xxxx	
Loss on disposal of division x	(xxxx)	xxxx
Income (loss) before extraordinary items		SR xxxx

(para 616)

8) Income (loss) before extraordinary items should be followed, where applicable, by individually material elements of gains or losses from casualties and/or involuntary expirations of assets in the following manner:
(para 617)

Income (loss) before extraordinary items	SR xxxx
Loss from flood (note)	(xxxx)
Net income (net loss)	xxxx

7. If there were no such items this caption should read net income (loss).

9) The last caption on the Statement of Income should always be Net Income (Net Loss) (para 618)

C) PRESENTATION IN THE STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS

1) A Statement of Sources and Applications of Funds must be presented for each period for which a Statement of Income is presented. The statement should portray all aspects of the financial and investing activities during the period.
(para 619)

2) There are a number of changes in the elements of the Statement of Financial Position which cannot be regarded as financing and investing activities and which do not affect the financial resources of the reporting entity. Consequently, these would be excluded from the Statement of Sources and Applications of Funds. Examples are :

a) Transfers to and from reserve accounts. These are internal allocations between accounts;

b) Stock dividends on common shares. A stock dividend on common shares involves an allocation of part of the retained earnings of the reporting entity to the shareholders without any distribution of cash or other assets.
(para 620)

3) Funds should be preferably expressed in terms of cash. However, when current assets and current liabilities are substantially monetary in nature, funds may be expressed in terms of working capital. The definition of funds used as the basis for presenting the sources and applications of funds should be disclosed.
(para 621)

4) Although the types of information which will be included in the statement may vary substantially between different industries and from one period to another, depending on their relative importance, there are certain changes in funds which are of major significance to the users of all financial statements and which should, therefore, be clearly displayed in the Statement of Sources and Applications of Funds in all cases. These are:

a) Funds provided from or used in operations;

b) Outlays for the purchase of non-fund assets[8] (identifying separately such items as investments, fixed assets and intangibles);

c) Proceeds from the sale of non-fund assets (identifying separately such items as investments, fixed assets and intangibles);

d) Issuance or assumption of non-fund debt[9] in exchange for fund assets;

8. The term non-fund assets refers to all assets not included in the definition of funds. For example, when funds are defined in terms of cash, non-fund assets encompass all of the other assets. On the other hand, when funds are defined in terms of working capital non-fund assets would encompass non current assets.

9. The term non-fund debt refers to all liabilities not included in the definition of funds. For example, when funds are defined in terms of cash, non-fund debt would encompass current and non-current liabilities. On the other hand, when funds are defined in terms of working capital, non-fund debt encompasses non-current liabilities.

e) Reduction of non-fund debt by repayment or reclassification;

f) Issuance of capital stock (or equity interests) in exchange for fund assets;

g) Redemption or repurchase of capital stock (or equity interests) in exchange for fund assets;

h) Dividends or other distributions to or on behalf of shareholders or owners in cash or in kind;

i) Dividends paid by subsidiaries to minority interests;

j) Subsidy; and

k) Increase (decrease) in funds during the period.
(para 622)

5) The ability of an enterprise to generate funds from operations of a reporting entity is an important factor in considering its financing and investing activities. Accordingly, funds from operations should be shown as a separate item in the Statement of Sources and Applications of Funds. Since extraordinary items (casualties and involuntary expiration of assets that is not related to operations) are by their nature significantly different from the normal business activities of the reporting entity, they should be excluded from funds from operations, and shown separately, for the same reason as they are presented separately in the Statement of Income
(para 623)

6) The normal business activities of a reporting entity may include sales or other income items in respect of which long-term credit is extended and cost of sales and other expense items in respect of which long-term indebtedness is incurred. Such transactions may be regarded as consisting of two elements: the charge or credit to income, and the related non-fund financing. It, therefore, would be appropriate to reflect the income element in funds from operations and the financing element as a source or an application of funds. It may be desirable to provide separate disclosure of the amount of such items included in funds from operations.
(para 624)

7) Other financing and investing transactions that do not involve cash or other elements of working capital should be displayed as a separate component of the Statement of Sources and Applications of Funds. Examples are, acquisition of non-fund assets by the issuance of capital stock (owners' equity interests) or non-fund debt and the conversion of non-fund debt to preferred or common stock. Each one of these transactions represents investing and financing aspects that do not involve the use of cash or other elements of working capital. Both aspects should be displayed on the face of the Statement of Sources and Applications of Funds under an appropriate caption such as "other investing and financing transactions". The investing and financing aspects of each one of those transactions are closely related and one should be deducted from the other, but both should be individually displayed on the face of the statement to show both the financing and investing aspects.
(para 625)

8) Prior period adjustments do not involve financing and investing activities in the current period since they relate to the economic activity of previous periods. Comparative Statements of Sources and Applications of Funds should be restated to show the appropriate financing and investing activity for all periods presented.
(para 626)

D) PRESENTATION OF CHANGES IN OWNERS' EQUITY

Changes in owners' equity in most circumstances will be presented adequately in a Statement of Retained Earnings and disclosures in the Notes to the Financial Statements as necessary However, When transactions affecting owner's equity accounts are unusual or complex, a Statement of Changes in Owners' Equity may be used to set forth fully the changes for the period in all accounts included in the equity section of the Statement of Financial Position. In all cases, changes in owners' equity should be reported either in Statement of Retained Earnings and in notes or in a Statement of Changes in Owners' Equity as appropriate.
(para 627)

E) PRESENTATION IN THE STATEMENT OF RETAINED EARNINGS

1. The Statement of Retained Earnings should separately report the changes in appropriated (reserved) and unappropriated retained earnings during the period.

2. The Statement of Retained Earnings should separately display the beginning balances of appropriated (e.g., the balances of legal, general and other reserves) and unappropriated retained earnings before and after any prior period adjustments.

3. Additions to and deductions from the beginning balances of appropriated and unapropriated retained earnings during the period should be separately displayed on the face of the Statement of Retained Earnings together with a description of the nature of the addition or deduction.
(para 628)

F) REPRESENTATION IN THE STATEMENT OF CHANGES IN OWNERS' EQUITY

1. The Statement of Changes in Owners' Equity should report separately the changes in paid-in capital; where applicable, donated capital; reserves and/or appropriated retained earnings; and unappropriated retained earnings.

2. The Statement of Changes in Owners' Equity should separately display the beginning balances of paid-in capital; where applicable, donated capital; reserves and/or appropriated retained earnings; and unappropriated retained earnings before and after any prior period adjustments.

3. Addition to and deductions from the beginning balances of paid-in capital; where applicable, donated capital; reserves and/or appropriated retained earnings; and unappropriated retained earnings should be separately displayed on the face of the Statement of Changes in Owners' Equity together with a description of the nature of the addition or deduction.
(para 629)
(Next paragraph is No. 679).

3.2 THE GENERAL DISCLOSURE

The standard of general disclosure defines disclosure requirements in the financial statements with respect to the following :

i) Nature of business.
ii) Significant accounting policies.
iii) Accounting changes and their treatment.
iv) Contingencies.
v) Commitments.
vi) Subsequent events.
(para 679)

3.2.1 NATURE OF BUSINESS DISCLOSURE

Notes to the Financial Statements should include a brief description of the nature of an entity's business.
(para 680)

3.2.2 DISCLOSURE OF ACCOUNTING POLICIES

A) A clear and concise description of the significant accounting policies of an enterprise should be included as an integral part of the financial statements.

As a minimum, disclosure of information on accounting policies should be provided in the following situations:

a) When a selection has been made from alternative acceptable accounting standards and methods;
b) When there are accounting standards and methods used which are peculiar to an industry in which an enterprise operates, even if such accounting standards and methods are predominantly followed in that industry;
c) When the financial statements are prepared on a basis not in conformity with one or more of the fundamental concepts of financial accounting for business enterprises in Saudi Arabia.
(para 681)

B) In order to provide an overview of the accounting policies of an entity these policies must be disclosed together in the form of a summary rather than in individual notes to the financial statements. Therefore, it is preferable for the disclosure of accounting policies to be provided as either:

a) The first note to the financial statements; or

b) A separate summary, to which the financial statements are cross-referenced.

Suitable titles would be «Summary of Accounting Policies» or «Accounting Policies».
(para 682)

C) Wrong or inappropriate treatment of items in the financial statements is not rectified either by disclosure of accounting policies or by notes or explanatory material.
(para 683)

3.2.3 CHANGE IN AN ACCOUNTING POLICY

A) When there is a change in an accounting policy of the reporting entity the new accounting policy should be applied retroactively by restating the financial statements of all prior periods presented, except in those circumstances when the necessary financial data is not reasonably determinable.
(para 684)

B) When a change in an accounting policy is applied retroactively, the financial statements of all prior periods presented for comparative purposes should be restated to give effect to the new accounting policy, except in those circumstances when the effect of the new accounting policy is not reasonably determinable for individual prior periods. In such circumstances, an adjustment should be made to the opening balance of retained earnings of the current period, or such earlier period as is appropriate, to reflect the cumulative effect of the change on prior periods.
(para 685)

C) For each change in an accounting policy in the current period, the following information should be disclosed:

a) A description of the change;

b) Justification of the change; and

c) The effect of the change on the financial statements of the current period.
(para 686)

D) When a change in an accounting policy has been applied retroactively and prior periods have been restated, the fact that the financial statements of prior periods that are presented have been restated and the effect of the change on those prior periods should be disclosed.
(para 687)

E) When a change in an accounting policy has been applied retroactively but prior periods have not been restated, the fact that the financial statements of prior periods that are presented have not been restated should be disclosed. The cumulative adjustment to the opening balance of the retained earnings of the current period should also be disclosed.
(para 688)

F) The disclosure of particulars, including Riyal amounts applies to each change in an accounting policy; it is not appropriate to net items when considering materiality.
(para 689)

G) A change in an accounting policy that does not have a material effect in the current period but is likely to have a material effect in future periods should be disclosed.
(para 690)

3.2.4 CHANGE IN ACCOUNTING ESTIMATES

A) The effect of a change in an accounting estimate should be accounted for in :

a) The period of change, if the change affects the financial results of that period only; or
(para 691)

b) The period of change and applicable future periods, if the change affects the financial results of both current and future periods.
(para 692)

B) Disclosure of the nature and effect on net income before extraordinary items and net income of the current period for a change in an accounting estimate that is rare or unusual or that may affect the results of both current and future periods, such as a change in the estimated service life of a fixed asset, should be made in the Notes to the Financial Statements.
(para 693)

C) Disclosure is not necessary for a change in an estimate made each period in the course of accounting for normal business activities, such as allowances for uncollectible accounts.
(para 694)

3.2.5 CHANGE IN THE REPORTING ENTITY

A) Accounting changes that result in financial statements that are in effect the statements of a different reporting entity should be reported by restating the financial statements of all prior periods presented in order to show financial information for the new reporting entity for all periods.
(para 695)

B) The financial statements of the period of a change in the reporting entity should describe the nature of the change and the reason for it.
(para 696)

C) The effect of the change on income before extraordinary items and on net income should be disclosed for all periods presented. Financial statements of subsequent periods need not repeat the disclosure.
(para 697)

3.2.6 CORRECTIONS OF ERRORS IN PRIOR PERIOD FINANCIAL STATEMENTS

A) The correction in the current period of an error in prior period financial statements should be accounted for retroactively. The financial statements of all prior periods presented for comparative purposes should be restated, as necessary.
(para 698)

B) When there has been a correction in the current period of an error in prior period financial statements, the following information should be disclosed:

1) A description of the error;
2) The effect of the correction of the error on the financial statements of the current and prior periods; and

3) The fact that the financial statements of prior periods that are presented have been restated.
(para 699)

3.2.7 CONTINGENCIES

A) The amount of a contingent loss should be accrued in the financial statements by a charge to income when both of the following conditions are met:

1) It is likely that a future event will confirm that an asset had been impaired or a liability incurred at the date of the financial statement; and

2) The amount of the loss can be reasonably estimated.
(para 700)

B) Disclosure of the nature of an accrual and the amount accrued is desirable.

C) The existence of a contingent loss at the date of the financial statements should be disclosed in Notes to the Financial Statements when:
(para 701)

1) The occurrence of the confirming future event is likely but the amount of the loss cannot be reasonably estimated; or

2) The occurrence of the confirming future event is likely and an accrual has been made but there exists an exposure to loss in excess of the amount accrued; or

3) The occurrence of the confirming future event is not determinable.
(para 702)

D) Contingent gains should not be accrued in financial statements.
(para (703)

E) When it is likely that a future event will confirm that an asset had been acquired or a liability reduced at the date of the financial statements, the existence of a contingent gain should be disclosed in Notes to the Financial Statements.
(para 704)

F) When the existence of a contingent gain, or a contingent loss which has not been accrued, is disclosed in a note to the financial statements, the information should include:

1) The nature of the contingency; and

2) An estimate of the amount of the contingent gain or loss or a statement that such an estimate cannot be made.

G) When the existence of a contingent gain or loss is disclosed in a note to the financial statements, it is desirable to include a reference to contingencies on the Statement of Financial Position.
(para 705)

H) Even though the possibility of loss may be remote, certain loss contingencies should be disclosed nonetheless. The common characteristic of these contingencies is «guarantee». This Includes:
(para 706)

1) Guarantees (both direct and indirect) or indebtedness of others;

2) Guarantees of lease payment of others; and

3) Guarantees to repurchase receivables or the related property.
(para 707)

I) Disclosure of the above and other guarantees should include:

1) The nature of the guarantee;

2) The amount of the guarantee;

3) The value (if an amount is known or can be estimated) of any recovery that can be expected to result (as in the case of the entity's right to proceed against an outside party).

3.2.8 COMMITMENTS

A) Unusual or large commitments of the reporting entity should be disclosed in Notes to the Financial Statements.
(Para 708)

B) The following information about unusual or large commitments should be disclosed:

1) A description of the commitment;

2) The terms of the commitment; and

3) The amount of the commitment.
(para 709)

C) When a commitment is disclosed in a note to the financial statements, it is desirable to include a reference to commitments on the Statement of Financial Position.
(para 710)

3.2.9 SUBSEQUENT EVENTS

A) Financial statements should not be adjusted for, but disclosure should be made of those events occurring between the date of the financial statements and the date of their issuance that do not relate to conditions that existed at the date of the financial statements but;

1) Cause significant changes to assets or liabilities in the subsequent period; or

2) Will or may, have a significant effect on the future operations of the entity.
(para 711)

B) Disclosure of a subsequent event that does not require adjustment of the financial statements would be made by way of a note to the financial statements.
(712)

C) Disclosure of a subsequent event that does not require adjustment of the financial statements should include:

1) A description of the nature of the event; and

2) An estimate of the financial effect, when practicable, or a statement that such an estimate cannot be made.
(para 713)
(Next paragraph is No. 744)

3.3 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO CONSOLIDATED FINANCIAL STATEMENTS

3.3.1 Consolidated financial statements should adhere to the general disclosure and presentation requirements for all financial statements. There are also certain general disclosure and presentation requirements which are peculiar to consolidated financial statements.
(para 744)

3.3.2 Consolidated financial statements should disclose the following:

A) The policy used by the parent company to consolidate the financial statements of its subsidiaries. This disclosure should be made as part of the disclosure of accounting policies;

B) The percentage of ownership interest held by the parent company in the subsidiaries that are consolidated;

C) The percentage of ownership interest held by the parent company in the subsidiaries that are not consolidated; and

D) The basis of accounting for unconsolidated subsidiaries in the consolidated financial statements.
(para 745)

3.3.3 A difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation. Normally the subsidiary can prepare for consolidation purposes statements for a period which exactly or nearly coincide with the fiscal period of the parent.
(para 746)

3.3.4 When, for purposes of consolidation, it is not possible to use financial statements for a period which substantially coincides with that of the parent's financial statements, this fact, and the period covered by the financial statements used, should be disclosed.
(para 747)

3.3.5 When the fiscal periods of a parent and a subsidiary, the investment in which is accounted for by the consolidation method, end in different dates, the effects of significant transactions of the subsidiary that occur between those dates and significantly affect the financial position or results of operations of the group should be recorded or disclosed, as appropriate.
(para 748).

recorded or disclosed, as appropriate.
(para 748)

3.3.6 In calculating consolidated net income, a deduction should be made in the amount of any minority interest's proportion of the subsidiary company's income or loss before extraordinary items. Such an amount is a separate item and should not be deducted from other items in the Statement of Income. The parent company's portion of the extraordinary items reported by a subsidiary should be disclosed as extraordinary items in the consolidated Statement of Income.
(para 749)

3.3.7 Minority interest in consolidated subsidiary companies should be shown separatelyon the Statement of Financial Position between liabilities and owner's equity.
(para 750)

3.3.8 Where a subsidiary company holds shares of the parent company, the issued share capital of the parent should be set out in full, with the cost of the shares held by the subsidiary shown as a deduction from shareholders' equity.
(para 751)
(Next para is No. 772)

3.4 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO DEVELOPMENT STAGE COMPANIES

3.4.1 Development stage companies should adhere to the general disclosure and presentation requirements for all financial statements. There are also certain general disclosure and presentation requirements which are peculiar to the financial statements of development stage companies.
(para 772)

3.4.2 The financial statements of a development stage company should disclose the following:

A) Identification of the financial statements as those of a development stage company; and

B) A description of the development stage activities in which the company is engaged.
(para 773)

3.4.3 In issuing the same basic financial statements as an established operating company, a development stage company should present therein certain additional information. The basic financial statements to be presented[10] and the additional information should include the following:

A) A Statement of Financial Position, including any cumulative net losses reported with a descriptive caption, such as «deficit accumulated during the development stage», in the owners' equity section.

B) A Statement of Income, showing amounts of revenue, expenses, gains and losses for each period covered by the Statement of Income and, in addition, cumulative amounts from the company's inception.

(10) Under some circumstances, an established operating company may issue less than a full set of financial statements, for example, only a Statement of Financial Position. This standard does not preclude that possibility for development stage company.

C) A *Statement* of Sources and Applications of Funds, showing the sources and uses of funds and other investing and financing transactions for each period for which a Statement of income is presented and, in addition, cumulative amounts from the enterprise's inception.

D) A Statement of Owners' Equity, showing from the company's inception:

1) For each issuance, the date and number of shares of stock, or equity interests issued for cash and for other consideration.

2) For each issuance, the Riyal amounts (per share or other equity unit and in total) assigned to the consideration received for shares of stock or equity interests. Riyal amounts should be assigned to any noncash consideration received.

3) For each issuance involving noncash consideration, the nature of the noncash consideration and the basis for assigning amounts.
(para 774)

3.4.4 In the first year in which the company is considered an operating company, Notes to the Financial Statements should disclose that in prior years the company had been in the development stage. If comparative statements include periods in which the company was first in the development stage and later an operating company, the cumulative amounts and other development stage disclosures are not required for the periods in which the company was in the development stage.
(para 775).

4. ILLUSTRATIVE FINANCIAL STATEMENTS AND GENERAL GUIDELINES FOR THEIR PREPARATION

4.1 ILLUSTRATIVE STATEMENTS

This appendix contains illustrative financial statements. Material contained in this appendix is for general use only.

1. The methods of presentation used are illustrative only and in no way prescriptive and other methods of presentation may equally comply with the General Presentation and Disclosures Standard.

2. The material contained in this appendix is organized as follows:

   i) Illustrative statements of financial position;

      a) Vertical classified comparative statement
      b) Horizontal classified comparative statement
      c) Horizontal unclassified comparative statement

   ii) Illustrative Statements of Income;
   iii) Illustrative Statements of Retained Earnings;
   iv) Illustrative Statements of Changes in Owners' Equity;
   v) Illustrative Statements of Sources and Applications of Funds.

ILLUSTRATIVE STATEMENS OF FINANCIAL POSITION

Three illustrative Statements of Financial Position are presented on the following pages. The first sample is a comparative classified vertical Statement of Financial Position containing the main captions that should normally be presented. The second sample is a comparative, classified horizontal Statement of Financial Position. The third sample is a comparative, unclassified horizontal Statement of Financial Position. Reference to notes to financial statements is not intended to illustrate minimum number of note references on a Statement of Financial Position. Rather, they are intended to illustrate format.

We wish to re-emphasize that whichever form is used, the classification, grouping and description of items must be carefully considered. The samples provided on the following pages are intended to illustrate general situations. The format used by the reporting entity should be selected with a view of presenting clearly the nature and amount of the entity's assets, liabilities and owners' equity.

SAMPLE A : VERTICAL COMPARATIVE CLASSIFIED STATEMENT OF FINANCIAL POSITION

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION
AS AT / / 14x2 H.

14x1				14x2	
SR	SR		Notes	SR	SR
		CURRENT ASSETS			
	xx	Cash in hand and with banks	( )	xx	
	xx	Accounts receivable	( )	xx	
	xx	Inventories	( )	xx	
	xx	Prepaid expenses	( )	xx	
	xx	________	( )	xx	
	xx	________	( )	xx	
xxx		Total Current Assets			xxx
		CURRENT LIABILITIES			
	xx	Notes payable	( )	xx	
	xx	Accounts payable	( )	xx	
	xx	Accrued expenses	( )	xx	
	xx	Dividends payable	( )	xx	
	xx	Current maturities of long-term debt	( )	xx	
	xx	Zakat	( )	xx	
	xx	________	( )	xx	
	xx	________	( )	xx	
(xxx)		Total Current Liabilities			(xxx)
xxx		Working Capital			xxx
		FIXED ASSETS, at cost (Note)			
	xx	Land	( )	xx	
	xx	Buildings	( )	xx	
	xx	Machinery and equipment	( )	xx	
	xx	Office furniture and equipment	( )	xx	
	(xx)	Less : Accumulated depreciation	( )	(xx)	
	xx	________	( )	xx	
	xx	________	( )	xx	
xxx		Total Fixed Assets			xxx
		INTANGIBLE ASSETS			
	xx	Patent	( )	xx	
	xx	Goodwill	( )	xx	
	xx	________	( )	xx	
	xx	________	( )	xx	
xxx		Total Intangible Assets			xxx
xxx					xxx

14x1 SR	14x1 SR		Notes	14x2 SR	14x2 SR
		NON-CURRENT LIABILITIES			
	xx	Long-term loans	( )	xx	
	xx	End of service indemnity	( )	xx	
	xx	______________________	( )	xx	
(xxx)		**Total Non-Current Liabilities**			(xxx)
xxx		**Net Assets**			xxx
		SHAREHOLDERS' EQUITY			
		Authorised share capital __________ shares,			
xx		par value SR __________ per share	( )	xx	
(xx)		(Less) Unissued share capital ________ shares	( )	(xx)	
xx		Paid up share capital		xx	
xx		Donated capital	( )	xx	
xx		Reserves or appropriated retained earnings		xx	
xx		______________________		xx	
xx		______________________		xx	
xxx		**Total Shareholders' Equity**			xxx
xxx		Contingent Liabilities	( )		xxx
xxx					xxx

The attached Notes No. (   ) to (   ) form an integral part of these financial statements.

SAMPLE A : HORIZONTAL COMPARATIVE CLASSIFIED STATEMENT OF FINANCIAL POSITION

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION
AS AT / / 14x2 H.

	Notes	14x2 SR	14x2 SR	14x1 SR	14x1 SR
CURRENT ASSETS					
Cash in hand and with banks	( )	xx		xx	
Accounts receivable	( )	xx		xx	
Inventories	( )	xx		xx	
Prepaid expenses	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
Total Current Assets			xxx		xxx
FIXED ASSETS, at cost (Note)					
Land	( )	xx		xx	
Buildings	( )	xx		xx	
Machinery and equipment	( )	xx		xx	
Office furniture and equipment	( )	xx		xx	
Less : Accumulated depreciation	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
Total Fixed Assets			xxx		xxx
INTANGIBLE ASSETS					
Patent	( )	xx		xx	
Goodwill	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
Total Intangible Assets			xxx		xxx
Total Assets			xxx		xxx

	Notes	14x2 SR	14x2 SR	14x1 SR	14x1 SR
CURRENT LIABILITIES					
Notes payable	( )	xx		xx	
Accounts payable	( )	xx		xx	
Accrued expenses	( )	xx		xx	
Dividends payable	( )	xx		xx	
Current maturities of long-term debt	( )	xx		xx	
Zakat provision	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
Total Current Liabilities			xxx		xxx
NON-CURRENT LIABILITIES					
Long-term loans	( )	xx		xx	
End of service indemnity	( )	xx		xx	
Total Non-Current Liabilities			xxx		xxx
SHAREHOLDERS' EQUITY					
Authorised share capital ______ shares par value SR ______ per share	( )	xx		xx	
Less : Unissued share capital ______ shares	( )	xx		xx	
Paid up share capital	( )	xx		xx	
Donated capital	( )	xx		xx	
Reserves or appropriated retained earnings	( )	xx		xx	
Unappropriated retained earnings	( )	xx		xx	
______________	( )	xx		xx	
______________	( )	xx		xx	
Total Shareholders' Equity			xxx		xxx
Contingent Liabilities			xx		xx
Total Liabilities and Shareholders' Equity			xxx		xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

SAMPLE C : HORIZONTAL COMPARATIVE UNCLASSIFIED STATEMENT OF FINANCIAL POSITION

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF FINANCIAL POSITION
AS AT / / 14x2 H.

		14x2		14x1	
	Notes	SR	SR	SR	SR
Cash in hand and with banks	( )		xx		xx
Accounts receivable	( )		xx		xx
Notes receivable	( )		xx		xx
Prepaid expenses			xx		xx
Land	( )	xx		xx	
Buildings	( )	xx		xx	
Office furniture	( )	xx		xx	
Less : Accumulated depreciation	( )	xx		xx	
			xxx		xxx
Goodwill	( )	xx		xx	
Patent	( )	xx		xx	
			xxx		xxx
			xxx		xxx

		14x2		14x1	
	Notes	SR	SR	SR	SR
Notes payable	( )	xx		xx	
Accounts payable	( )	xx		xx	
Accrued expenses	( )	xx	xxx	xx	xxx
Shareholders' equity :					
Authorised share capital _______ shares					
par value SR ___________ per share	( )	xx		xx	
Less : Unissued share capital _______ shares	( )	(xx)		(xx)	
Paid up share capital	( )	xx		xx	
Donated capital	( )	xx		xx	
Reserves or appropriated retained earnings	( )	xx		xx	
Unappropriated retained earnings	( )	xx		xx	
			xxx		xxx
Contingent Liabilities	( )		xxx		xxx
			xxx		xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

MINORITY INTERESTS IN CONSOLIDATED STATEMENT OF FINANCIAL POSITION

If there is any minority interest in any of the consolidated subsidiaries, the consolidated statements of financial position should have a main capital between «Long Term Loans» and «Shareholders' Equity» showing the amount of the minority interest as of the date of each statement of financial position (whether classified or not classified) presented as follows in case of the classified vertical statement of financial position of a joint stock company:

14x1H. S.R.		Notes	14x2H. S.R.	14x2H. S.R.
xx	Long term loans	( )	xx	
xx	Provision for terminal benefits	( )	xx	
xx				xx
xx	Minority interest in subsidiaries*	( )		xx
xx				xx
	Shareholders' equity :			
	Authorized share capital ________ shares			
	par value SR. ________ per share		xx	
	Less : Unissued share capital ________ shares		(xx)	
xx	Paid up share capital		xx	
xx	Donated capital	( )	xx	
xx	Reserves or appropriated retained earnings		xx	
xx	Unappropriated retained earnings		xx	
xx				xx
xx	Contingent Liabilities	( )		xx
xx				xx

* The term «consolidated» should be included if there are any unconsolidated subsidiaries.

ILLUSTRATIVE STATEMENT OF INCOME

Three illustrative Statements of Income are presented on the following pages as follows :

1. Statement of Income showing income from continuing operations and extraordinary items (Sample A);
2. Statement of Income showing income from continuing operations, discontinued operations and extraordinary items (sample B); and
3. Statement of Income for a company that receives a subsidy from the government equal to its net losses plus 15% of paid-in capital as secured profit for shareholders (sample C).

Reference to Notes to Financial Statements is not intended to illustrate minimum number of note references on a Statement of Income. Rather, they are intended to illustrate format.

The format used by the reporting entity should be selected with a view of presenting clearly the components of net income.

SAMPLE (A) : STATEMENT OF INCOME : INCOME FROM CONTINUING OPERATIONS AND EXTRAORDINARY ITEMS

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF INCOME
FOR THE YEAR ENDED / / 14x2 H.

14x1 H.				14x2 H.	
SR	SR		Notes	SR	SR
	xx	Net sales	( )	xx	
	(xx)	Cost of goods sold	( )	(xx)	
xxx		Gross profit			xxx
		Expenses related to major operations :			
	xx	Selling	( )	xx	
	xx	General and administrative	( )	xx	
xxx					xxx
xxx		Income from major operations			xxx
		Other operating income (loss) :			
	xx	Rental income, net	( )	xx	
	xx	Investment income	( )	xx	
	(xx)	Loss on sale of fixed assets		(xx)	xxx
xxx		Net income before extraordinary loss (profit)			xxx
xxx		Extraordinary loss (profit)	( )		(xxx)
xxx		Net income			xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

SAMPLE (B) : STATEMENT OF INCOME : INCOME FROM CONTINUING OPERATIONS DISCONTINUED OPERATIONS AND EXTRAORDINARY ITEMS

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF INCOME
FOR THE YEAR ENDED / / 14x2 H.

14x1 H.				14x2 H.	
SR	SR		Notes	SR	SR
	xx	Net sales		xx	
	(xx)	Cost of goods sold		(xx)	
xxx		Gross profit			xxx
		Expenses related to major operations :			
	xx	Selling		xx	
	xx	General and administrative	( )	xx	
xxx					xxx
xxx		Income from continuing major operations			xxx
		Other operating income (loss) :			
	xx	Rental income, net	( )	xx	
	xx	Investment income	( )	xx	
	(xx)	Loss on sale of fixed assets		(xx)	
xxx		Income from continuing operations			xxx
		Discontinued operations :			
	xx	Income (loss) from discontinued operations of Division X		xx	
	(xx)	Loss on sale of discontinued operations assets		(xx)	(xxx)
xxx		Net income before extraordinary loss			xxx
xxx		Extraordinary loss			(xxx)
xxx		Net income			xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

SAMPLE (C) : STATEMENT OF INCOME : INCOME FROM CONTINUING OPERATIONS AND OPERATING SUBSIDY

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF INCOME
FOR THE YEAR ENDED / / 14x2 H.

14x1 H.				14x2 H.	
SR	SR		Notes	SR	SR
	xx	Net sales	( )	xx	
	(xx)	Cost of goods sold	( )	(xx)	
xxx		Gross profit			xxx
		Expenses related to major operations :			
	xx	Selling	( )	xx	
	xx	General and administrative	( )	xx	
xxx					xxx
xxx		Income from major operations			xxx
		Other operating income (loss) :			
	xx	Rental income, net	( )	xx	
	xx	Investment income	( )	xx	
	(xx)	Loss on sale of fixed assets		(xx)	
xxx					xxx
(xxx)		Net loss before operating subsidy			(xxx)
xx		Operating subsidy			xx
xxx		Net income			xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

MINORITY INTEREST IN THE CONSOLIDATED STATEMENTS OF INCOME

If there is any minority interest in any of the consolidated subsidiaries, the consolidated statement of income should have a main caption between «Income (loss) before minority interest in net income of consolidated subsidiaries» and «Net income» as follows:

14x1 H. S.R.		Note	14x2 H. S.R.	S.R.
xx	Net income before extraordinary items			xx
	Extraordinary loss :			
xx	Disasters loss	( )		(xx)
xx	Net income before minority interest			xx
(xx)	Minority interest in subsidiaries*			(xx)
xx	Net income			xx

* The term «consolidated» should be included if there are any unconsolidated subsidiaries.

ILLUSTRATIVE STATEMENT OF RETAINED EARNINGS

One illustrative Statement of Retained Earnings is presented on the following page. The format used by the reporting entity should be selected with a view of presenting clearly the changes in appropriated and unappropriated retained earnings during the periods of presentation.

SAMPLE : STATEMENT OF RETAINED EARNINGS

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF RETAINED EARNINGS
FOR THE YEAR ENDED / / 14x2 H.

	NOTE	STATUTORY RESERVE	GENERAL RESERVE	UN-APPROPRIATED RETAINED EARNINGS
		SR	SR	SR
Balance 14 x 0 H. as previously Reported		xxx	xxx	xxx
Adjustment applicable to the year ended 14 x 0 H.	( )	(xxx)	(xxx)	(xxx)
Balance / /14 H. as restated		xxx	xxx	xxx
Net income for year ended / /14 x 1 H.		—	—	xxx
		xxx	xxx	xxx
Transfer to reserves		xxx	xxx	(xxx)
Dividends		—	—	(xxx)
Balance / /14 x 1 H.		xxx	xxx	xxx
Net income for the year ended / /14 x 2 H.		—	—	xxx
		xxx	xxx	xxx
Transfer to reserves		xxx	xxx	(xxx)
Dividends		—	—	(xxx)
Retained Earnings		xxx	xxx	xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

ILLUSTRATIVE STATEMENT OF CHANGES IN OWNERS' EQUITY

One illustrative Statement of Changes in Owners' Equity is presented on the following page. The format used by the reporting entity should be selected with a view of presenting clearly the changes in all owners' equity accounts during the period (s) of presentation.

SAMPLE: STATEMENT OF CHANGES IN OWNERS' EQUITY

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
YEAR ENDED Dhu Al Hajjah 30, 14x2 & 14x1 H.

	Note	PAID-UP SHARE CAPITAL SR	DONATED CAPITAL SR	STATUTORY RESERVE SR	GENERAL RESERVE SR	UNAP-PROPRIATED RETAINED EARNINGS SR
Balance Dhu Al Hajjah 30, 14x0 H. as previously reported		xxx	xxx	xxx	xxx	xxx
Adjustment applicable to the year 14x0 H.		—	—	(xxx)	(xxx)	(xxx)
Balance Dhu Al Hajjah 30, 14x0 H. as restated		xxx	xxx	xxx	xxx	xxx
Sale of 1000 shares of capital		xxx	—	—	—	—
Net income, 14X1 H.		—	—	—	—	xxx
Transfer to reserves		—	—	xxx	xxx	(xxx)
Donation of land for plant facilities	( )	—	xxx	—	—	—
Dividends		—	—	—	—	(xxx)
Balance Dhu Al Hajjah 14x1 H.		xxx	xxx	xxx	xxx	xxx
Net income 14x2 H.		—	—	—	—	xxx
Transfer to reserves		—	—	xxx	xxx	(xxx)
Dividends		—	—	—	—	(xxx)
Balance Dhu Al Hajjah 30, 14x2 H.		xxx	xxx	xxx	xxx	xxx

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

ILLUSTRATIVE PRESENTATIONS OF SOURCES AND APPLICATIONS OF FUNDS

The following pages contain four sample presentations of sources and applications of funds as follows:

Sample A : Statement of Sources and Applications of Funds (Funds defined in terms of working capital - unbalanced format).

Sample B : Statement of Sources and Applications of Funds (Funds defined in terms of working capital - balanced format).

Sample C : Statement of Sources and Applications of Funds (Funds defined in terms of cash -unbalanced format).

Sample D : Statement of Sources and Applications of Funds (Funds defined in terms of cash -balanced format)

The reporting entity should select the appropriate form of Statement of Sources and Applications of Funds that would present the sources of funds, their applications, investment and other financing operations in a clear manner.

SAMPLE (A) : WORKING CAPITAL — UNBALANCED FORMAT

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS
FOR THE YEAR ENDED Dhu Al Hajjah 30, 14x2 & 14x1 H.

14x1H. S.R.		Note	14x2H. S.R.	14x2H. S.R.
	WORKING CAPITAL PROVIDED BY :			
	Operations :			
xx	Net income before extraordinary loss		xx	
	Add (Deduct) items which did not provide or require working capital :			
.x	Depreciation		xx	
xx	Amortization		xx	
(xx)	Gain on sale of fixed assets		(xx)	
xx	Working capital provided by operations			xx
	Extraordinary items :			
xx	Indemnity for losses (casualties)			xx
xx	Total working capital provided by operations			xx
	Other sources :			
—	Proceeds from sale of fixed assets		xx	
xx	Long-term debt		xx	
xx	Issued share capital		xx	xx
xx	Total working capital provided			xx
	WORKING CAPITAL APPLIED TO :			
xx	Repayment of long-term debt		xx	
xx	Dividends		xx	
xx	Zakat		xx	
xx	Purchase of fixed assets		xx	
xx	Total working capital applied			xx
(xx)	Increase (Decrease) in working capital			xx
	Other investing and financing transactions :			
—	Issuance of share capital to acquire land			xx
—	Acquisition of land in exchange for share capital			(xx)

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

SAMPLE (B) : WORKING CAPITAL — BALANCED FORMAT

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS
FOR THE YEAR ENDED Dhu Al Hajjah 30, 14x2 & 14x1 H.

14x1H. S.R.		Note	14x2H. S.R.	14x2H. S.R.
	WORKING CAPITAL PROVIDED BY :			
	Operations :			
xx	Net income before extraordinary loss		xx	
	Add (Deduct) items which did not provide or require working capital :			
xx	Depreciation of fixed assets		xx	
xx	Amortization		xx	
—	Gain on sale of fixed assets		(xx)	
xx	Working capital provided by operations			xx
	Extraordinary items :			
xx	Indemnity for losses (casualties)			xx
xx	Total working capital provided by operations			xx
	Other sources :			
—	Proceeds from sale of fixed assets		xx	
xx	Long-term debt		xx	
xx	Issued share capital		xx	xx
xx	Total working capital provided			xx
	WORKING CAPITAL APPLIED TO :			
xx	Repayment of long-term debt		xx	
xx	Dividends		xx	
xx	Zakat		xx	
xx	Purchase of fixed assets		xx	
..	Total working capital applied			xx
xx				xx
xx	Increase (Decrease) in working capital			xx
(xx)				
	Other investing and financing transactions :			
—	Issuance of share capital to acquire land			xx
—	Acquisition of land in exchange for share capital			(xx)

The attached Notes No. (   ) to (   ) form an integral part of these financial statements.

SAMPLE (C) : CASH DEFINITION — UNBALANCED FORMAT

ARABIAN COMPANY
A JOINT STOCK COMPANY

STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS
FOR THE YEAR ENDED Dhu Al Hajjah 30, 14x2 & 14x1 H.

14x1 H. S.R.		Note	14x2 H. S.R.	14x2 H. S.R.
	CASH PROVIDED BY :			
	Operations :			
xx	Net income before extraordinary loss		xx	
	Add (Deduct) items which did not provide or use cash :			
xx	Depreciation		xx	
xx	Amortization		xx	
—	Gain on sale of fixed assets		(xx)	
(xx)	(Increase) decrease in inventories		xx	
xx	(Increase) decrease in trade receivables		(xx)	
(xx)	(Increase) decrease in prepaid expenses		xx	
xx	Increase (decrease) in account payable		(xx)	
(xx)	Increase (decrease) in accrued expenses		xx	xx
xx				
	Extraordinary items :			
xx	Indemnity for losses (casualties)			xx
xx	Total cash provided by operations			xx
	Other sources :			
xx	Long-term debt		xx	
xx	Short-term debt		xx	
—	Issued capital		xx	xx
xx	Total of cash provided			xx
	CASH APPLIED TO :			
xx	Repayment of long-term debt		xx	
xx	Dividends		xx	
xx	Purchase of fixed assests		xx	
xx	Zakat		xx	
xx	Total cash applied			xx
(xx)	Increase (Decrease) in cash			xx
	Other investing and financing transactions :			
—	Issuance of share capital to acquire land			xx
—	Acquisition of land in exchange for share capital			(xx)

The attached Notes No. ( ) to ( ) form an integral part of these financial statements.

4.2 COMPUTATIONAL GUIDELINES — FUNDS FROM OPERATIONS

The following computational guidelines are intended to aid in the calculation of flow of funds from operations, and reflect a common method of calculation by adjusting income before extraordinary items for non-fund items. These guidelines are not intended to suggest a particular format or presentation on the Statement of Sources and Applications of Funds.

1. There are a number of items entering into the determination of income before extraordinary items which do not reflect financing or investing activities. They neither use nor provide funds and, therefore, do not affect the flow of funds from operations. Examples of these items are:

   a) Depreciation, depletion, amortization. The use of funds occurred when the asset was purchased, not when its cost is charged to income;

   b) Write-down of non-fund assets. The write-down of non-fund assets does not involve an actual use of funds. The use of funds occurred when the asset was purchased, not when its cost is charged to income;

   c) Minority interest's share of net income. There is no use of funds until distributions are made to the minority interest.

2. Income before extraordinary items may include gains or losses on the disposal of non-fund assets or the settlement of non-fund liabilities, e.g., gains or losses on sale of fixed assets or on retirement of long term debt. Although these gains or losses are related to the operations of the reporting entity, they do not in themselves provide or use funds and, therefore, should be eliminated from income in determining the flow of funds from operations. The proceeds from the disposal of the asset or the outlay for the settlement of the liability represent a movement of funds and only these amounts should appear separately as a source or application of funds in the statement.

3. The sources of funds from operations in respect of investments accounted for by the equity method should include only the dividends received. Separate display on such dividends is desirable.

4. The flow of funds from, or the application of funds to, operations may be reflected as a single amount in the Statement of Sources and Applications of Funds. It is not considered necessary to detail revenue and expense items which do not provide or use funds. However, where it is considered desirable to provide a link between income before extraordinary items and funds from operations, the items which do not provide or use funds could be shown, either as one net amount or in detail. This reconciliation may appear on the face of the statement, in a separate tabulation or in the notes to the financial statements. There is a danger that a user of the financial statements might regard the reconciling items as sources or applications of funds, especially when the reconciliation is included on the face of the statement. Accordingly, there should be a clear indication that such items do not constitute sources or applications of funds.

IV. APPENDICES

APPENDIX A :	EXPLANATORY FOREWORD
APPENDIX B :	OBJECTIVES OF FINANCIAL ACCOUNTING—ANALYTICAL SURVEY
APPENDIX C :	CONCEPTS OF FINANCIAL ACCOUNTING—ANALYTICAL SURVEY
APPENDIX D :	GENERAL PRESENTATION AND DISCLOSURE STANDARD—ANALYTICAL SURVEY

APPENDIX A : EXPLANATORY FOREWORD

PREFACE

HISTORICAL REVIEW OF THE PROJECT

In mid 1399H. talks were held with H.E. the Deputy Minister of Commerce, Mr. Yousaf Al-Hamdan, at that time. The subject was accounting environment, auditing profession and aspects of its development in Saudi Arabia. At that time, the situation seemed critical and certain deficiencies in the profession were having a more serious impact on the economic and financial activities in the country than was actually recognized. The discussion concluded with an agreement on the necessity of taking practical measures to remedy such deficiencies and to develop the profession in a manner that would enable accountants and auditors to cope with the fundamental changes occuring in this field. Three months later, further discussions on this subject were held with H.E. the Minister of Commerce, Dr. Sulaiman Al Saleem, and it was determined that the profession in Saudi Arabia was not keeping abreast with the changes taking place in the country. However, deficiencies were not clearly identified to allow designing effective solutions. A brief summary of deficiencies which have a general impact on the financial,commercial and economic activities, and also on the level of development of the profession itself being one of the fundamental activities of society is provided in this preface.

To assist the Ministry in taking appropriate steps for developing the profession, Al-Rashed firm, through its professional activity, formed a team of researchers, with the participation of Dr. Abdullah Al-Faisal from the department of accountancy at King Saud University, to conduct a preliminary survey in order to define the deficiencies. The survey was summarized in a memorandum which specifies deficiencies in the major areas of the profession.

The finding of the study was reviewed by the Ministry and was accepted as a suitable start for the development of the profession. Al-Rashed firm was requested to prepare a plan taking into consideration the experiences of other countries in this field, and the specific requirements of the of the Kingdom's environment. The result, was a comprehensive plan illustrating methods to be followed to develop the profession. This plan comprises the preparation of accounting and auditing standards and an internal organisation of the profession which provide bases for its continuous development.

The plan was discussed with concerned authorities at the Ministry and it was decided to develop the profession in two phases which are :

PHASE 1 :

Conduct a comparative study of the profession in three different countries. The purpose of the study was to obtain information about the development of the profession in these countries to benefit from their experiences.

The Ministry of Commerce commissioned the Al-Rashed firm to start phase 1 of the project. Three countries were selected for this comparative study. To make the selection, nine different countries were identified and classified into three groups based on the extent of development of their profession, their economic environments and the ability to benefit from their experiences in developing the profession in the Kingdom. The three groups are as follows :

The First Group :	U.S.A; England and Canada
The Second Group :	France, West Germany and Sweden
The Third Group :	Tunisia, Venezuela and Brazil

Selected countries, one of each group, to comprise the study were U.S.A., West Germany and Tunis.

This comparative study specifically consisted of :

i) Review of authoritative pronouncements, laws and regulations of the three countries which relate to :
   a) Accounting standards and financial reporting requirements;
   b) Auditing standards and other auditing requirements;

c) Professional ethics; and
d) The internal organization of the profession.

ii) Interviews with officials representing the profession from the three countries to seek the help of experts from these countries proficient in their languages.

iii) Analysis of data gathered from steps i and ii.

iv) The preparation of a comparative report to be written in Arabic, setting forth the profession's status in the three countries; the report should touch on the following :

a) A comparison of the internal organization of the profession; the standards of accounting and auditing; and the code of professional ethics in the three countries.

b) Tentative conclusions as to the implications of the study to the development of the profession in Saudi Arabia.

A detailed comparative study report on phase 1 results was submitted to the Ministry of Commerce. The report was discussed with Al-Rashed firm in a meeting attended by H.E. The Minister of Commerce, H.E. The Deputy Minister and other high ranking officials of the Ministry. Later on, a discussion was conducted with H.E. The Deputy Minister of Commerce, Dr. Abdul-Rahman Al-Zamil, to determine the most suitable method for the implementation of phases II and III of the project.

Two options were considered which are :

OPTION ONE :

Combine phases two and three into one comprehensive study to develop the profession in the Kingdom of Saudi Arabia to cope with developments in other areas within the Kingdom and accommodate the best available practices of other developed countries. However, it was decided that combining the two phases would require a substantial amount of time including a field survey in order to specify the major beneficiaries from financial statements in the Kingdom, the information required by them to make their decisions and the extent of the profession's capability to provide such information .

OPTION TWO :

Implement phase two for the time being, especially the most immediate requirements for developing the profession. Specifically, limit this phase to developing auditing standards, the internal organisation of the profession, the code of professional ethics, the financial accounting conceptual framework, and the general presentation and disclosure standard.

The Ministry of Commerce chose option two and entrusted the Al-Rashed firm to implement it. The contract was signed on 11.10.1402H.

PHASE II : STUDY OF THE PROFESSION'S CURRENT CONCERNS

This phase of the plan concentrated on the following aspects of the profession :

1. Selected subjects from financial accounting which cover the following :
   a) Determination of the objectives of financial accounting.
   b) Selection and definition of the most important concepts of financial accounting.
   c) Preparation of standard of general presentation and disclosure.
2. Auditing standards.
3. Internal organisation of the profession.

A) METHOD OF IMPLEMENTATION

Extensive research was conducted and a variety of methods were explored to determine the best approach for the implementation of this phase in order to arrive at recommendations suitable for dealing with the existing environment in the Kingdom within a reasonable time frame and also to establish a basis for continuous development of the profession with the assistance of professionals in the Kingdom who are capable of following up such recommendations after being approved and developed. Due care and attention was taken to involve technical experts from the selected countries who had mastered the Arabic language, hereinafter called «the experts», and highly qualified Saudi professors and advisors, hereinafter called «the advisors», were also invited to take part in the preparation and review of the recommendations of the experts. Al-Rashed firm's officials particularly Sheikh Abdul-Aziz Al-Rashed and Mr. Yousef Al-Mobarak, hereinafter called «the officials», have extended all possible efforts and expertise to organise the work of both the experts and the advisors and gave it top priority over all other work in Al-Rashed firm. Experts from other Arab countries, hereinafter called «the Arab experts», were also asked to assist with one or more aspects of the project including translation.

It is worth noting that translation of all parts of the projects from English into Arabic and vice versa was carried out by the experts themselves. The services of highly specialized translators to help with the translation were hired but to no avail from the viewpoint of time and quality. This was due to the special characterisitics of the project's components which required a thorough understanding of each statement within the context of the whole project, and not individually whether in any one paragraph or within other paragraphs. This had its impact on the cost and timing of the project.

The proper organisation and coordination of work among the participants (experts, advisors, officials and Arab experts) has largely contributed to the achievement of the stated objectives of the project as regards quality, speed, comprehensiveness, suitability to the Kingdom's circumstances and refraining from depending, without adequate study, on the experience of an individual country.
The project was divided into three major parts, each assigned to a team of experts and an advisor who also participated extensively in the project parts. Following is an overview of the method of implementation of the project which will help in interpreting the final results.

(1) A number of meetings were held among team members and certain advisors to prepare a background paper setting forth for the different teams the status quo of the profession and the laws and regulations which govern the profession in the Kingdom. Several meetings were held inside the Kingdom and abroad and culminated with the compiling of the most important aspects of the profession and the basic study trends in one comprehensive paper which included the laws and basic background that might affect the profession in the Kingdom, and the bases that might affect the preparation of the project's parts. This paper was prepared in both Arabic and English and distributed to the team members who were requested to take the stated information into consideration while preparing the initial drafts for each part of the project.

(2) Individual working visits to the Kingdom were arranged for team members at various stages of the project and they conducted actual case studies and participated in the discussion of certain problems revealed by the audits of certain clients of the Al-Rashed firm. Some of the team members, together with Al-Rashed firm's officials, worked continuously on the project from its inception four years ago to its completion. All of them were in continuous contact whether they were experts, advisors or officials.

(3) Upon deliberate and in-depth study of all aspects of the project and visits to a number of professional institutes in this field and considering the work experience and knowledge of the team members, it was decided that the most suitable approach to implement this project was to divide it into the following segments :

    a) The study of selected subjects in financial accounting including :
        o Objectives of financial accounting.
        o Basic concepts in financial accounting.
        o Preparation of General Presentation and Disclosure Standards.

These issues were handled by the following experts :

1. Dr. Sabry Heakal, Ph. D. in accountancy, 1968, and a fellow of the American Institute, with 11 years experience in teaching accounting and auditing in the U.S.A. where he was promoted to the level of a full professor and Head of the Accountancy Department at the University of Minnesota, St. Claude. Dr. Heakal has 5 years experience as a partner in-charge of the technical aspects of accounting and auditing in one of the major public accounting firms in the United States. Dr. Heakal has also contributed to the various activities of the American Institute of Certified Public Accountants and is presently a member of one of the technical committees of this institute.

2. Dr. Mohamed E. Mostafa, Ph. D. in Accountancy, University of Illinois 1956, with a number of research works and publications in a variety of academic subjects of international concern. Dr. Mostafa conducted research work for the United Nations on the use of accounting data in industrial projects of developing nations. Dr. Mostafa has held the position of advisor to the International Labour Office since 1975. Most of Dr. Mostafa's research work is devoted to the development of financial accounting. Dr. Mostafa has held a number of postions in U.S. universities including head of an accountancy department and currently occupies the post of the Dean of the School of Business Administration at California State University.

3. Dr. Abdul-Rahman I. Al-Humaid, advisor, Ph. D. in accountancy, with diversified experience as advisor to a number of government agencies followed an academic career at King Saud University until he was promoted to the post of Head of the Accountancy Department in the Faculty of Administrative Sciences.

b) Auditing standards, which cover :
General standards ... planning auditing, control, recording, evidence ... reporting standard and relevant procedures. These areas were handled by the following team members :

1. Mr. David Hatherly, who is the holder of a Master's degree in Accountancy and is a fellow of the British Institute of Chartered Accountants. Mr. Hatherly is presently head of the technical division for accountancy and auditing research at the Institute of Chartered Accountants in Scotland. He has 11 years of accounting and auditing experience with a major accounting firm. Mr. Hatherly is also the author of the book "Collection of Evidence for Auditing".

2. Mr. Peter Skuze, Licentiate in Law and a fellow of the British Institute of Chartered Accountants. Mr. Skuze is the partner in charge of the technical aspects of accounting, auditing and training in a medium sized company in England. He represented his company in the discussions held to finalise draft recommendations relevant to the auditing standards prepared by the British Institute of Chartered Accountants. Mr. Skuze has over 13 years experience in the field of accounting and auditing.

3. Dr. Abdullah Al-Faisal, Advisor, Ph. D. in Accountancy, with more than four years experience as professor of accountancy in the Faculty of Administrative Sciences at King Saud University. Dr. Al-Faisal is part-time consultant to a large number of government agencies. He has been acquainted with this project since the initial stages of its development.

c) Internal organisation of the profession :
This was handled by the following team members :

1. Mr. Ivan O. Bull, a fellow of the American Institute of Certified Public Accountants (AICPA). He was Chairman of the board of directors of said institute for 1976. Mr.

Bull also headed the AICPA committee in charge of the affairs of small businesses and was a member of the executive committee in charge of the operations of the Institute and the ad hoc committee formed to study the problems confronting the accounting profession in the U.S.A. which developed into the council presently in charge of issuing the accounting and auditing standards. Mr. Bull is also a member of the advisory council in charge of the preparation of consolidated financial statements for the government of the United States. Mr. Bull has over 35 years experience in the fields of accounting and auditing. The latest post in his career was as the managing partner of one of the major accounting firms in the United States.

2. Mr. Wallace E. Olson, a fellow of the AICPA, deputy Chairman of the board of directors of the AICPA (1972-1973), head of the executive committee and managing director of the Institute (1973-1980), Head of the AICPA division in charge of the code of ethics (1970-1972), and a partner (managing director) of a major accounting and auditing firm in the United States.

3. Dr. Abdullah AL-Moneef, Advisor, Ph. D. in accountancy, part time consultant to many government agencies and professor of Tax Accounting at the Faculty of Administrative Sciences at King Saud University for two years.

(4) Each team prepared the preliminary drafts of the section for which they were responsible. The draft was reviewed and then returned to them with fundamental comments so that they could prepare their study and proposals to be sent to the members of the other teams for study and comment.

(5) The drafts of all the sections were distributed among the teams in charge of the other sections and they were requested to send their comments in writing to the officials to be studied and sent to the other teams.

(6) The notes made by the team members together with the comments of the advisors were sent to each team in order to review them and get acquainted with the efforts exerted by other teams and their mutual impact. Many contacts took place between the team members, the advisors and the officials during the preparation of the final draft which would be distributed to the team members, the advisors and the officials in order to discuss it in a meeting to be attended by all team members, the advisors and the officials. There were several alternatives regarding the location of the meeting. The Scottish Institute generously offered to host the meeting and to provide for all of the necessary facilities. After studying the best alternatives is was decided to hold the meeting in Riyadh.

(7) During the period from 6.1.1403 to 12.1.1403H. a meeting was held in Kasr Al-Riyadh Hotel attended by all six experts, the three advisors and AL-Rashed firm's officials. Continuous morning and evening sessions were held in a private conference room. The members were provided with all shorthand and recording facilities. The meetings continued for several days during which the proposals forwarded by each team were studied and specific recommendations were made. Important issues were revealed which necessitated that the Ministry of Commerce and other relevant bodies' reaction towards them be sounded out. We all felt that such a meeting would greatly affect our judgements as regards the correctness of our research approach and the suitability of our proposals.

(8) In a meeting hosted by the Institute of Public Administration, an overview presentation of draft recommendations was made to H.E. the Minister of Commerce, H.E. the Deputy Minister of Commerce and other concerned high ranking officials from the Ministry. His Excellency the Minister of Finance and their Excellencies the Deputy Ministers as well as their Excellencies

مرجع (٥)
Art. (8) ص (١٠٥)

the Governor and Deputy Governor of SAMA attended the meeting. The Institute of Public Administration generously arranged for the meeting and the recording of its proceedings. The significance of this meeting was manifested in clarifying the relevant trends and in giving Al-Rashed firm impetus by asserting that the concerned authorities are giving due care and attention to the profession. It was useful in clarifying the importance of the issues which were the subject of elaborate study by the team members themselves. It also gave impetus to the team members, the advisors and the officials, thus confirming their interest in the project and that their efforts would be taken care of by those responsible for the project's approval and follow-up of its implementation.

(9) Team members, the advisory group and Al-Rashed firm held further meetings in Kasr Al-Riyadh Hotel to discuss the results of their presentation to the Ministers' meeting and final conclusions from the previous days meetings and discussions were drawn. Members of each team were requested to adjust their draft recommendations as necessary and send them to the officials in Riyadh. One of the experts was commissioned to read the adjusted draft recommendations in their final form as prepared by the team members.

(10) The final draft recommendations were sent to the officials and reviewed by the advisors. A meeting was then held at Al-Rashed firm, attended by the officials, the advisors and Dr. Sabry Heakal to discuss the final copy of the draft recommendations.

(11) Another meeting was held at the Riyadh Hyatt Regency for several days to discuss the final copy of the draft recommendations. This meeting was attended by Al-Rashed firm's officials, the advisor and Dr. Heakal in order to discuss the results of the three team's revisions of the draft recommendations. The proceedings of this meeting were fully recorded.

(12) Team members were then called in for further discussion with the advisors and Al-Rashed officials in Riyadh. This discussion resulted in further amendments of the final product

On 9.6.1403H. a meeting was held in Riyadh attended by the advisors, Dr. Sabry Heakal and Al-Rashed officials. All outstanding issues of the project and the amendments resulting from the previous meeting were discussed. Each advisor was assigned a certain segment of the project in order to finally ensure its adaptability to the circumstances of the Kingdom in general and the present conditions of the profession in particular, and to ensure its accuracy from the technical point of view, clarity of style and general consistency.

(13) During the whole period and at various stages all the parts and studies were translated into Arabic. After this meeting the Arab experts were requested to review the translation of some of the final products whether previously translated or still under consideration. This being done, the study was delivered to the advisors and other experts for final review.

(14) The Ministry of Commerce forwarded this study to the appropriate government departments and to a selected group of certified public accountants seeking their comments and advice.

(15) Replies were studied and summarised. The study was then amended in accordance with suggestions found acceptable by the Ministry.

(16) Ministerial Resolution No. 692, dated 28.2.1406 was finally issued approving this study which is concerned with the objectives and concepts of fincancial accounting and the standard of general presentation and disclosure, and is considered an official reference and guideline to all certified public accountants who are licensed to practise this profession in Saudi Arabia.

مرجع الاستشار

ص ١٤٢ عربي

ص ١٠٦ (انجليزي)

Art- No. (16)

APPENDIX B : OBJECTIVES OF FINANCIAL ACCOUNTING: ANALYTICAL SURVEY

OBJECTIVES OF FINANCIAL ACCOUNTING

TABLE OF CONTENTS

1. EXPLANATORY FOREWORD

1.1 INTRODUCTION

The general objective of this appendix is to study and analyse the scope of financial accounting in Saudi Arabia to provide a basis for the issuance of the standards of financial accounting.
(para 2)

1.2 THE NEED FOR ACCOUNTING STANDARDS

The Kingdom of Saudi Arabia is undergoing substantial changes in all aspects, particularly in the business enterprise sector. The varying degrees of these changes have created a serious state of lack of balance. A clear example of this is the marginal development in the accounting and auditing profession as compared to other sectors of the economy. While business enterprises have drastically changed and greatly developed to the effect of creating a complexity of relationships never encountered in the history of Saudi Arabia, the accounting and auditing profession did not develop enough to cope with those changes.
(para 3)

The effect of this imbalance is reflected in the form and content of measurement of operations, events and circumstances which affect the financial positions, results of operations and general disclosure of those results to the competent readers of the financial statements. Lower standards applied in the practice of this profession will inevitably lead to very serious results, the most important of which is the lack of confidence in the financial statements which present the financial position and the results of operations of the business enterprises. This will result in reservation on part of the competent readers who will seek other means to understand the financial position and results of operations of the business enterprises. These alternative methods of verifying financial information due to lack of confidence in audited financial statements will affect the quality and volume of financial and business transactions in particular and the national economy in general.
(para 4)

One of the most effective techniques of developing this profession is to issue standards of financial accounting which would determine the methods for the measurement of the effect of operations, events, and circumstances on the financial position of the business enterprise and would present the results of its operations to the competent readers of the financial statements. Many countries have recognized the importance of accounting standards and have accordingly issued such standards to be the basis for the measurement of the effects of operations, events and circumstances and to present results to all competent readers of the financial statements.

The need for financial statements has been recognized in the Company Law. Article 123 requires the directors of a joint stock company to prepare at the end of every fiscal year an inventory of the company assets and liabilities as of that date, as well as a balance sheet, a profit and loss account and a report showing the company activities and financial situation during the preceding fiscal year. Article 155 extends this requirement to share commandite companies while Article 175 requires managers of a limited liability company to prepare for every fiscal year a Balance Sheet, a Profit and Loss Account and a report showing the activities and financial situation of the company. Also, Article 26 requires a collective name partnership to prepare a Balance Sheet and a Profit and Loss Account at the end of the partnership fiscal year, Article 39 extends this requirement to simple commandite partnerships and Article 47 extends it to joint ventures.

Except for Article 26, which states that the profits and losses and of every partner should be determined on the basis of the Balance Sheet and the Profit and Loss Account, the Company Law does not provide an explicit rationale for the preparation of annual financial statements. In addition, the law does not define the form or content of the required financial statements.
(para 5)

Notwithstanding the lack of an explicit rationale in the Company Law[1] for the preparation of annual financial statements, an implicit rationale can be discerned. The Company Law for the most part, treats a business enterprise, organized in accordance with its provisions, as an entity that is separate from its owners. Article 13 states that every company incorporated under the law shall be deemed as a juristic person as of the date of its incorporation. In addition, the law, especially in the case of joint stock and limited liability companies, is predicated on the separation of the ownership and the management of these legal entities. The implicit rationale in the Company Law for the preparation of annual financial statements must be, therefore, the information needs of absentee equity investors for periodic test readings that can help them make decisions involving the business enterprise.
(para 6)

In light of the above we conclude that the Saudi Company Law does not expressly cover financial accounting standards. The study of other relevant regulations and by-laws has also led us to the same conclusion. Furthermore, no official or professional entity has, so far, issued any accounting standards in the country.
(para 7)

It is, therefore, clear that the absence of accounting standards will have a direct negative effect on the national economy as a whole, as manifested in the following:

1. Difficulty of Making Decisions

The absence of accounting standards may lead to the availability of different principles for the treatment of the operations, events and circumstances of business enterprises. This will make it difficult to compare the financial positions and results of operations of such enterprises and to compare between the various alternatives in the process of decision making. It goes without saying that such comparison is considered to be the cap-stone for decision making. For example, government agencies which use the financial statements of certain firms in determining subsidies (electricity, gas, public transportation) or granting loans (Saudi Investment Fund) will find it difficult to compare the financial position of those organisations. The reason for this difficulty is that operations, events and circumstances of similar nature are not treated in accordance with the same accounting standards, which makes it difficult to take the appropriate decisions with respect to granting subsidies or loans.

External users of the financial statements will also encounter some difficulty in comparing between the various business enterprises for investment purposes. Different ways of presenting information in the financial statements of those enterprises due to the application of different accounting methods in handling operations, events or circumstances of similar nature will eventually lead to difficulty in taking any investment decisions.
(para 8)

2. Faulty Decision Making

The absence of accounting standards may lead to the application of improper accounting methods for the measurement of operations, events and circumstances which will affect the presentation of financial information and the results of those operations to the external users of those statements. This will eventually prevent those financial statements from fairly presenting the financial position and the results of operations of the enterprise. Due to the fact that information contained in the financial statements is considered one of the main components in the process of taking a variety of decisions by various users, such decisions will inevitably be affected by

1. Article (66) of Saudi Company Law States that «a corporation shall be administered by a board of directors» Articles 152 and 153 state that «a partnership limited by shares shall be managed by one or more general partners who will be controlled by a board of controllers. While Articles 21-34 stipulate that partners in a partnership shall appoint one or more managers to manage the affairs of the company».

this faulty information. Government agencies, for example, use financial statements in deciding on matters relating to the grant of subsidies. If such statements were not properly prepared, this will affect the decisions relevant to determining those subsidies.

Lenders also use information contained in the financial statements, among other information, in making decisions with respect to granting business loans. Whenever the financial statements are deficient or faulty, this will lead to faulty decisions in granting such loans.
(para 9)

3. Complication Of The Decision Making Process

The absence of accounting standards will lead to the preparation of financial statements in a complicated manner which makes it difficult for external users to understand the information contained in those statements without reference to the original sources of such information which may not be possible in most of the cases.
(para 10)

1.3 THE SIGNIFICANCE OF ACCOUNTING STANDARDS

Modern business enterprises in Saudi Arabia, that is, enterprises organized for profit, are characterized by the separation between management and ownership.

With a condition of detached ownership, the scope of financial accounting has necessarily been expanded. The function of reporting information to absentee owners has been added. Absentee owners need periodic test readings about the performance of the enterprise that can help them make decisions about their investment in the enterprise and evaluate management's discharge of its stewardship responsibility. This development has greatly increased the need for accounting standards. The absentee owners, unlike the owner/manager, do not have the opportunity to combine reported information with first-hand knowledge of the conditions and activities of the business enterprise. The quality of their decisions about their investments in the business enterprise and their evaluation of management depend critically, among other things, on the relevancy and reliability of the information on which their decisions and evaluations are based. This makes it evident that there is a need for accounting standards to ensure that relevant and reliable information is communicated to absentee owners.
(para 11)

The provision of relevant and reliable informtion is not limited to absentee (owners). Absentee owners are not the only parties at interest. Modern business enterprises continually draw new capital from many sources in the form of new equity participations or loans. Business enterprises who seek capital operate in varying circumstances of possible success or failure. Those who can supply capital make decisions as to whether and where to invest or lend and at what return. Decisions by those who can supply capital to a business enterprise require information to assess the prospects of the enterprise.

The quality of decisions made by those who can supply capital to a business enterprise depends, among other things, on the relevance and reliability of the information on which their decisions are based. Accordingly, relevant and reliable information is critical to prospective equity investors as well as current and prospective lenders and accounting standards are needed to ensure that.
(para 12)

Under these circumstances current and prospective equity investors and lenders, as well as other parties, are subject to management discretion in terms of the relevance and the reliability of the information it communicates to them. To be sure, much of the burden of seeing that relevant and reliable information is communicated falls on the shoulders of chartered accountants. To discharge this responsibility, the chartered accountant must be endowed with broad understanding, a keen sense of equity and a high degree of objectivity if his work is to be most effective. But he needs also to be fortified by a set of authoritative financial accounting standards to which particular issues may be referred.
(para 13)

Unfortunately, chartered accountants in Saudi Arabia have not yet had the benefit of a set of authoritative financial accounting standards to furnish guidance and support. This condition has rendered the burden of discharging their full obligations an almost impossible task. Chartered accountants in Saudi Arabia have been asked and have been willing to certify the correctness and completeness of the financial statements when no authoritative standards of correctness and completeness have been established.
(para 14)

1.4 THE IMPORTANCE OF CONCEPTUAL FRAMEWORK FOR FINANCIAL ACCOUNTING STANDARDS

The circumstances surrounding the use and importance of financial statement information in Saudi Arabia clearly indicate the need for financial accounting standards. But such standards can not be determined by an appeal to authority or to common opinion. The approach to standards should be by the way of the objectives of financial statements so that the established standards may be relevant thereto, and by the way of the fundamental concepts of financial accounting so that the established standards may be consistent. To be relevant, financial accounting standards need to be clearly related to the essential objectives of the financial statements of business enterprises. To be consistent, standards need to rest upon well defined concepts.
(para 15)

The relevance of issued standards to the objectives of financial accounting is evident. Irrelevant standards will be useless and their objectives will be difficult to achieve. The specific objective of financial statements is to provide suitable information that would enable users of those statements to take proper financial decisions. Accounting standards provide guidelines for the measurement of operations, events and circumstances that would affect the financial position of the business enterprise and the results of its operations. Such standards should, therefore, be strictly relevant to objectives peculiar to the business environment of the Kingdom of Saudi Arabia. To emphasise this relationship between standards and objectives of financial accounting, the establishment of financial accounting objectives in Saudi Arabia will be the basic and primary step which precedes the issuance of accounting standards.
(para 16)

Understanding and appreciation of accounting standards by users of the financial statements and professional accountants and auditors is also a basic condition for the proper application of those standards. Financial accounting is not an empirical science; it is a social discipline which requires that its standards are generally accepted by users and professional accountants. Unless these standards are based on specific and clear-cut objectives, it will be difficult to accept those standards and to apply them.
(para 17)

Finally, standards should be internally consistent or, otherwise, they will be self-contradictory and difficult to accept or apply. The best way to ensure this internal consistency is to issue these standards within a conceptual framework which defines the concepts and objectives of financial accounting.
(para 18)

On the basis of the above argument and in line with the experience of other countries in this respect, we notice that it is difficult to issue standards of the quality described above through appeal to official authorities or to the public opinion. They should, rather, be issued on the basis of a conceptual framework which defines the objectives of financial accounting and relates those objectives and concepts in a systematic and logical sequence.
(para 19)

1.5 THE INTERRELATIONSHIP BETWEEN THE CONCEPTUAL FRAMEWORK AND THE STANDARDS OF FINANCIAL ACCOUNTING

Accounting standards are mainly concerned with establishing the proper methods for the definition, measurement, presentation and clarification of the various captions contained in the financial statements. They are also concerned with the effect of the operations, events and circumstances on the financial position of the business enterprise and the results of its operations. Each accounting standard is usually concerned with a specific element of the financial statements or with a certain type of operations, events or circumstances which affect the financial position and results of operations of a given business enterprise. The objectives of financial accounting are realised within this conceptual framework by defining the nature of information which needs to be produced to meet the needs of the users of financial statements. The conceptual framework of financial accounting, on the other hand, is mainly concerned with defining the nature and quality of information produced by financial statements to meet the requirements of the users of this information. In this respect the logical relationship is established between the standards of financial accounting and their conceptual framework; because without defining the required information (objectives) and without defining the nature and quality of this information (concepts), it will be difficult to determine the appropriate methods for the measurement, presentation, and disclosure of the components of financial statements and the effect of operations, events, and circumstances on the financial position and the results of operations of a given business enterprise (standards). This relationship is clearly delineated in the following figure.
(para 20)

Elements of the Conceptual Framework and Standards in their logical sequence	Main objective of each element	Degree of definition
↓	↓	↓
Objectives of Financial Accounting	Define the nature of financial accounting information that should be produced to meet the requirements of users.	Generally defined
↓	↓	↓
Concepts of Financial Accounting	Define the nature and quality of information produced by financial accounting to meet the requirements of users.	Specifically defined
↓	↓	↓
Standards of Financial Accounting	Define the basic appropriate methods for the measurement, presentation and disclosure of the elements of financial statements and the effect of operations, events and circumstances on the financial position and results of operations of the business enterprise.	More specifically defined

RELATIONSHIP BETWEEN THE COMPONENTS OF CONCEPTUAL FRAMEWORK AND THE STANDARDS OF FINANCIAL ACCOUNTING

In short, the need for defining the components of the conceptual framework of financial accounting before the issuance of standards should be emphasised. This is due to the relationship which connects both the conceptual framework and the standards in a logical sequence. The conceptual framework and the standards together form a connected chain of events and if any step in this sequence is missing it will inevitably interrupt the buildup of this sequence and adversely affect the achievement of objectives of financial accounting.
(para 21)

1.6 THE IMPORTANCE OF FINANCIAL ACCOUNTING AS A COMPONENT OF THE CONCEPTUAL FRAMEWORK

Financial accounting, as a service tool, is concerned with the measurement of the effect of operations, events and circumstances on the financial position and results of operations of a given enterprise. The most important functions of financial accounting are, therefore, manifested in the definition, analysis, measurement, classification, summary and reporting the results of operations, events, circumstances and their effect on the financial position and the results of operations of a given business enterprise. In this respect, financial accounting is considered to be a service tool the main objective of which is to produce and convey accounting information which would assist users of the financial statements of a given business enterprise in taking the appropriate decisions with respect to this enterprise.
(para 22)

The objectives of financial accounting, on the other hand, cannot be determined in a vacuum. They should rather be extracted in terms of the users' needs for information. Therefore, to determine the objectives of financial accounting, it is imperative to first determine the objectives of the products of financial accounting (namely the financial statements, and other relevant reports). Because the main objective of determining objectives is to use these objectives as land marks for laying out standards which would govern the measurement, presentation and disclosure of captions stated in the financial statements. These objectives will also determine the effect of operations, events, and circumstances on the financial position and results of operations of the business enterprise. It is, therefore, imperative to have objectives which are in conformity with the needs of external users for information contained in the financial statements in order for those standards to serve their stated purpose. Without establishing this relationship between the objectives of financial accounting and the users' needs for information, the standards may lead to the production of misleading information which does not meet the requirements of the external users of the financial statements.
(para 23)

The products of financial accounting that are published for external users consist of general purpose and specific purpose financial statements or reports. General purpose financial statements are intended to address a group or more of users. The Saudi Company Law requires the issuance of such financial statements. As previously stated, a number of articles of the company law stipulate that the managements of business enterprises must prepare reports on the financial position and results of operations which take the form of balance sheets and income statements of their enterprises.

Those statements are considered to be of general purpose because they are issued for the benefit of one or more groups of users. Specific purpose financial statements or reports are tailored to meet the specific needs of a particular user, for example, the financial statements specifically prepared to determine government subsidies and financial reports submitted to the zakat and tax authorities for tax considerations or the financial statements prepared to be submitted to a given bank or lending areas with the objectives of obtaining a loan.
(para 24)

In light of the above, it is evident that the appropriate method of defining the objectives of financial accounting within the conceptual framework that meets the requirements in Saudi Arabia is based on the stated objectives of the products of this financial accounting. Therefore, in defining the objectives of financial accounting, general purpose financial statements have been emphasised because they are the end product of financial accounting. Specific purpose financial statements have been excluded from this study for the following reasons:

1) Users of specific purpose financial statements and reports have the authority to determine information which must be submitted to them, as contrasted to the users of general purpose financial statements.

2) When the objectives of financial accounting are defined in conformity with general purpose financial statements, this will assist in setting accounting standards which, after minor adjustments, will also suit the purposes of specific users such as the Zakat and Income Tax Department, and other government agencies and funds which grant subsidies or loans.

3) Setting accounting objectives tailored to meet the requirements of specific users will make it difficult for those objectives to meet the need of the majority of external users who may not have the capability or the authority to define the financial information which must be supplied to them by the business enterpirse concerned.
(para 25)

For the above reasons the objectives of financial accounting were determined in conformity with the objectives of general purpose financial statements. These objectives will mainly determine the framework for setting accounting standards which will take into account the social, legal and economic aspects of the environment in Saudi Arabia.
(para 26)

1.7 THE EFFECT OF THE ENVIRONMENT ON DETERMINING THE OBJECTIVES OF FINANCIAL STATEMENTS

For the objectives of financial statements to be successful as a basis for setting viable standards, these objectives should be derived from and consistent with the environment dominant in Saudi Arabia. Unsuitable objectives will mostly lead to setting standards that do not meet the environmental requirements and are, therefore, difficult to apply. However, the difficulty at this point resides in defining the aspects of this environment through field research which is not feasible at the present time due to the pressing need for such accounting standards. We have, therefore, resorted to the experience of the Ministry of Commerce in analysing the work environment of business enterprises and the needs of external users of the general purpose financial statements as supported with practical experience and personal observations.
(para 27)

In this respect, the Saudi Company Law is considered to be the main reference which determines the legal environment of business enterprises. It defines the conditions of formation and management-shareholders relationships and conditions of termination and liquidation of companies. What mainly concerns us at this point is the protection of the interests of owners/investors through providing them periodically with financial information that would assist them in taking the appropriate decisions. This emphasis on shareholders, particularly in the case of joint-stock companies, is considered to be one of the main objectives of the issuance of financial statements in Saudi Arabia. The Company Law did not, in fact, define any means other than financial statements to convey the necessary financial information to those users. Emphasis on the financial statements is, therefore, deemed essential to abiding by the provisions of the Company Law in Saudi Arabia.
(para 28)

Additionally, certain observations and personal experience have contributed directly or indirectly to defining the objectives of financial statements. These observations cover, but are not limited to, the following factors:

1. Rapid development of the national economy.

2. Adoption of the laisser-faire system of economy.

3. Availability of surplus liquidity that needs to be invested.

4. Modern trends of investment in shares rather than real estates.

5. The trend of major investors towards choosing among a variety of investment options.

6. Limited information available to investors and others who do not have the capability or the authority to determine the information which should be available in financial statements issued for external users.

7. Nonavailability of professional financial analysts to provide guidance to investors in their evaluation of investment alternatives.

8. Occasional reliance on information from private sources which may be inaccurate in making decisions of financial nature, particularly decisions relevant to investment.

9. Trend towards imitation by the majority of minor investors.

10. Increased number of small investors with limited capital who seek investment opportunities for their funds.
    (para 29)

All these factors and others will undoubtedly impact the statement of objectives of financial statements. The legal, economic and social aspects of the environment in the Kingdom are considered to be a major indicator of the need of the society as a whole for financial information to assist them in making the right decisions. These factors also emphasise the fact that objectives should account for the needs of various sectors of the economy and society who may not have their own means of obtaining such information which will guide them to the best investments available hence assist the development of the national economy.
(para 30)
(Next paragraph is No. 103)

2. COMMENTARY

2.1 INTRODUCTION

Financial accounting is considered to be an important tool in the process of making decisions in modern business enterprises. This importance is manifested in the information contained in financial statements and the need of various sectors for this information in making decisions relevant to running the affairs of business enterprises. In Saudi Arabia, as in other countries, to define the objectives of financial accounting which will be the basis for the issuance of accounting standards, the following conditions have to be fulfilled:

1. Define the sectors of users for whom the objectives of financial accounting will be mainly addressed.

2. Determine the common needs for financial information of sectors of external users already defined in the previous step.

3. Define objectives which comply with the common requirements for information by the various sectors of external users, taking into consideration the type of information which can be produced by financial accounting.
   (para 103)*

The importance of defining a statement of objectives which will be the basis for the issuance of standards of accounting is manifested in describing, in general terms, the information which must be contained in the financial statements (the end product of financial accounting) and in discriminating between this information and other types of information which may be utilized by external users in making their decisions with respect to a given business enterprise. Such statement of objectives must, therefore, give a general description of the types of information which the financial statements may contain and discriminate between this information and other types of information used by external users. This general description, in fact, represents one of the main links which connect the statement of objectives, concepts and standards of financial accounting.
(para 104)

2.2 USERS OF FINANCIAL STATEMENTS

Users of the financial statements may be divided into the following two main categories:
(para 105)

A) USERS DIRECTLY INVOLVED IN THE BUSINESS ENTERPRISE

This category of users includes present and prospective investors (shareholders), lenders, Zakat and Income Tax Department; Government, government funds; the management, personnel, clients and suppliers of the business enterprise. With the exception of the management itself, the remaining users in this category are considered to be external users, because they do not keep abreast of the day-to-day affairs of the enterprise.

B) USERS INDIRECTLY INVOLVED IN THE BUSINESS ENTERPRISE

This category of users includes government control agencies and those concerned with planning and directing the national economy. Users in this category are also considered to be external users because they are not usually acquainted with the daily affairs of the business enterprise.

Users in the above two categories may also be classified in terms of their capacity or authority to define their information needs, as follows:

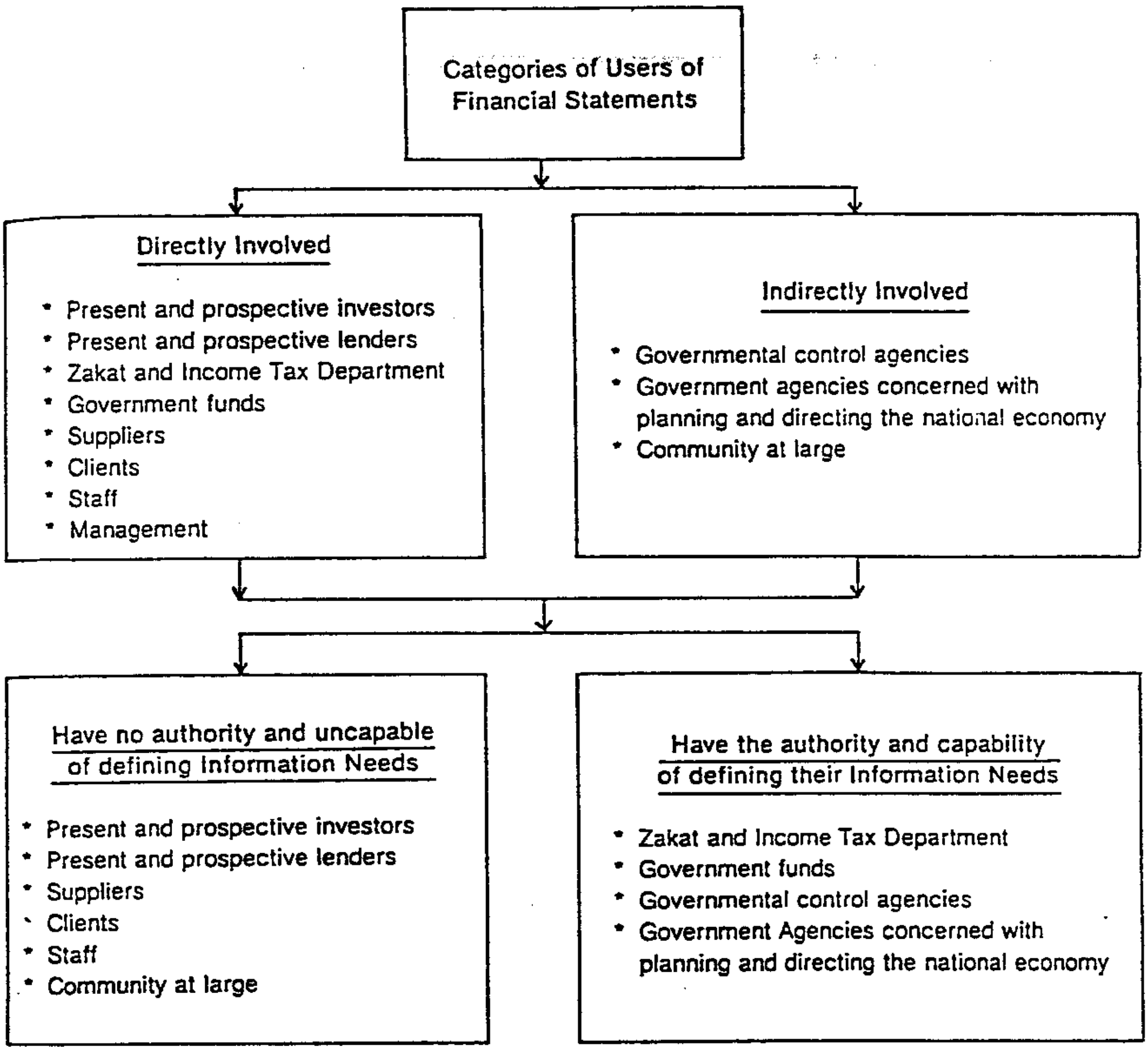
★ Missing paragraphs are relevant to the text of the standard and are already stated in the introduction of this book.

a) Users who have the capability or the authority to define their information needs of the business enterprise

This group of users includes the Zakat and Income Tax Department, government funds, management of the business enterprise itself, governmental control agencies, and government agencies concerned with planning and direction of the national economy.

b) Users who do not have the capability or the authority to define their information needs

This group covers the remaining categories of users. Although some lenders may have the capability to define their information needs from a given business enterprise, in most cases,these lenders mainly depend on the financial statements as submitted by the borrowing business enterprise. However, because these users cannot impose specific financial accounting standards for the preparation of those financial statements, they were also classified within this category of users. The following figure outlines the above mentioned classifications:


Categories of Users of Financial Statements
Directly Involved
Present and prospective investors
Present and prospective lenders
Zakat and Income Tax Department
Government funds
Suppliers
Clients
Staff
Management
Indirectly Involved
Governmental control agencies
Government agencies concerned with planning and directing the national economy
Community at large
Have no authority and uncapable of defining Information Needs
Present and prospective investors
Present and prospective lenders
Suppliers
Clients
Staff
Community at large
Have the authority and capability of defining their Information Needs
Zakat and Income Tax Department
Government funds
Governmental control agencies
Government Agencies concerned with planning and directing the national economy

2.3 MAIN USERS ADDRESSED BY THE STATEMENT OF OBJECTIVES:

The Statement of Objectives of Financial statements is mainly concerned with external users who do not have the authority or the capability to determine their information needs of the business enterprise. The quality of information available to them is, therefore, subject to the judgement of the business enterprise with which they deal. This category of users includes present and prospective investors and lenders, suppliers, clients, and personnel of the business enterprise. This is due to the fact that this statement mainly concentrates on the production of general purpose financial statements which serve external users. It was, therefore, logical not to concentrate on the specific needs of the following categories of users.
(para 106)

A) MANAGEMENT OF THE BUSINESS ENTERPRISE

Although the management of a given business enterprise may use financial statements as a source of information, the main role of management is manifested in the preparation of general purpose financial statements addressed for external users. The management of any business enterprise is, in fact, capable of obtaining all their information needs, inclusive of financial statements and reports prepared for internal use. Therefore, objectives of the financial statements should concentrate on the external rather than the internal users.

B) GOVERNMENT DEPARTMENTS

These include Zakat and Income Tax Department, Government Funds, Governmental Control Agencies, and Government agencies concerned with planning and directing the national economy.

It is evident that the general purpose financial statements which are prepared for external users will also meet the requirements of government departments. However, this category of users have the official authority to define their information needs from any given enterprise. Furthermore, the requirements of these government departments are usually determined by certain specific objectives which may not be similar to the needs of other external users of the financial statements. Therefore, emphasis on the needs of these departments may lead to setting objectives of financial statements which are not compatible with the common needs of the other external users. As stated earlier, other external users of the financial statements do not have the authority enjoyed by government departments to define and obtain the information which they may need from the business enterprise. It is, therefore, logical to concentrate on the needs of this category of users and consider these needs as the basis for setting the objectives of general purpose financial statements which are addressed to external users. This emphasis on external users does not mean that such financial statement will be rendered unsuitable for government departments such as Zakat and Income Tax Department, government funds, controlling agencies as well as agencies concerned with the planning and direction of the national economy. For these departments to make proper use of general purpose financial statements, information presented in those statements may have to be adapted at varying degrees to meet the requirements of each of such departments or, otherwise, they may request the business enterprise to supply them with special financial reports tailored to their specific needs.

2.4 COMMON INFORMATION NEEDS OF EXTERNAL USERS

The importance of equity investors as a group of users of financial statements does not require much explanation as this general idea seems to be widely accepted in the Company Law. The information needs of other potential users, e.g., prospective equity investors as well as current and prospective lenders have not received as much attention in the Company Law.
(para 107)

However, we believe that few, if any, would rank the information needs of prospective equity investors in making decisions involving a particular business enterprise far below the information needs of its current equity investors. Both groups need information about a business enterprise to help them make decisions involving the enterprise. Current equity investors need information to help them decide whether to sell, hold or increase their investment in the business enterprise. Prospective equity investors need information to help them decide whether to invest or not invest in the business enterprise. The financial statements of a business enterprise can and should provide, at least partially, for the information needs of both groups. Accordingly, we believe that the information needs of prospective equity investors should be considered along with the information needs of current equity investors when the objectives of the financial statements of business enterprises in Saudi Arabia are defined.
(para 108)

We also believe that few would disagree with the proposition that the financial statements should also take into consideration the information needs of current and prospective lenders. Current and prospective lenders make investment decisions similar to those made by equity investors, so they have similar needs for financial information. The basic decisions made by lenders and pertaining to the business enterprise are the decisions to make the loan or invest in debt securities issued by the enterprise and this, in our view, requires among other things the same fundamental financial information equity investors need.
(para 109)

Current and prospective equity investors and lenders invest or lend cash with the expectation of getting more cash. Accordingly, they are primarily concerned with the business enterprise's ability to generate favorable cash flow. They need financial information that is indicative of the business enterprise's potential to generate favorable cash flow. This leaves us with the conclusion that evidence (indications)of the business enterprise's ability to generate favorable cash flow in the normal course of business should have top priority in the financial statements.

Business enterprises in Saudi Arabia are organized for profit. In addition, investors and lenders invest in or lend to business enterprises they expect to continue. Accordingly, they are interested in the ability of a business enterprise to generate favorable cash flows, as well as the adequacy of that cash flow to meet its obligations when they fall due and make regular distributions to its owners without curtailing the scale of its operations. The best indications of the ability of the business enterprise to generate favorable cash flow is its ability to generate:

I) Sufficient earnings; and

ii) Convert those earnings into sufficient cash flow.

Accordingly, equity investors and lenders are directly interested in information about the ability of the enterprise to generate earnings and convert those earnings into cash flow.
(para 110)

The sufficiency of the earnings is almost always measured in relative, not absolute terms. Investors and lenders tend to compare the earnings of a particular business enterprise with the earnings that can be obtained from other investments. Earnings are always related to the economic resources that are utilized by the business enterprise before they are compared with earnings from other investment alternatives. In addition, the sufficiency of the cash flow generated from earnings depends on the business enterprise's requirements to maintain the scale of its operations, as well as its debt and owners' equity cash outflow requirements. Accordingly, equity investors and lenders are directly interested in information about a business enterprise's economic resources and the claims against those resources, i.e. its assets, liabilities and owners' equity.
(para 111)

The Saudi government is a major investor in and/or lender to many business enterprises. The Saudi government does not always invest or lend on the basis of immediate monetary return. Other objectives are also important, such as industrialization, development of human resources and the balanced distribution of economic activities throughout the country. This suggests that the government as a current or prospective investor or lender is directly interested in information about the progress of business enterprises in achieving certain defined non-monetary objectives. While this is true, we believe that the government as a current or a prospective investor or lender is also concerned about the economic viability of the business enterprises it invests in or lends money to. The economic viability of a business enterprise depends, among other things, on its ability to generate favorable cash flow. Accordingly, the types of information that serve private investors' and lenders' information needs ought to serve some of the government's information needs.

Obviously, other indicators of enterprise progress toward achieving non-monetary objectives require other types of information. However, since indicators of enterprise progress toward achieving non-monetary objectives might be different from one business enterprise to another, the types of information needed are not subject to generalization. Accordingly, the government information needs that relate to its nonmonetary investments or lending objectives ought to be satisfied through special reports. The power and authority of the government as an investor or lender are such that it ought to be able to prescribe the form and contents of such special reports.
(para 112)

In addition to investors and lenders, suppliers, clients and personnel of the business enterprise represent the major external users who must be taken into consideration in the Statement of Objectives. The common need of all these users is manifested in the acquisition of indicators which would assist them in evaluating the potential continuity of their relationship with the business enterprise. It is evident that continued relationship of these users with the business enterprise depends, among other things, on the enterprise's capacity to continue as a source of income (in case of personnel) and as a source of goods or services (in case of clients) or as a consumer of goods and services (in case of suppliers). It is also evident that the business enterprise's survival mainly depends on its capacity to generate favourable income which can be turned into cash flow which would be sufficient to meet its commitments and make regular payments to the equity investors without having to reduce the volume of its operations. In evaluating this capacity, employees, clients, and suppliers should employ the same historical indicators used by investors and lenders in evaluating the potential of this enterprise of generating favourable cash flow.

We can conclude from the above that primary external users have the same need for historical information on the business enterprise's capacity to generate income that may be converted to favourable cash flow. General purpose financial statements that are prepared for external users should, therefore, provide the required information within the capacity of financial accounting to produce such information.
(para 113)

2.5 LIMITATIONS OF GENERAL PURPOSE FINANCIAL STATEMENTS

General purpose financial statements are the only source of information available for external users to make decisions with respect to a given business enterprise. However, making decisions relevant to a given business enterprise requires the availability of a variety of information part of which will be found in the financial statements while others should be sought from other sources. The Company Law in Saudi Arabia, therefore, stipulates that boards of directors of joint stock companies are required to produce annual management reports which include other kinds of information which are deemed necessary for shareholders in making certain decisions (e.g. information relevant to taxation, or appropriation of subsidies in case of companies entitled to such subsidies, or information relating to the issuance of additional stock... etc.). In fact, limitation of general purpose financial statements are attributed to the following reasons:

A) Difficulty of producing specific information of any significance on a given enterprise through financial statements.

B) Potential contradiction between the specific requirements of users and the common needs of primary external users for information.
(para 114).

2.5.1 DIFFICULTY OF PRODUCING SPECIFIC INFORMATION OF ANY SIGNIFICANCE ON THE PERFORMANCE OF A GIVEN BUSINESS ENTERPRISE

1. Evaluate Management Performance Apart From The Enterprise Performance

Financial statements used to be considered the basis for evaluating the performance of the management of the busines enterprise. Present equity investors decide in light of the financial information they have on hand either to renew or to withdraw their vote of trust in the management of the enterprise. The primary question which triggers the minds of equity investors is usually concerned with the efficiency of management in utilizing the enterprise's resources and managing its funds in a manner that would achieve the stated objectives of the enterprise. The common objective of equity owners is, of course, to increase their share of cash flow which is generated from their investments in the enterprise. The achievement of this objective, as indicated earlier, depends on the ability of the enterprise to realise favourable cash flows. This means that equity owners use information contained in the financial statements with respect to the performance of the enterprise in evaluating the performance of the enterprise's management. The reason for that is that financial accounting and financial statements cannot separate the performance of management from that of the enterprise itself. The performance of management is naturally one of the factors which contribute to the performance of the enterprise. However, there are other factors which affect the performance of the enterprise over which the management has no control. The financial statements, therefore, cannot contribute any specific information to assist the equity owners in generally evaluating the performance of management separately from the performance of the enterprise as a whole.
(para 115)

2. Evaluate the Enterprise's Progress Toward Achieving Non-monetary Goals

For the production of information with respect to a given enterprise, financial accounting depends on the measurement of the monetary impact of operations, events and circumstances on the financial position of that enterprise. However, information contained in general purpose financial statements to be supplied to external users are strictly relevant to the financial position, results of operations and changes resultant from investment operations and financing as reflected in the Statements of Sources and Applications of Funds of this enterprise for a given period of time. Therefore, to follow up the progress of the enterprise and to ensure its achievement of stated objectives which are not subject to the measurements employed by financial accounting, other indicators (which fall outside the scope of general purpose financial statements) should be employed.
(para 116)

3. Direct Measures of the Enterprise's Future Cash Flows

In producing financial information relevant to a given enterprise, financial accounting mainly concentrates on operations, events and circumstances of historical nature which impact the financial position and results of operations of that enterprise. Direct measures of the enterprise's cash flows depends on forecasting the impact of that enterprise's operations, events and circumstances on the future of its cash flows. Therefore, direct measures of such cash flows fall outside the scope of financial accounting and the information contained in the general purpose financial statements.
(para 117)

4. Direct Measures of the Present Value of the Business Enterprise

The role of financial accounting with respect to information contained in general purpose financial statements prepared for external users is limited to providing historical indicators on the ability of the enterprise to generate income and favourable cash flows and the relation of this ability with the available economic resources of the enterprise. The main objective of these indicators is to assist primary external users in evaluating the enterprise's ability to continue to generate favourable cash flow in the future. Irrespective of the fact that indicators contained in the financial statements would help investors in the evaluation of their investments in a given enterprise, and deciding on the acquisition of equity or on continuing to keep such equity, financial accounting, however, does not aim at giving direct measures of the value of the business enterprise. Such value, in fact, depends on a variety of factors most of which fall outside the scope of operations, events and circumstances covered by financial accounting.
(para 118)

5. Direct Measures of the Risk Associated with Holding an Equity Interest or a Loan Position in the Business Enterprise:

Financial accounting also gives some indicators on the historical ability of the enterprise with respect to overcoming adverse conditions and taking advantage of available opportunities and enhancing the enterprise's ability to generate sufficient cash flows. These indicators, among other factors, will help investors in making their own personal judgements associated with holding an equity interest or a loan position in the business enterprise. However, financial accounting in general and financial statements in particular do not provide direct measures of such risks.
(para 119)

2.5.2 POTENTIAL CONTRADICTION AMONG THE NEEDS OF VARIOUS USERS FOR INFORMATION

In order for the Statement of Objectives of Financial Statements to realise its objective ofsetting accounting standards, it would be necessary to emphasise the external users' common need for information which may be generated from financial accounting. Without this emphasis, the Statement of Objectives may be self-contradictory. The common need of external users for information is manifested in the enterprise's ability to generate favourable cash flows. It is evident that information compatible with the common requirements of primary external users referred to in the proposed FinancialStatement Objectives will partially satisfy the needs of other categories of external users. However, this need satisfaction may vary from one sector of external users to another. This means that, in most cases, such external users may have to adapt this information to their specific needs. These users may also need specific reports which will address their particular needs. These external users not directly considered in the Statement of Objectives are government agencies concerned with zakat and taxation, funds, agencies concerned with planning and direction of the national economy and control agencies. These areas, however, enjoy the authorities which enable them request information in the form of specific reports to be submitted to them by the enterprises concerned. Furthermore, the preparation of general purpose financial statements in accordance with the common needs determined in the proposed Statement of Objectives, will help these government agencies evaluate the information presented in those statements and determine their suitability and/or the adjustment of this information to suit their needs. In this manner, the Statement of Objectives and Standards based on those objectives will form a positive step forward to the fulfillment of objectives of those government agencies.
(para 120)

2.6 COMPARISON OF THE RECOMMENDED OBJECTIVES AND LIMITATIONS WITH THOSE IN THE U.S.A., WEST GERMANY AND TUNISIA

Comparison of the recommended Objectives and Limitation of the Financial Statements of Business Enterprises with those in the U.S.A., West Germany and Tunisia is beneficial in understanding the recommendations set forth in the statement. The U.S.A., West Germany and Tunisia are selected as the basis for the comparison because they were the subject of the comparative study that made up the first stage of the project. Appendix A is a matrix containing the comparisons.

1. THE UNITED STATES

The comparison with the United States is based on the Statement of Financial Accounting Concepts No. 1, «Objectives of Financial Reporting by Business Enterprises» issued by the Financial Accounting Standards Board in November 1978. This statement is the first in a series of statements that have either been issued or will be issued by the Financial Accounting Standards Board as part of its project to develop a conceptual framework for financial accounting and reporting in the United States.(1)

2. WEST GERMANY

The comparison with West Germany is based on the German Corporate Law which was revised and has been effective since 1966, special laws dealing with certain companies and the German Commercial Code. In West Germany, financial accounting regulations have been legally specified. Legal requirements have been supplemented by more specific accounting rules prescribed by the official German Accounting Institute (Institute der Wirtschaft Sprufer); however, these guidelines are to be in accordance with the legal requirements.

3. TUNISIA

The comparison with Tunisia is based on the Uniform Accounting Plan (Plan Compatable General) issued in 1966. The plan contains the Tunisian accounting requirements applicable to business enterprises.

The United States is the only country that has an explicit authoritative Statement of the Objectives of Financial Accounting and Reporting. In the United States, the objectives of financial accounting and reporting are focussed on general purpose external financial reporting by business enterprises. The objectives stem primarily from the needs of external users who lack the authority to prescribe the information they want and must rely on information management communicates to them. The main function of financial accounting and reporting is to provide information that can assist external users to make decisions involving the business enterprises.
(para 121)

In the statement issued by the United States the objectives are directed toward the common interests of many users in the ability of an enterprise to generate favourable cash flows but are phrased using investment and credit decisions to give them a focus. «Investors» and «creditors» are used broadly and include not only those who have or contemplate having a claim to enterprise resources but those who advise or represent them.
(para 122)

The objectives pertain to financial reporting and are not restricted to financial statements. Investors, creditors and others are assumed to use information about the business enterprise in various ways to assess the prospects for cash flows. Although financial reporting should provide basic information to

(1) Other statements issued to date are:

i) Statement of Financial Accounting Concepts No. 2, «Qualitative Characteristics of Accounting Information», May 1980.

ii) Statement of Financial Accounting Concepts No. 3, «Elements of Financial Statements of Business Enterprises»,December 1980.

iii) Statement of Financial Accounting Concepts No. 4, «Objectives of Financial Reporting by Non Business Organizations», December 1980.

aid them, they are expected to do their own assesments of the prospects for cash flows.
(para 123)

The limitations of financial reporting set forth in the FASB Statement of Concepts No. 1 stem mostly from the stated characteristics and limitations of financial accounting information. Other limitations are also implied. For example, by focussing the objectives on the information needs of investors and lenders the implication is that financial reporting may not provide for the information needs of other users, such as taxation authorities, except coincidently.
(para 124)

The comparison between the recommendations for Saudi Arabia and the stated objectives of financial reporting for business enterprises in the United States reveals certain similarities as well as dissimilarities. The two are similar in terms of their focus on the information needs of investors and lenders, their perception that investors and lenders need information that can help them assess the prospect of cash flow to them and their general perception of the nature of the information that should be provided through the financial statements. The dissimilarities are mainly related to the degree of specificity of the two statements. The U.S.A. objectives are too general to provide adequate guidance for the establishment of financial accounting standards in Saudi Arabia.
(para 125)
(Following paragraph is No. 202)

APPENDIX B
COMPARATIVE MATRIX OF OBJECTIVES AND LIMITATIONS

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
OBJECTIVES OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES	OBJECTIVES OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES	OBJECTIVES OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES	OBJECTIVES OF FINANCIAL REPORTING BY BUSINESS ENTERPRISE
• The basic objective of financial statements is to provide information useful for making business decisions by those who do not have the power or the authority to prescribe information they want from the business enterprise. Specifically, the financial statements are intended to provide information that can aid current and prospective equity investors and lenders in assessing the potential cash flow to them from holding an equity interest or a loan position in the business enterprise. • An objective of the financial statements is to provide information that can help current and prospective equity investors and lenders assess the historical ability of the business enterprise, to generate favourable cash flow and the adequacy of that cash flow. • An objective of the financial statement is to provide information about the historical ability of the business enterprise to generate earnings, convert those earnings into cash flow, pay its obligations when they fall due and make distributions to its owners without curtailing the scale of its operations. Periodic measurement of income and information about income is, therefore, the central objective of financial accounting and the financial statements of a business enterprise. • To be useful, periodic measurement of income should be based on accrual accounting. Current and prospective equity investors and lenders are not only interested in	• Financial reporting is not an end in itself but is intended to provide information that is useful in making business and economic decisions about business enterprises: • Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. • Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors and others assess the amounts, timing and uncertainty of prospective net cash in-flows to the related enterprise. • Financial reporting should provide information about economic resources of an enterprise, the claims to those resources and the effects of transactions, events and circumstances that change its resources and claims to those resources. • The primary focus of financial reporting is information about earnings and its components. • Financial reporting is expected to provide infor-	There is no explicit statement of objectives of financial statements of business enterprises. However, the Corporation Law which became effective in 1966 states that, the annual financial statements should conform to proper accounting principles. They shall be clear and well set out and give as true a view of the company's financial position and of its operating results as is possible pursuant to the valuation provisions set forth in the law. The form of financial statements is set forth in considerable detail in the law.	There are no explicitly stated objectives for the financial statements of business enterprises in the Uniform Accounting Plan issued in 1966. The plan itself is a uniform system of accounting applicable to the private as well as the public sector. The objectives of the plan are: improvement in fiscal control and national economic planning through systematic information for the social accounts and standardization of rules for financial statement presentation.

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
transactions and events that had an effect on the enterprise's cash flow during the period, but also in those transactions and events that will impact cash flow beyond the reporting period. • To be useful, information about income should include the sources and components of that income and should differentiate between recurring and non-recurring sources. Information about the sources, components and incidents of income helps investors and lenders in forming their own expectations about the future and its relation to the past. • An objective of financial statements is to provide information about the enterprise's assets, liabilities and owners' equity. Current and prospective equity investors and lenders seek to compare the enterprise's performance with others. These comparisons are almost always made in relative, not absolute terms. Information about the enterprise's assets, liabilities and owners equity provides a basis for current and prospective equity investors and lenders to evaluate information about the enterprise's income and help them compare its performance with those of others. • To be useful, measurement of and information about assets that are not direct sources of cash should be, to the extent possible, geared toward providing indications of their direct cash in-flow potential. • To be useful, measurement of and information about assets that are not direct sources of cash	mation about an enterprise's financial performance during a period and about how management of an enterprise has discharged its stewardship responsibility to owners.		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
should be, to the extent possible, geared toward providing indications of their service potential to the enterprise operations. • To be useful, measurement of and information about liabilities should be, to the extent possible, geared toward providing indications of their direct cash out-flow potential. • An objective of financial statements is to provide information about the sources and utilization of the enterprise's cash or other liquid resources. Information about the enterprise's sources and utilization of cash or other liquid resources assists current and prospective equity investors and lenders assess the historical ability of the enterprise to convert earnings into cash flow and the sufficiency of those cash flows. • The type of information set forth in the previous paragraph is also useful in helping equity investors (owners) evaluate the management performance and its discharge of its stewardship responsibility.			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
LIMITATIONS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES	LIMITATIONS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES EXPLICITLY STATED LIMITATIONS	LIMITATIONS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES	LIMITATIONS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES
The financial statements will not provide: • Information that can be used, without adjustment, for tax or zakat computation. • Information that can be used, without adjustment, for subsidy computation. • Information that can be consolidated, without adjustment, into national accounts. • Information that can be used to evaluate management performance apart from the enterprise performance. • Direct measure of the value of the business enterpise. • Direct measure of the risk associated with holding an equity interest or a loan position in the business enterprise.	• Although financial reporting may provide information that may help those who desire to estimate the value of a business enterprise, financial accounting is not designed to measure directly the value of an enterprise. • Financial reporting, and especially financial statements, usually can not and does not separate management performance from enterprise performance. Financial reporting provides information about an enterprise during a period when it was under the direction of a particular management but does not directly provide information about that management's performance. IMPLIED LIMITATIONS Because of the focus of the statement of objectives on the information need of investors and creditors there is an implication that the information may need to be adjusted by other users, who do not have similar information needs, to suit their purposes. Accordingly, other limitations recommended explicitly for Saudi Arabia might be implied in the U.S.A.	No explicit statement of limitations of financial statements of business enterprises could be found.	No explicit statement of limitation of financial statements of business enterprises could be found.

APPENDIX C
CONCEPTS OF FINANCIAL ACCOUNTING
COMMENTARY

OBJECTIVES AND CONCEPTS OF ACCOUNTING

OBJECTIVES OF FINANCIAL ACCOUNTING

TABLE OF CONTENTS

1. EXPLANATORY FOREWORD

1.1 INTRODUCTION

To be consistent, financial accounting standards need to rest upon fundamental concepts. A concept is a fundamental term that is given meaning. A term is fundamental because repeated reference to it will be necessary, either explicitly or implicitly, when financial accounting standards are being established, interpreted or applied. For example, the term asset is fundamental because many of the financial accounting standards will deal with assets of the business enterprise and, therefore, repeated reference to the meaning of an asset will be necessary when those standards are being established, interpreted or applied.
(para 202)

1.2 IMPORTANCE OF DEFINING THE CONCEPTS OF FINANCIAL ACCOUNTING

The importance of defining the concepts of financial accounting is manifested in complementing the conceptual framework required for setting relevant and consistent standards. To be relevant, financial statements must be based on clear financial statement objectives (the end product of the financial statements). To be consistent, financial accounting standards must be based on a fully integrated group of concepts which define major accounting terms in conformity with a conceptual framework which suits financial accounting in Saudi Arabia. Without these concepts, issued standards might be contradictory. The advantages of defining the concepts of financial accounting are summed up in the following.
(para 203)

1) ADAPTABILITY TO THE SAUDI ENVIRONMENT

Financial accounting is a means for defining measurement and communication of financial information relevant to the financial and economic operations of a given enterprise. This definition, measurement and communication of financial information to users may take different forms and would, therefore, require various standards. The basic framework for the definition, measurement and communication of financial information should, therefore, be determined in a manner suitable to the business environment in Saudi Arabia prior to the issuance of financial accounting standards.
(para 204)

2) UNDERSTANDABILITY

Well defined financial accounting concepts will help users of the accounting standards better understand the nature of accounting information contained in the financial statements and the limitations associated with the use of such information, in a manner that would enhance their ability to utilize such information effectively.
(para 205)

3) STANDARDIZED ACCOUNTING TERMINOLOGY

Accounting terms in Saudi Arabia are presently used in a non-standardized manner. Without having standardized concepts of financial accounting, terms will have different connotations which will limit the users' ability to understand accounting information.
(para 206)

4) ASSIST CHARTERED ACCOUNTANTS IN MAKING APPROPRIATE DECISIONS

Well defined financial accounting concepts will guide chartered accountants in making the right

decisions when they are faced with problems for which no accounting standard has been established.
(para 207)

1.3 CLASSIFICATION OF FINANCIAL ACCOUNTING CONCEPTS

Financial accounting concepts are classified into four main categories, as follows:

1.3.1 CONCEPTS OF THE BASIC ELEMENTS OF FINANCIAL STATEMENTS

These concepts define the basic elements of the financial statements. As stated in the recommended statement, the basic elements of the financial statements of a business enterprise are, therefore, assets, liabilities, owners' equity, revenues, expenses, gains, losses, net income (net loss), investments by owners and distributions to owners. These ten elements are of two types. The first type is financial position elements and includes the first three elements. The second type is changes in financial position elements and include the last seven elements. The two types of elements are fundamentally related in that assets, liabilities and owners' equity are changed by elements of the other type and in that way an increase (decrease) in an asset can not occur without a corresponding decrease (increase) in another asset or a corresponding increase (decrease) in a liability or owners' equity. The results of the financial accounting process are expressed in a set of fundamentally related financial statements which articulate with each other and rest upon the same underlying data.
(para 209)

1.3.2 EVENTS, TRANSACTIONS AND CIRCUMSTANCES

These concepts define the events, transactions and circumstances which affect the financial position and the results of operations of a given entity. Definition of events, transactions and circumstances take into account changes in the financial position and results of operations which are subject to financial accounting measurement in any given entity.
(para 210)

1.3.3 MEASUREMENT CONCEPTS

Measurement in financial accounting involves the determination of the amounts of the basic elements of financial statements of a particular business enterprise. The measurement concepts define certain assumptions underlying the measurement process and the basic characteristics of the measurement process itself. Measurement concepts are divided into two main categories. The first category is concerned with safeguarding the capital to be employed as a basis for measurement of income and determination of changes in the financial position which represent the elements of income of a given entity. Concepts of measurement were defined on the assumption that income cannot be realised unless capital funds are secured. The second category is concerned with the attribute or attributes of measureable elements of the financial statements. This determination calls for setting the basis for measurement. As stated in the commentary, the concept of measurement has been defined on the basis of the assumption that measurable elements depend on the nature of the asset or liability subject to measurement and its direct (or indirect) relationship with the entity's cash flows.
(para 211)

1.3.4 THE QUALITY OF INFORMATION CONCEPTS

The quality of information concepts define the characteristics or the criteria of useful accounting information. These characteristics or criteria should assist those responsible for establishing accounting standards as well as those responsible for the preparation of financial statements in evaluating financial information produced by alternative accounting methods and in differentiating between necessary and unnecessary disclosures.
(para 212) (Next paragraph is No. 356)

2. COMMENTARY

2. COMMENTARY

2.1 WHY CONCEPTS ARE NEEDED

Financial accounting is a measurement and communication process. Measurement of a business enterprise's activities and performance and communication of information about those activities and performance may take many forms. Concepts are needed to define the basic features of the measurement and communication process that should be adopted in Saudi Arabia. The concepts together with the objectives and limitations of financial statements form the necessary foundation for establishing financial accounting standards that are relevant and consistent. To be relevant, standards need to be clearly related to the objectives of financial statements. To be consistent, the standards need to rest upon a set of integrated concepts. Concepts are needed, therefore, to guide the body responsible for establishing accounting standards. In this respect, the Financial Accounting Standards Board in the United States notes :

> «Financial reporting concepts by nature are pervasive. They concern the similarities of economic circumstances across industry lines and among companies. Those similarities are significant. There are, of course, dissimilarities that must be considered too-including things like different types of contracts and financing arrangements, different kinds of resources, different kinds of obligations, and different regulatory and government requirements-though similarities are the basis for concepts with general application.
>
> Standing between the underlying concepts and accounting practices in specific situations are accounting standards-general solutions to identified financial accounting problems. Standard setting, to be evenhanded, must be built on established concepts and solve unique problems by referring to objectives; that is what provides the evenhandedness.
>
> Attainment of objectives involves a balance of presumed usefulness and practicability of relevance of information and its reliability-of benefit and cost. That balancing is the job of standard setting, the task of the Financial Accounting Standard Board. A conceptual framework can provide a constant thread of reason, a basis for solution-a constitution-to guide the FASB. It will narrow the range of alternatives to be considered by the Board because some alternatives will clearly be «unconstitutional». It will also provide the members of the Board with a common foundation on which to debate the merits of the alternatives.
>
> Concepts cannot be expected automatically and unequivocally to resolve specific problems. Like a constitution, a conceptual framework for financial accounting and reporting will require interpretation and, occasionally, amendment. Setting standards is an ongoing activity because new or unique situations are always arising to which concepts must be applied or interpreted»[1].

Concepts are an essential building block in any scheme designed to increase the credibility of financial statements by enhancing their comparability. In this respect the Financial Accounting Standard's Board of the United States notes:

> «Increased comparability of the information contained in financial statements is one of the most important implications of a conceptual framework. Since comparing alternative investment or lending opportunities is an essential part of most investment decisions, investors and creditors desire financial statement information that is comparable, both for single enterprises over time and between enterprises at the same time. They also want to be able to compare enterprise performance using data unclouded by different methods of ac-

1 . Financial Accounting Standard Board, «An Analysis of Isues Related to Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statement and their Measurement», December 2, 1976, Stamford.

counting for the same facts and circumstances. Consequently, investors and creditors rank comparability among the most important qualities of useful financial statement information»[2].

«Without a conceptual underpinning, periodic earnings and financial position are essentially matters of judgement and personal opinion. Preciseness of definition of fundamentals narrows subjectivity, circumscribes the areas for applying judgements, and provides a frame of reference for those judgements. A conceptual framework should foster consistency of treatment of like things, provide the means for identifying unlike things, and leave open for judgement the estimates inherent in the accounting process. Without the discipline that a sharpened conceptual framework can provide it is doubtful whether financial reporting generally can attain an optimal level of credibility»[3].

2.2 FOR WHOM CONCEPTS ARE MEANT

Concepts are primarily intended to guide the body responsible for establishing accounting standards. They provide a frame of reference to which all standards should be anchored, thus, assuring their internal consistency. But a conceptual frame of reference can and should be useful to other parties including preparers, auditors and users of financial statements. In this respect the Financial Accounting Standards Board of the United States notes that a conceptual framework would:

A) «Provide a frame of reference for resolving accounting questions in the absence of a specific promulgated standard. A conceptual framework can provide direction for analysis of circumstances that give rise to accounting questions not specifically addressed in a promulgated standard. It can guide that analysis by focusing consideration on some alternative solutions while eliminating others from the realm of possibility. It can give financial statement preparers and auditors some degree of confidence, though by no means assurance, that if a detailed rule on the question were promulgated consistent with the conceptual framework it would prescribe the same resolution. Thus, a conceptual framework is a guide for predictable analysis and judgment.

B) Determine the bounds for judgement in preparing financial statements. A conceptual framework cannot and should not be so detailed that it automatically provides an accounting answer to a set of financial facts. Overprescription of detail would make it mechanistic, not conceptual. Judgement would be squeezed out, and a probable result would be frequent mismatches of accounting solutions and business problems. At the same time, the conceptual framework cannot be left so abstract that a high degree of subjectivity prevails in applying the concepts, for then the factors that underlie the skepticism of present financial reporting would continue. A conceptual framework does not eliminate judgement in preparing financial statements, as some have prophesied. Rather, it determines the bounds for judgement.

C) Increase financial statement users' understanding of and confidence in financial statements. Financial statement users often lament the «quality of earnings» or, more precisely, a perceived lack thereof. Some users believe that accounting numbers are prepared on the basis of an amorphous set of principles and rules that permit too much freedom in deciding what financial statements should show. If a conceptual framework for financial accounting and reporting makes sense and-equally important-if financial statement users make the requisite effort to understand the framework, the confidence that those users have in the information contained in financial statements will increase. Financial statement users will recognize that the definitions and measures of the basic elements of financial statements (assets, liabilities, earnings, etc.) are consistent from company to company. The need for them to attempt to make compensatory adjustments, addbacks, or eliminations to achieve comparability should decrease significantly.

2. Ibid p. 8
3. Ibid p. 9

Moreover, financial statement users will understand the limitations of accounting information, and that also is important. Thus, their ability to use financial statement information with intelligence and confidence in assessing the performance and prospects of a business enterprise will be enhanced»[4].
(para 357)

2.3 ELEMENTS OF FINANCIAL STATEMENTS

The basic elements of financial statements are the building blocks for financial accounting. The function of financial accounting is (1) to measure the assets held by a specific entity; (2) to reflect the claims against the interests (liabilities and owners' equity) in that entity; (3) to measure changes in those assets, liabilities and owners' equity; (4) to assign the changes to specific periods of time; (5) to classify the changes into those that represent revenues, expenses, gains, losses and those that represent other changes in assets, liabilities, and owners' equity; (6) to express the foregoing in terms of money as a common denominator; and (7) to provide periodic reports about the entity's assets, liabilities, owners' equity as of a particular point in time, net income and its components and the sources and utilization of cash or other liquid funds.
(para 358)

This perception of the function of financial accounting necessitates that the elements of financial statements should be defined.

1) ELEMENTS OF THE FINANCIAL STATEMENTS

Assets, liabilities, owners' equity, revenues, expenses, gains, losses, investment by owners and distribution to owners. These elements are the building blocks in the structure of financial accounting because financial accounting measurement and reporting of results are based on these elements.

2. EVENTS, TRANSACTIONS AND CIRCUMSTANCES

Financial accounting concerns itself with the measurement of changes which take place in a given business enterprise's assets, liabilities and owners' equity. It is also concerned with determining the reasons of those changes and defining their concepts. Changes in assets, liabilities and owners' equity which are subject to measurement by financial accounting are, in fact, a result of the events, transactions, and circumstances of the business enterprise. However, due to the fact that a given business enterprise may be affected by a variety of events, transactions and circumstances of which some may be liable to measurement and others do not lend themselves to such measurement, it would, therefore, be necessary to determine those events, transactions and circumstances which lend themselves to financial accounting measurement.

3. FINANCIAL ACCOUNTING MEASUREMENT

Measurement of elements of financial statements and changes in those elements is considered to be one of the major functions of financial accounting. Financial accounting measurement involves certain assumptions with respect to the business enterprise concerned and the period of time subject to this measurement. Financial accounting measurement is also characterised with a variety of features which discriminate it from other types of measurement. Basic assumptions and characteristic features of financial accounting are, therefore, delineated in these concepts of financial accounting measurement.

4. THE QUALITY OF INFORMATION CONCEPTS:

The ultimate objective of financial accounting is to produce and communicate useful information which takes the form of financial statements and other reports which help areas concerned to make the appropriate decisions with respect to a given business enterprise. Information produced by financial accounting are usually affected by methods of measurement and disclosure adopted

4. Ibid pp. 6 & 7

by the enterprise's management. Financial accounting standards will limit the measurement and disclosure alternatives. However, these standards are not expected to eliminate all other available alternative methods of measurement and disclosure. Additionally, setting of financial accounting standards involves selection among the various measurement and disclosure alternatives. The best criterion of such selection, is the utility of information which may be produced by each such alternative method of measurement or disclosure. Determining the characteristics of useful information is the function of the concepts of quality of information.
(para 359)

2.3.1 THE FUNDAMENTAL CONCEPTS OF FINANCIAL ACCOUNTING

The definition of basic elements of financial accounting has two aspects: consistency of financial statements and the definition of the main elements on the basis of which depends the basic component of the financial statements.
(para 360)

With respect to consistency, before defining the elements of financial statements, the components of Financial Position Statements and Income Statement of a given business enterprise must be subjected to the same methods of financial accounting measurement. This may involve a decision of whether to follow the same method for measurement of the value of stock inventory as listed in the Statement of Financial Position or determining the cost of commodities sold as stated in the Income Statement. In other words, it should be determined if the measurement of changes in assets, liabilities and owners' equity is performed in accordance with the same methods applied for the measurement of those assets, liabilities and owners' equity. This will also determine if it is possible to define the elements of the Income Statement irrespective of defining the elements of the Statement of Financial Position. It is clear that consistency depends on whether it is necessary to subject the elements of both the Statement of Financial Position and the Income Statement to separate methods of measurement in order to produce useful information on the performance of the business enterprise, its economic resources and the rights incurred thereof, taking into consideration the objectives which define financial statements and the limits of their application. In our opinion, it is not necessary to separate the elements of Income Statement from those of Statement of Financial Position in order to produce information which would help achieve the stated objectives of financial statements. On the contrary, consistency among the elements of the Income Statement and Statement of Financial Position should be a basic condition to enable primary external users to evaluate the performance of the business enterprise in light of available economic resources and commitments. We have, therefore, defined the elements of financial statements on the basis of their consistency and ability to achieve the recommended statement of objectives and limitations of financial statements.
(para 361).

There are two basic approaches to the definition of the basic elements of financial statements:

i) The asset and liability approach; and

ii) The revenue and expense approach.

These two approaches involve two distinct conceptual views of net income (earnings) measurement. The conceptual issue in choosing between the asset and liability approach and the revenue and expense approach is concerned with reflecting the most fundamental elements of financial statements whose definitions control the definitions of other elements. The asset and liability approach depends on definition of assets and liabilities to define net income (earnings) and its components. The revenue and expense approach depends on definition of revenues, expenses, gains and losses, and relating them to define net income (earnings).
(para 362)

In the asset and liability approach, net income (earnings) is a change in net assets (assets less liabilities) and, therefore, represents changes in measures of relevant attributes of assets and liabilities. Under this approach, the positive elements in net income - revenues - and gains are defined in terms of increases in assets and decreases in liabilities during the period; the negative elements in net income -expenses and losses - are defined in terms of decreases in assets and increases in liabilities during the period. Assets and liabilities are the key concepts under this approach and the definitions of all other elements of financial statements - owners' equity, revenues, expenses, gains, losses, investment by and distribution to owners are dependent on the definitions of the key concepts. Under this approach, net income is determined through a process of matching revenues, expenses, gains and losses. However, good matching of these components of net income is the inevitable consequence of good definitions and measurement of assets and liabilities.
(para 363)

In the revenue and expense approach, the concepts of revenue, expense, gain and loss are the key concepts and net income is defined in terms of differences between these elements. Measuring net income, under this approach, depends primarily on good definitions of revenues, expenses, gains and losses. The primary concern in the revenue and expense approach is to measure net income of the enterprise, not to measure increases or decreases in its wealth. Measuring net income, under this approach, incidentally results in measuring an increase or decrease in owners' equity. Since revenues, expenses, gains and losses are the governing concepts, measures of assets and liabilities are generally determined by the requirements of the net income measurement process. Thus, a balance sheet reflecting this approach may include as assets and liabilities or as other elements, items that do not represent assets and liabilities under the asset and liability approach. For example, business enterprises may suffer losses from fire, flood and other casualties that occur randomly and cannot be predicted for individual enterprises. However, insurance can spread the risk over many enterprises at a relatively small cost to each. An enterprise that pays insurance premiums to an insurer has an insurance expense for the period covered that it deducts from revenues to measure income. Many enterprises choose to bear all of the risk of loss rather than pay an insurer to bear it. Since those enterprises incur no obligations to pay other entities or suffer no decrease in assets unless a fire, flood or other casualties occur, under the asset and liability approach, losses should be recognized as deductions from revenues for periods in which the casualties occur. Under the revenue and expense approach the revenues of these enterprises must cover uninsured losses and that a proportionate part of future losses should be deducted from revenues of each period. Otherwise, costs of losses will not be properly matched against related revenues, and income will be overstated in most periods and greatly understated in periods in which the fire, flood or other casualties occur.
(para 364)

The definitions of the elements of financial statements set forth in this statement adopts the asset and liability approach because measurement of income under the revenue and expense approach would be less reliable. Revenues and expenses are not precise concepts in the revenue and expense approach, and income is, therefore, a significantly less precise concept than in the asset and liability approach. The lack of preciseness makes income in the revenue and expense approach unduly subject to the effects of personal opinion about what income of an enterprise for a period should be. On the other hand, the limits of definitions of revenues, expenses, gains, losses and net income that are imposed by relating them to change in assets and liabilities, make the concept of income more precise and the resulting measure of income reliable. Financial accounting and financial statements, in our view, are primarily historical in that information about events that have taken place provides the basic data of financial accounting and financial statements.
(para 365)

It should be noted that there is no automatic linking of either of the asset and liability or the revenue and expense approaches with a particular measurement basis. Either approach is compatible with measurement of several different attributes of the elements of financial statements. For example, historical cost, current replacement cost, net realizable value or discounted future cash flows could be

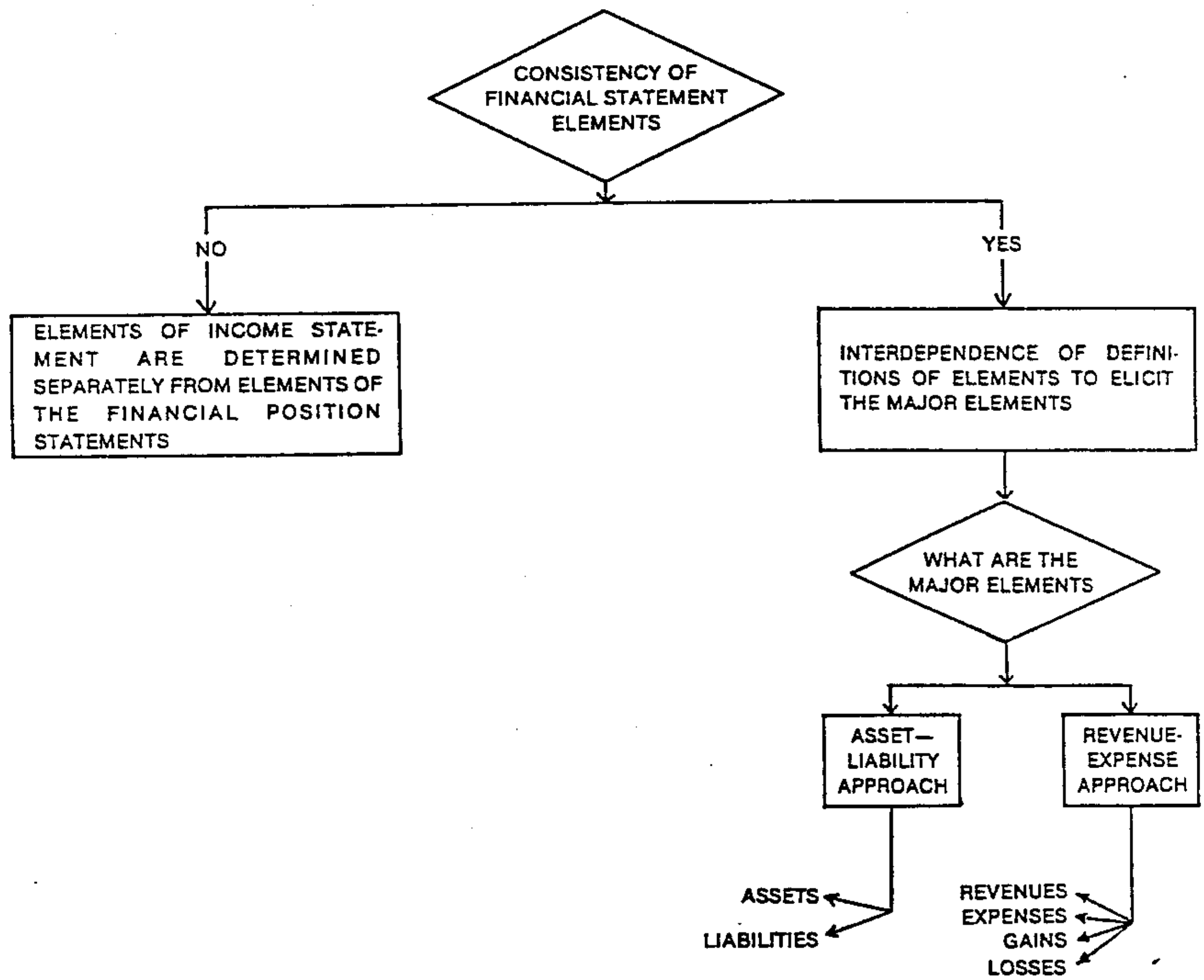
used as a measurement basis under either of the two approaches. Disagreements about the attributes of elements of financial statements that should be measured are not the causes of substantive differences between the two approaches.
(para 366)

It should also be noted that differences between the two approaches do not reflect differences in opinion as to which financial statements is more useful to equity investors and lenders. Most advocates of either approach would agree that the information in the Statement of Income is likely to be more useful to investors and lenders than the information in the Statement of Financial Position. That is, most ad vocates of either approach agree that income measurement is the focus of financial accounting and the financial statements. The basic difference between the two approaches is what should be included and what should be excluded from assets, liabilities, revenues, expenses, gains and losses. Under the asset and liability approach assets are defined in terms of economic resources that represent a potential benefit to the particular business enterprise. The potential benefit is an eventual direct or indirect net cash inflow to the enterprise. The revenue and expense approach, on the other hand, is less concerned with whether assets are economic resources than with whether costs are appropriately matched with revenues. Thus, under this approach, assets would include all items that would be included under the assets and liability approach as assets, plus deferred charges waiting to be matched with revenues in future accounting periods even though those deferred charges do not represent economic resources.
(para 367)

Under the asset and liability approach, liabilities represent present obligations of an enterprise to transfer assets to other entities in the future. The revenue and expense approach accepts this concept of liabilities but also recognizes certain deferred credits and reserves necessary to match costs with revenues to measure income properly.
(para 368)

Under the asset and liability approach, revenues, expenses, gains and losses are defined and measured by increases in assets and/or decreases in liabilities and, accordingly, the increases in assets and/or decreases in liabilities that represent those elements are dependent on the definitions of assets and liabilities. Under the revenue and expense approach revenues, expenses, gains and losses are defined and measured independently from assets and liabilities. However, since the Statement of Income and the Statement of Financial Position are related, the recognition of revenues, expenses, gains and losses under the revenue and expense approach results in increases in assets and/or decreases in liabilities (para 369)

The following figure summarises the various alternatives which are taken into consideration in defining the elements of financial statements and alternatives selected as a basis for defining the elements in this statement.
(para 370)



2.3.2 CONCEPTS OF FINANCIAL ACCOUNTING MEASUREMENT

2.3.2.1 ASSUMPTIONS UNDERLYING THE MEASUREMENT PROCESS

Four concepts define four basic assumptions that underlie the measurement process in financial accounting. These are:

i) The entity concept;
ii) The going concern concept;
iii) The measurement unit concept; and
iv) The periodic reporting concept.

Although these might be considered self-evident they need to be defined to complete the conceptual basis of financial accounting.
(para 371)

A) The Entity Concept

The entity concept is in accordance with the Company Law which assures separation of the affairs of the business enterprise from the affairs of its owners. Article 13 of the Company Law states that, except for joint ventures, every company incorporated under the Law shall be deemed as juristic person as of the date of its incorporation. Furthermore, the law, especially in the case of joint stock and limited liability companies, is predicated on the separation of the ownership role from the management role. But even if the concepts were not supported by law, it would have been amply evident by observations of how business enterprises are organized and managed in Saudi Arabia.
(para 372)

B) The Going Concern Concept

The going concern concept is also evident from limited observations of investment and lending decisions in Saudi Arabia. Investors and lenders invest in or lend to enterprises they expect to continue. They are necessarily interested in information about how the enterprise is faring as a going concern not as an entity that is about to be liquidated. Even when the law limits the legal life of a company to a certain number of years (usually thirty years) the intent is not to force liquidation after that period of time. Rather the intent is to review the privilege granted to the enterprise to conduct business under the originally specified legal form. To give the going concern concept operational meaning our recommendation is to define it as follows:

> In the absence of persuasive evidence to the contrary, the economic entity is assumed to have a remaining life greater than that of its limited life assets.

This means that the recorded amounts for the limited life assets represent investment made by the enterprise in those assets which it expects to recover in the normal course of business not through forced or voluntary liquidation. Liquidation values are, therefore, not relevant in financial accounting unless persuasive evidence would indicate that the invested amounts in limited life assets will be recovered through forced or voluntary liquidation of those amounts.
(para 373)

C) The Measurement Unit Concept

It is self-evident that the monetary unit in Saudi Arabia is the Saudi Riyal and that financial statements in the Kingdom reflect measures stated in the Saudi Riyal. However, the monetary unit is both a medium of exchange and a measure of exchangability or «standard of value». The

first of these characteristics, that is, medium of exchange, specifies the type of economic system in Saudi Arabia - one in which money is almost used universally to pay for goods and services and to discharge debt. This characteristic is not of much significance since accounts can and had been kept in ancient societies in the absence of money. It is the second characteristic that is important in financial accounting. Financial accounting involves measurement of assets, liabilities, owners' equity and changes therein. In order to measure, a unit common to all objects that are to be measured is needed. This is merely a logical requirement that two or more objects must be expressed in identical units before they can be added together or subtracted one from the other. In an exchange economy, such as that of the Kingdom, the only measure common to all objects that do or can enter into the exchange is their exchangeability or «value in exchange» and this is expressed in terms of money in its function as a common denominator or standard of value. This leads to the question as, to whether the use of the Saudi Riyal as a measurement unit does in fact express all objects (nonmonetary assets and liabilities) in terms of a common unit. The value of a Saudi Riyal in exchange is measured by its purchasing power. The purchasing power of the Saudi Riyal is not fixed. Rather, it is dependent on the value of other objects in exchange (their prices) which are determined by the forces of supply and demand. The purchasing power of the Saudi Riyal increases when the prices of objects and services it can buy go down and vice versa. Under these conditions it is obvious that the Saudi Riyal cannot be the same measuring unit all the time, that is, it cannot have the same purchasing power all the time when prices of objects and services it can buy are not stable all the time. To assume that it is stable as a measuring unit would not be consistent with reality. This leads to the recommendation set forth in this statement that moderate changes in the purchasing power of the Saudi Riyal that persist for several years or substantial changes in its purchasing power that occur over short periods require restating the financial statements for general price level changes. The objective behind the restatement is not to change the measurement basis used in financial accounting, rather the objective is to express the same measurement basis in a common unit, that is, Saudi Riyals with the same purchasing power.
(para 374)

D) The Periodic Reporting concept

The periodic reporting concept is supported by observations. Financial statements are prepared to provide test readings at regular intervals. In addition, the company law calls for periodic reporting at the end of each fiscal year during the life of the business enterprise. The principal alternative to the period as the basis for reporting is the completed project or venture. For the typical business enterprise in the Kingdom, the period is clearly more superior.
(para 375)

2.3.2.2 THE BASIC FEATURES OF THE MEASUREMENT PROCESS

The recommendations set forth in this statement under the recognition measurement basis and matching concepts reflect two choices. The first choice is the capital maintenance view and the second choice is the attribute or attributes of financial statement elements that should be measured.
(para 376)

A) Maintenance of Share Capital

Income results only after capital has been maintained or costs have been recovered. The capital maintenance view chosen, therefore, divides a business enterprise's return on investment (income) from its return on investment (capital or cost recovered). The Financial Accounting Standards Board in the United States defines two major concepts of capital; Financial Capital and Physical Capital; and describes the major differences between the two as follows:

«The major difference between the two concepts is the way they account for changes in values of assets held. The financial capital concept views capital maintenance in money value terms and recognizes increases or decreases in values of assets held as gains or losses, which may be separated from operating earnings by describing them as holding gains or losses. The other concept views capital maintenance in terms of the physical properties of assets and, therefore, recognizes no gains or losses from changes in value of the same productive capacity of an enterprise. Thus, changes in values of assets held, such as inventory, property, plant, equipment and some intangibles, are included in earnings in the financial capital maintenance view but are excluded from earnings and taken directly to capital in the physical capital maintenance view.
(para 377)

Proponents of financial capital maintenance view disagree about the timing of recognition of increases or decreases in values of assets held and about whether they should be included in operating earnings or disclosed separately as holding gains or losses. Proponents of physical capital maintenance view disagree about the definition of same productive capacity. Some favour replacement of physical assets in kind. Others regard productive capacity either as the capacity to produce the same volume of goods or services or the capacity to produce the same value of goods and services.
(para 378)

It should be recognized, of course, that maintenance of capital is an abstraction needed to measure earnings to divide return of capital from return on capital. The abstraction does not assume that assets are actually replaced when used or that they will necessarily be replaced in the future»[5].

Proponents of the physical capital concept favor accounting for assets such as inventories, property, plant, equipment and intangibles at their current replacement costs without recognizing changes in their replacement prices as holding gains and losses. That is, the changes in replacement prices of these assets during a period are not components of income but a capital maintenance adjustment of owners' equity.
(para 379)

The recommendations set forth in this statement adopt the financial capital maintenance view. These recommendations are supported by two considerations:

— The first is the nonreliability and impracticality of current replacement cost measures in Saudi Arabia especially when one considers that many of the assets that would be subject to current replacement cost measurement are obtained outside the country. Accordingly, their replacement cost depends on where the assumed replacement would be obtained and how it would be obtained.

— The second consideration is more fundamental. Business enterprises invest cash in nonmonetary assets, e.g., inventories, property, plant, equipment and intangibles, with the expectations of generating more cash. Investments in these assets involve a necessary holding period that varies from one asset to another while they are being utilized to generate cash. Gains or losses due to changes in the prices of those assets during their respective holding periods are measures of the success or failure of the decisions to invest in those assets as much as gains or losses from their utilization. To be sure, to replace an existing asset might require more cash than the amount of cash originally invested. However, cash requirements to replace assets are a management of income as opposed to a measurement of income consideration.
(para 380)

(5) Ibid pp. 14, 15

B) Attribute/s that should be measured

The second choice that underlies the recommendations set forth in this statement is the attribute or attributes of financial statement elements that should be measured. Various proposals have emerged in the United States and other countries(6) that call for accounting measures of attributes that are different from those measured and presented in financial statements presently. The Financial Accounting Standards Board in the United States described five attributes that have been used or proposed for measuring and presenting various classes of assets and liabilities as follows:
(para 381)

— Historical cost/historical proceeds-the amount paid to acquire an asset (less subsequent amortization) or the amount received when a liability was incurred. Although present financial statements are frequently characterized as being primarily concerned with the attribute of historical cost, that description fits well only a few major classes of assets such as inventories (and then only when they have not been written down to market under the rule of lower-of-cost-or-market); property, plant and equipment; and intangibles. Historical proceeds, the liability counterpart of historical cost for assets, is used today, for example, to measure cash borrowings and cash advances from customers.
(para 382)

— Current cost/current proceeds-the amount required currently to obtain the same asset or the amount that would be received if the same obligation were incurred currently. Proponents differ about the meaning of «the same asset», some meaning replacement in kind and others meaning replacement of equivalent productive capacity. Current cost is used today, for example, for inventories carried at market under the lower-of-cost-or-market value. Current cost also is the measure adopted by the Securities and Exchange Commission in its Accounting Series Release No. 190, which requires large publicly held companies to disclose certain replacement cost data.
(para 383)

— Current exit value in orderly liquidation-the amount of cash that could be obtained currently by selling an asset (that is, current market value, if a market exists), or the amount required currently to eliminate an obligation. Current exit value is used by mutual funds, brokers and dealers in securities, and some insurance companies to account for marketable securities.
(para 384)

(6) For example, the Sandilands Report in England which recommends that financial statements be prepared on a basis described as «Current Cost Accounting». Report of the Inflation Accounting Committee (EEP Sandiland Eq., CBE, Chairman) Inflation Accounting (London - Her Majesty's Stationery Office, 1975)

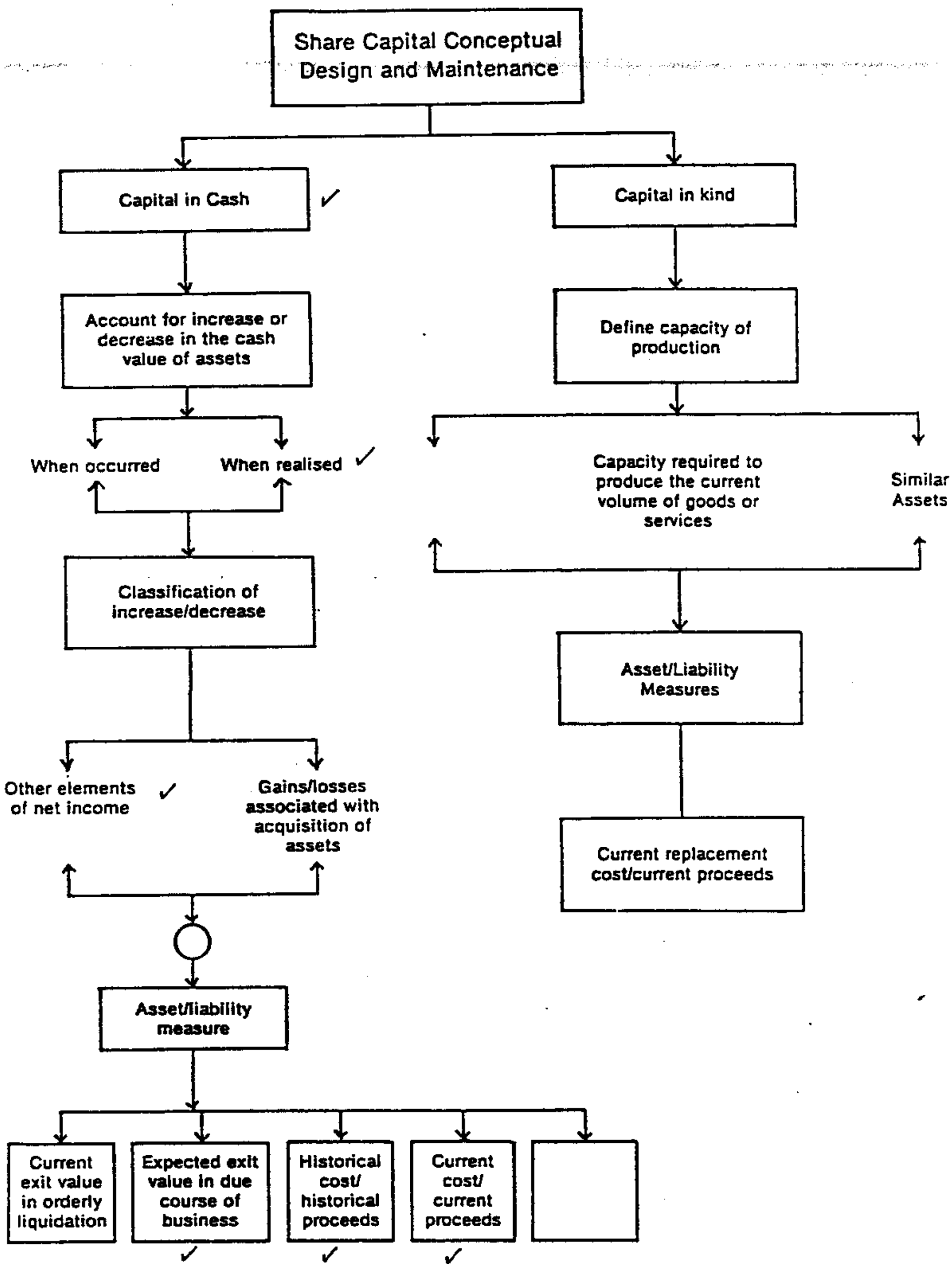
— Expected exit value in due course of business-the nondiscounted amount of cash into which an asset is expected to be converted (that is, its net realizable value) or the non-discounted amount of cash expected to be paid to eliminate a liability. Trade accounts receivable are presently measured at their expected exit values, as are accrued wages and income taxes payable.
(para 385)

— Present value of expected cash flows-the discounted amount of net cash inflows pertaining to an asset or the discounted amount of net cash outflows required to eliminate a liability. Measures of present values of long-term receivables and long-term obligations are widely used in present financial statements. Initially, the historical cost of most long-term receivables is equivalent to the present value of expected interest and principal payments. Also, capitalized leases are necessarily measured at the present value of expected lease rentals.»(7)
(para 386)

The choice of the financial capital view of capital maintenance, discussed in the previous paragraph, does not lead automatically to any one of these attributes exclusively. Any of the five attributes described by the Financial Accounting Standard Board can be selected as a measurement basis under the financial capital maintenance view. The recommendations set forth in this statement are based on the belief that the choice of an attribute should be based on its relevancy to the objectives of financial statements as well as its reliability. The objectives of financial statements suggest that the selection of the attribute to be measured depends on the nature of the asset or liability. In this respect, assets and liabilities are either monetary or nonmonetary. Monetary assets and liabilities are more directly and definitely related to the enterprise's future cash flows than nonmonetary assets and liabilities. Measurement of and information about monetary assets and liabilities should provide indications of their direct contribution to the enterprise's future cash flows. The attributes that are most consistent with this view are the expected exit value in due course of business or the present value of expected cash flows as outlined under the measurement basis concept in this statement.
(para 387)

On the other hand, measurement of and information about nonmonetary assets and liabilities should provide indications of their indirect contribution to the enterprise's future cash flows, that is, their service potential to the enterprise. The attribute that is most consistent with this view is the historical cost/historical proceeds. The use of historical costs is essential to an assessment of an enterprise's fundamental ability to add sufficient utility of time, place, or form to the materials, products or services it buys, so that they can be sold above cost. In addition, historical costs are soundly based on recognition of the effect of actual, not merely possible, transactions. Historical costs are relevant because they represent prices that the enterprise participated in establishing, not prices established exclusively by other entities. Finally, the most common, the best understood, the simplest, the most versatile concept of profit is the excess of selling price over cost. The following figure summarises the alternatives available and those selected to be the basis for defining the concepts and characteristic features of elements to be measured.
(para 388)

(7) Financial Accounting Standard Board, op. cit. p.p. 16-17



Note: (✓) indicates the concepts chosen

2.3.3 THE QUALITY OF INFORMATION CONCEPTS

The quality of information concepts describe the criteria that make financial accounting information useful. These criteria are intended to guide those responsible for establishing accounting standards in Saudi Arabia as well as preparers and auditors of financial statements in selecting among alternative accounting and/or disclosure alternatives. The recommended criteria for useful accounting information substantially encompass all of those that have been adopted or recommended in other countries. For example, they substantially encompass those that have been adopted by the Financial Accounting Standards Board in the United States(8) except for the cost/benefit criteria which we deleted from our recommendations. To be sure, to gather, process and communicate information requires time and effort and costs money. Useful information is an economic good and accordingly its benefit must exceed its cost. Clearly the cost/benefit relationship is an appropriate criterion of a proposed accounting standard or in the choice from among alternatives. However, this criterion was neglected in our recommendations because we are not able, at the present time, to present any generally applicable observations about it beyond the obvious necessity to compare the cost and value of information when establishing a standard or when selecting among alternatives.
(para 389)

Our recommendations also encompass those recommended by the Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales in 1975.(9) This Committee recommended relevant, understandable, reliable, complete objective, timely and comparable as desirable characteristics of accounting information.
(para 390)

The eight criteria of useful information recommended in this statement can be of practical assistance to preparers of financial statements who wish to maximize the value of their output to external users. We do not, however, visualize successful use of these criteria in any simple, automatic way. The professional judgement of experienced and conscientious preparers will be important.
(para 391)

The eight criteria are not of equal importance. Relevance and reliability are clearly the major considerations in the selection of measurement methods to apply to any asset or liability. Measurement methods can be ranked on the basis of relevance to equity investors' and lenders' information need. On the other hand, the reliability of a specific measurement method can only be judged by reference to the special circumstances. Comparability and neutrality are appropriate criteria of both measurement and communication. Timeliness, understandability, materiality and optimal disclosure are criteria of effective communication or reporting; they have little applicability to the measurement process.
(para 392)

(8) See appendix B for comparison of concepts recommended for Saudi Arabia with those in the United States.

(9) Accounting Standard Steering Committee of the Institute of Chartered Accountants in England and Wales, The Corporate Report (London-ICAEW, 1975), p. 28.

2.4 COMPARISON OF RECOMMENDED CONCEPTS WITH THOSE IN THE U.S.A., WEST GERMANY AND TUNISIA

Appendix A contains a comparison of the recommended concepts with those in the United States, West Germany and Tunisia. The comparison with the United States is based on the Financial Accounting Standard Statements of Financial Accounting Concepts:

No. 2 «Qualitative Characteristics of Accounting Information» Published May 1980.

No. 3 «Elements of Financial Statements of Business Enterprises» published December 1980.
(para 393)

The comparison with West Germany is based on the financial accounting provisions in the revised Corporate Law which has been effective since 1966 and the requirements for accounting and fiscal statements set forth in the German Commercial Code (see Appendix C and D).
(para 394)

The comparison with Tunisia is based on the Tunisian Plan Compatable General which has been mandatory for the public and private sectors in Tunisia since 1966.
(para 395)

It should be noted that in the United States, the asset and liability view of income has been adopted by the Financial Accounting Standards Board as a basis for the definitions of the elements of Financial Statements. However, there are differences between the definitions of the elements of financial statements adopted by the Financial Accounting Standards Board and those recommended for Saudi Arabia. All of these exceptions are obvious and can be discerned from reading Appendix B to this statement. The one difference that is not obvious is very fundamental. It concerns the definition of comprehensive income in the United States. Comprehensive income is defined to include all changes in equity during a period except those resulting from investment by or distributions to owners. Under this concept of comprehensive income, capital contributions from nonequity owners would be considered income to the the enterprise receiving it. The definition of net income recommended for Saudi Arabia would exclude from income capital contributions from nonequity sources. For example, all government grants to a business enterprise, revenue as well as capital grants, would be reflected as income under the Financial Accounting Standards Board's concept of comprehensive income. On the other hand, under the concept of net income recommended for Saudi Arabia, only revenue grants would be reflected as income and capital grants would be taken directly to net assets.
(para 396)

The difference between the two income concepts also affects the definitions of gains in the United States and Saudi Arabia. We believe that the concept of net income recommended for Saudi Arabia is more consistent with the objectives of financial statements than the comprehensive income concept of the Financial Accounting Standards Board. Financial statements are used by investors and lenders to evaluate the enterprise performance. We believe that performance flows primarily from fulfilment by the enterprise of the terms of its transactions with outside entities that result in revenues, expenses associated with those revenues and gains and losses. Therefore, we would exclude from net income and include in the amount of capital any capital contributions to the enterprise from nonequity sources.

It should also be noted that final pronouncements have not yet been issued by the Financial Accounting Standards Board on the measurement concepts that have been addressed in our recommendations for Saudi Arabia. Accordingly, comparison between the measurement concepts recommended

for Saudi Arabia and possible conclusions that the Financial Accounting Standards Board may reach on measurement, recognition, measurement unit and matching issues would serve no useful purpose.
(para 397)

Comparison with WestGermany and Tunisia is difficult in view of the lack of official pronouncements on the subjects addressed in our recommendations for Saudi Arabia. However, it is clear that in both countries historical cost/historical proceeds are the attributes selected generally for measurement. Conservatism is the basic principle of valuation in West Germany in so far as current assets are concerned. German law requires that current assets be written down to the lower of replacement or reproduction cost or net realizable value. Current assets may also be written down, in West Germany, to the extent permissible for purposes of taxation. The application of the German Tax Law often leads to an understatement of assets in statutory financial statements. The chief examples are accelerated depreciation for various types of fixed assets and inventory reserves of up to 20 percent on certain imported products. Normally, advantage can be taken of these provisions of tax law only if the amounts involved are reflected in the financial statements.
(para 398)

In Tunisia, on the other hand, financial accounting is geared toward a set of objectives that are fundamentally different from those recommended for Saudi Arabia. Accordingly, the comparison with Tunisia at the concept level does not serve a useful purpose.
(para 399)

(Next paragraph is No. 503)

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
Elements of Financial Statements • Assets: An asset is any item capable of providing future services or benefits, the rights to which have been acquired by the enterprise as a result of past transactions or events and which is presently measurable in monetary terms with acceptable reliability, provided that it is not directly associated with an immeasurable obligation. • Liabilities: A liability is a present obligation of the business enterprise to transfer assets or provide services to other entities in the future as a result of past transactions or events and which is presently measurable in monetary terms with acceptable reliability, provided that it is not directly associated with an immeasurable, but valuable right. • Owners' Equity: Owners' equity is the residual interest in the assets of the enterprise that remains after deducting its liabilities. • Revenues: Revenues of a business enterprise are increases of its assets or decreases of its liabilities or a combination of both during a specific period of time from selling or producing goods, allowing other entities to use enterprise assets, rendering services or other profit-directed activities that constitute the enterprise's ongoing major operations. • Expenses: Expenses are the expiration of assets or the incurrence of liabilities (or a combination of both) during a specific period of time from selling or producing	**Elements of Financial Statements** Financial Accounting Standards Board Statements of Financial Accounting Concepts No. 3 identifies and defines the following elements: • Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. • Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. • Equity is the residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest. • Investment by owners are increase in net assets of a particular enterprise resulting from transfers to it from other entities or something of value to obtain or increase ownership interests (or equity) in it. Assets are most commonly received as investments by owners, but that which is received may also include services or satisfaction or conversion of liabilities of the enterprise. • Distributions to owners are decreases in net assets of a particular enterprise resulting from transfering assets, rendering services, or incurring liabilities by the enterprise to owners. Distributions to owners decrease ownership interests (or equity) in an enterprise.	**Elements of Financial Statements** The revised corporation law which has been in existence since 1966 as well as the specific accounting rules prescribed by the official German accounting institute (Institute der wirtschaftsprifer) do not contain generic definitions of the elements of financial statements. However, the Corporation law contains a detailed listing of the items that should be included in the balance sheet and profit and loss statement. It also includes provisions for individual captions of the annual balance sheet and profit and loss statement. A translated version of the accounting provisions in the corporation law listing the items to be included in the balance sheet and the profit and loss statement is included as appendix C. (Articles 151, 152, 157 and 158). • Assets include fixed and financial, current, deferred charges and unpaid contributions to the share capital of those who have been called. Fixed and Financial assets include all those items which at the date of the balance sheet are intended to serve the business permanently. Current assets include typical assets that are normally classified under this caption except that they include the company's own purchased shares. • Liabilities include share capital, disclosed reserves, provision for diminution in value provisions for accrued liabilities for a term of at least four years, other liabilities, deferred income and retained earnings. • Elements of profit and loss statement include proceeds from turnover,	**Elements of Financial Statements** The Tunisian Plan Compatable General adopted in 1966 is centered around a uniform classification of accounts. Accounts are codified on the basis of the decimal system, classification having been set up in accordance with economic and legal requirements. There are ten classes or groups of interrelated accounts, and each class, except the last, has ten main accounts (see appendix E). Classes 1 - 5 form the balance sheet or financial position accounts, i.e., assets and liabilities, classes 6, 7 and 8 are the operating and profit and loss accounts, i.e., income and expense accounts; class 9 consists of the operating analysis account with its cost breakdowns, while the last class 10 contains the information or special accounts covering non-financial information needs such as commitments. The Plan Compatable General does not include generic definitions of the elements of financial statements similar to those in the U.S.A. or those recommended for Saudi Arabia. However, the operating and profit and loss accounts (Classes 6, 7 and 8) do differentiate between revenues, expenses, gains and losses.

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
goods, allowing others to use enterprise assets, rendering services or other profit-directed activities that constitute the enterprise's on going major operation. • Gains: Gains are increases in owners' equity (not assets) resulting from peripheral or incidental transactions of the business enterprise with other entities and other events and circumstances affecting it during a specific period except those that result from revenues or investments by owners or other capital contributions from non-equity sources. • Losses: Losses are decreases in owners' equity (net assets) resulting from peripheral or incidental transactions of the enterprise with other entities and other events and circumstances affecting it during a specific period except those that result from expenses or distributions to owners. • Net Income (Net Loss): Net income (net loss) of a business enterprise for a specific period of time is the increase (decrease) in owners' equity, i.e., net assets, during the period resulting from its revenues, expenses, gains and losses which are associated with that period. It includes all changes in net assets during a period except those resulting from investment by or distribution to owners or from capital contributions from nonequity sources. • Investment by owners: Investment by owners are increases in the net assets of the business enterprise resulting from transfers of assets to it	• Comprehensive income is the change in equity (net assets) of an entity during a period from transactions and other events and cumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. • Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) during a period from delivering services, or other activities that constitute the entity's ongoing major or central operations. • Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations. • Gains are increases in equity (net assets) from peripheral or incidental transactions of an equity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.	aggregate performance, gross profit, income from incidental or peripheral sources and profit or loss for the year. The law specifies which items of income and expenses must be shown separately in the profit and loss statement; those not so shown are included under «other income» and «other expenditures».	

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
from other entities, the performance of services for it by other entities, or the settlement of its liabilities by other entities - to obtain or increase equity interests in the enterprise. Distribution to owners: Distributions to owners are decreases in the net assets of the business enterprise resulting from transferring assets, rendering services or incurring liabilities by the enterprise to its owners to reduce or terminate their equity interest in the enterprise.			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
The Measurement Concepts • The Entity Concept: The business enterprise is conceived of as an economic entity separate and distinct from the parties who furnish its assets. • The Going Concern Concept In the absence of persuasive evidence to the contrary, the business enterprise is assumed to have a remaining life greater than that of its limited life assets. • The Periodic Reporting Concept: The life of the business enterprise is broken into reporting periods to provide interested parties with test readings by which they can evaluate the entity's performance. The most common reporting period in Saudi Arabia is a year, Calendar or fiscal. A principal task of financial accounting is the assignment of the enterprise's continuous stream of activities to specific reporting periods. • The Measurement Unit Concept: The monetary unit is the common denominator in which measurement in financial accounting is expressed. The monetary unit in Saudi Arabia is the Saudi Riyal. In the absence of significant changes in its general purchasing power, the Saudi Riyal is assumed to be stable as a measuring unit. • The Recognition Concept: The effects of external and internal events on the entity's assets and liabilities should be recognized and reported in the time periods to which they relate in accordance with the following criteria	**The Measurement Concepts** The Financial Accounting Standards Board has not yet issued final pronouncements dealing with the entity, going concern, the periodic reporting, the measurement unit, the recognition, the measurement basis or the matching concepts. However, FASB Statement of Financial Accounting Concepts No. 3, which deals basically with the elements of financial statements, contains a brief discussion of some of the measurement concepts that underlie or are otherwise closely related to the elements of financial statements. The following is a summary of this discussion: • Accrual Accounting attempts to record the financial effects on an enterprise of transactions and other events and circumstances that have cash consequences for the enterprise in the periods in which those transactions, events and circumstances occur rather than only in the periods in which cash is received or paid by the enterprise (paragraph 79). • Allocation is the accounting process of assigning or distributing an amount according to a plan or a formula. It is broader than and includes amortization, which is the accounting process of reducing an amount by periodic payments or write-downs. (paragraph 82) • Realization in the most precise sense means the process of converting noncash resources and rights into money and is most precisely used in accounting and financial reporting to refer to sales of assets for cash or claims to cash. The	**The Measurement Concepts** Although the Corporation Law does not explicitly state all the measurement concepts that underlie financial accounting in West Germany, a review of the valuation provisions set forth in the law and Articles 38 to 44 of the Commercial Code (See Appendix D) reveals the following: • The Entity Concept, that is, the business enterprise is conceived as an entity in its own right. • The Time Period Concept, performance is measured in relation to a time period, i.e., a year, as opposed to a completed venture, project etc. • The Monetary Unit Concept, the Deutsche Mark is the unit of measurement with no provision for changes in its purchasing power. • Valuation of Assets and Liabilities, acquisition cost or manufacturing cost is the maximum balance sheet value for assets whereas liabilities must be carried at the amount actually payable; unrealized gains may not be reflected in the carrying amounts, except annuity obligations which are carried at their discounted value. Conservatism is the basic philosophy of valuation insofar as current assets are concerned. The law requires that current assets be written down to the lower of replacement or reproduction cost or net realizable value. Current assets may also be written down to the extent permissible for purposes of taxation. Losses and drop in prices between the balance sheet date and the later time of valuation are recognized	**The Measurement Concepts** The Tunisian Plan Compatable General includes several provisions that relate to the measurement aspects of financial accounting. A review of these provisions indicates that the following are the main concepts that underlie the measurement provisions set forth in the Plan. • Accrual accounting. Transactions and events are recorded when they occur rather than only in the period in which cash is received or paid by the business enterprise. • The Time Period Concept. Performance is measured in relation to a time period. • The Monetary Unit concept. The Tunisian Dinar is the unit of measurement with no provision for changes in its purchasing power. • The Measurement Basis Concept. The Tunisian plan prescribes rules on valuation especially in regard to the write-off of fixed assets and inventories. Valuation is based on historical cost. • Measuring the Results of Operations. The results of operations are measured in stages as follows: i) The first stage is designed to measure the value added by the accounting unit which is measured by matching operating revenue with operating expenses except that expenses are limited to those that represent expired goods and services purchased outside the

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
rather than when cash is received or paid. • Exchanges between the entity and other entities should be recognized in the accounting records when the transfer of assets or liabilities takes place or when services are rendered or when assets are used. • Nonreciprocal transfers to or from owners (as owners) should be recognized when the transfer of assets or liabilities takes place. • Nonreciprocal transfers to or from entities other than owners should be recognized when assets are disposed of or their loss is discovered (for example, in the case of theft), or when liabilities are incurred or discovered (for example, in the case of penalty imposed on the entity). • Casualties involving the entity should be recognized when the sudden, unanticipated expiration of the entity's assets occurs or is discovered. • Damage or destruction of the entity's assets caused by other entities should be recognized when the damage or destruction occurs or is discovered. • Favorable circumstances involving current gains to the entity should not be recognized when they occur. Instead, their efforts should be recognized at the time of later exchanges or transfers. Although, such favorable circumstances create current gains to the entity, for example, the increase in the market	related terms realized and unrealized, therefore, identify revenues or gains or losses on assets sold and unsold, respectively. (paragraph 83) • Recognition is the process of formally recording or incorporating an item in the financial statements of an entity. Thus, an asset, liability, revenue, expense, gain or loss may be recognized (recorded) or unrecognized (unrecorded). (Paragraph 83) • Matching of costs and revenues is combined or simultaneous recognition of the revenues and expenses that result directly and jointly from the same transactions or other events. In most business enterprises, some transactions or events result simultaneously in both a revenue and one or more expenses. The revenue and expense(s) are directly related to each other and require recognition at the same time. Many expenses, however, are not related directly to particular revenues but can be related to a period on the basis of transactions or events occurring in that period or by allocation. Recognition of those expenses is largely independent of recognition of particular revenues, but they are deducted from particular revenues by being recognized in the same period. Some costs that cannot be directly related to particular revenues are incurred to obtain benefits that are exhausted in the period in which the costs are incurred. Other costs are also recognized as expenses in the period in which they are incurred because the period to which they otherwise	to the extent that they affect goods on hand or liabilities at the balance sheet date. For example, if a debtor goes into bankruptcy after the balance sheet date, the receivable is reduced in value if it is considered that the debtor was already in difficulty at the balance sheet date. Intangible assets purchased may be capitalized or expensed when acquired. • Measuring the Results of Operations. The results of operations are determined by the net change during the period in those balance sheet items which are, in a sense deferred for later transfer into the profit and loss statement. From this follows the formal principle of balance sheet continuity; i.e., the closing balance sheet of one period is necessarily the opening balance sheet of the next. However, although current assets written down at the end of the year are carried forward at the new valuation into the next year, they do (if on hand at the end of the next year) necessarily remain at the written-down valuation but may be revalued upward within the limits of the acquisition cost or manufacturing cost. If a material revaluation is made, the amount of write-up must be disclosed. • Accrual Accounting Transaction, events and unfavorable circumstances affecting the business enterprise are recorded when they occur rather than in the period in which cash is received or paid by the enterprise.	accounting unit. For example, expenses in this stage do not include wages and salaries or depreciation. ii) In this stage, the incidental or peripheral operating income, operating subsidies and the value added determined in the previous stage are added together and matched with wages, salaries and indirect taxes (for example, duties, value added tax) to arrive at operating income. iii) In this stage, financial income is added to operating income (determined in the previous stage) and matched with financial expenses, direct taxes (except income taxes), depreciation and provisions for different allowances to arrive at net operating income. iv) In this stage, net operating income is increased by extraordinary gains, reduced by extraordinary losses and income taxes to arrive at net profit (loss) for the year.

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
prices of its assets such gains are not recognizable. They do not reflect or measure the progress of operating activity; they are not the result of any transaction or any act of conversion; they make available no additional liquid resources which may be used to meet obligations or make disbursements to owners; and they have little or no legal standing as gains. • Unfavorable circumstance involving current losses to the entity should not be recognized when they occur unless they are indicative of a permanent loss, that is, the recorded amount of assets will not be recovered in the normal course of business. • Gain contingencies should not be recognized until they are confirmed by future recognizable events. • Loss contingencies should be recognized if available information indicates that it is probable that one or more future events will occur confirming that an asset had been impaired and the amount of the loss can be reasonably estimated. • Utility added to assets by internal events should not be recognized until it is confirmed by later exchanges. However, changes in assets caused by internal events should be recognized by regrouping the recorded amounts for those assets to reflect the status of their transformation into products or services.	relate is indeterminable or not worth the effort to determine. However, many assets yield their benefits to an enterprise over several periods, for example, prepaid insurance, buildings, and various kinds of equipment. Expenses resulting from their use are normally allocated to the periods of their estimated useful lives (the periods over which they are expected to provide benefits) by a «systematic and rational» allocation procedure, for example, by recognizing depreciation or other amortization. (Paragraphs 86, 87, 88, 89).		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
The Measurement Basis Concept • Acquiring assets: The basis for measuring and initially recording acquired assets is their fair value on the date of acquisition, that is, their acquisition cost. • Incurring liabilities: The basis for measuring and initially recording incurred liabilities is the present value of the amounts to be paid. • Measurement of monetary assets after acquisition: The basis for measuring and reporting recorded monetary assets is the present value of the amount expected to be collected. • Measurement of nonmonetary assets after acquisition: The basis for measuring and reporting recorded nonmonetary assets is their historical costs after adjustment for decline in their service potential because of use or because of unfavorable circumstances, damage or destruction. This basis of measurement is applicable whether the nonmonetary asset is held by sale in its present form, held for use or held as an investment to yield income and/or appreciation. • Measurement of monetary liabilities after they have been incurred. The basis for measuring and reporting recorded monetary liabilities is the present value of the amounts expected to be paid. • Measurement of nonmonetary liabilities after they have been incurred: The basis for measuring and reporting recorded nonmonetary liabilities is the original price			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
established by the entity in the transactions that resulted in the incurrence of those liabilities. • Measurement of effect of internal events on the recorded amounts of assets: The acquisition costs of assets which are partially or completely depreciated are determined and grouped to reflect the cost of products on the time periods during which the internal events occur. • Settlement of liabilities measured: The basis for measuring and recording the settlement of liabilities, that is liability decreases, is their recorded amounts. • Effect of internal events measured: The basis for measuring the output of product resulting from internal events is the previously recorded amounts of assets (their acquisition or historical costs) that are consumed. The Matching concept: Matching is the process of recognizing, measuring and relating revenues, expenses, gains and losses of an entity for an accounting period. The matching process is accomplished by separately recognizing and measuring revenues and gains and separately recognizing and measuring expenses and losses. When these are summarized and the algebraic sum is determined, it represents net income (net loss). • Revenue recognition: Revenues should be recognized when two conditions are met: i) The earning process is complete or virtually complete; and ii) An exchange has taken place.			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
• Revenue Measurement: Revenues should be measured at the price established in the exchanges, that is, by the amount of the increase in the entity's assets or decrease in its liabilities resulting from delivering products, providing services or allowing others to use assets without consideration of any simultaneously related reductions in assets or increases in liabilities. • Expense Recognition: Expenses should be recognized based on one of these criteria: i) Direct association with revenues recognized during the period; or ii) Allocation of cost between periods benefited; or iii) Immediate recognition. Expense Measurement: Expenses should be measured by the amount of the decrease in assets or the increase in liabilities resulting from the rendering of goods or services or from permitting others to use the entity's assets without consideration of the revenues which occur simultaneously. i) The measurement basis for expenses which are recognized by direct association with revenues recognized during the period should be the acquisition or historical cost of the assets that have expired or the amount of the liability incurred. ii) The measurement basis for expenses which are recognized by			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
allocation should be the acquisition or historical cost of the asset whose cost is being allocated to the periods benefited. iii) The measurement basis for expenses recognized based on immediate recognition should be the acquisition prices of the benefits acquired. • Gains should be recognized only when transfer of assets or liabilities takes place. Recognizable gains may result from exchanges or from nonreciprocal transfers with entities other than owners. The recognition criteria set forth under the recognition concept limit recognizable gains to those that result from events that involve transfer of assets or liabilities between the entity and entities other than owners. • Losses are any decreases in net assets other than those resulting from distribution to owners or those resulting from the creation of revenues. The recognition concept limit recognizable losses to those that result from: i) Exchange - such losses should be recognized when the transfers have taken place; ii) Nonreciprocal transfers-such losses should be recognized when the transfers have taken place; iii) Theft or damage to the entity's assets by others-such losses should be			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
recognized when discovered; iv) Casualties-such losses should be recognized when the casualty occurs or is discovered; v) Unfavorable circumstances which have a current effect on the entity-such losses should be recognized when the unfavorable circumstances indicate that the recorded amounts for the affected assets are permanently impaired; and vi) Probable loss contingencies-such losses should be recognized when available information indicates that one or more future events are likely to occur confirming the loss or impairment of an asset or the incurrence of a liability provided that the amount of loss can be reasonably estimated.			

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
The Quality of Information Concepts	Quality of Information Concepts		
The quality of information concepts define the characteristics or the criteria of useful accounting information. These characteristics or criteria should assist those responsible for establishing accounting standards, as well as, those responsible for the preparation of financial statements in evaluating financial information produced by alternative accounting methods and in differentiating between necessary and unnecessary disclosures. • Relevance - Information about a particular entity which meets the other criteria of useful information is relevant if it helps current and prospective equity investors and lenders evaluate the outcome from holding an equity interest or a loan position in that entity. • Reliability - Reliability is the characteristic which permits users to depend upon information with confidence. Reliable financial accounting information reflects two qualities as follows: i) The information is accurate representation of what it purports to represent. That is, there is close «correspondence» between such information and reality. Appraising a measurement method in terms of this quality, that is, the degree to which information produced by the method corresponds with reality, cannot be done in general. Specific circumstances must be known before	Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2 identifies and defines several qualitative characteristics of accounting information. The following are highlights of those characteristics: • Relevance • Relevant accounting information is capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations. Information can make a difference to decisions by improving decision makers' capacities to predict or by providing feedback on earlier expectations. Usually, information does both at once, because knowledge about the outcomes of actions already taken will generally improve decision makers' abilities to predict the results of similar future actions. Without a knowledge of the past, the basis for a prediction will usually be lacking. Without an interest in the future, knowledge of the past is sterile. • Timeliness, that is, having information available to decision makers before it loses its capacity to influence decisions, is an ancillary aspect of relevance. If information is not available when it is needed or becomes available so long after the reported events that it has no value for future action,		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
one can say whether a given measurement method can be considered sufficiently reliable in the case at hand. ii) The information is verifiable. Verifiable financial accounting information provides results that can be substantially duplicated by independent measures using the same measurement and/or disclosure methods. • Neutrality -Neutrality is meant as a positive term for the absence of bias. It clearly overlaps reliability because biased information is unreliable. Neutral financial accounting information is directed toward the common needs of external users and is independent of presumptions about particular needs of specific users of the information. Neutral financial accounting information is evenhanded information and, therefore, is free from bias towards predetermined results. Neutrality, therefore, requires that: i) Choice from among alternative measurement and/or disclosure methods is based only on assessment of the relevance and reliability of the information produced by the alternative methods; and ii) In applying measurement and/or disclosure methods which require estimates, management will not deliberately understate or	it lacks relevance and is of little or no use. Timeliness alone cannot make information relevant, but a lack of timeliness can rob information of relevance it might otherwise have had. • Reliability • The reliability of a measure rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the user that it has that representational quality. To be useful, information must be reliable as well as relevant. Degrees of reliability must be recognized. It is hardly even a question of black or white, but rather of more reliability or less. Reliability rests upon the extent to which the accounting description or measurement is verifiable and representationally faithful. Neutrality of information also interacts with those two components of reliability to affect the usefulness of the information. • Verifiability is a quality that may be demonstrated by securing a high degree of consensus among independent measures using the same measurement methods. Representational faithfulness, on the other hand, refers to the correspondence or agreement between the accounting numbers and the resources or events those numbers purport to represent. A		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
overstate the required estimates in order to achieve certain predetermined results. • Comparability-Comparable financial accounting information allows external users to identify real similarities and differences in the business entity's performance of other entities for the same period or in relation to its own performance in prior years. There are two aspects of comparability, that are significant to the usefulness of financial accounting information. These are: I) Interperiod comparability of financial accounting information relating to the same entity, that is, consistency. II) Interentity comparability, that is, comparability between entities, especially between entities within the same line of business. • Timeliness-Financial accounting information should be available to external parties when it is needed. If information is not available when it is needed or becomes available so long after the reported events that has no impact on future action, the information loses its usefulness. There are two aspects of timeliness. One is frequency of reporting that is, the length of the shortest reporting period. It is possible to report too frequently or too infrequently. The other aspect of timeliness is the lag between the end of the reporting period and the date the financial statements are issued. A long lag between the end	respondence, however, does not guarantee that an accounting measurement will be relevant to the user's needs if the resources or events represented by the measurement are inappropriate to the purpose at hand. • Neutrality means that, in formulating or implementing standards, the primary concern should be the relevance and reliability of the information that results, not the effect that the new rule may have on a particular interest. A neutral choice between accounting alternatives is free from bias towards a predetermined result. The objectives of financial reporting serve many different information users who have diverse interests, and no one predetermined result is likely to suit all interests. • Comparability and Consistency • Information about a particular enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. Comparability between enterprises and consistency in the application of methods over time increases the informational value of comparisons or relative economic opportunities or performance. The significance of infor-		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
of the reporting period and the date the financial statements are issued reduces the usefulness of the information. Optimal frecuency and minimal lag are, therefore, important criteria of useful accounting information. • Understandability- Information cannot be useful to external users who can not understand it. Understandability depends on the extent and nature of the data contained in the financial statements, the way the data is presented as well as the background and abilities of external users. The strengths and limitations of financial statement readers should not be overlooked by those who establish financial accounting standards and those who prepare financial statements if there is serious interest in communicating with external users. • Materiality and Optimal Disclosure - Those two concepts are interrelated and relate also to the concepts of relevance and reliability. Materiality and optimal disclosure are interrelated because if the information is material, it should be disclosed and at the same time information that is not disclosed is presumed to be immaterial. Materiality and optimal disclosure relate to relevance because irrelevant information is considered immaterial and, therefore, should not be disclosed. Materiality and optimal disclosure also relate to reliability because to be reliable the financial statements should, among other things, disclose all material relevant information.	mation, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark. • Materiality • Materiality is a pervasive concept that relates to the qualitative characteristics, especially relevance and reliability. Materiality and relevance are both defined in terms of what influences or makes a difference to a decision maker, but the two terms can be distinguished. A decision not to disclose certain information may be made, say, because investors have no need for that kind of information (it is not relevant) or because the amounts involved are too small to make a difference (they are not material). Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgement has to be made, will not generally be sufficient basis for a materiality judgement. The Board's present position is that no general standards of materiality can be formulated to take into account all the considerations that enter into an experienced human judgement. Qualitative materiality criteria may be given by the Board in specific standards in the future, as in the past, as appropriate.		

SAUDI ARABIA	UNITED STATES	WEST GERMANY	TUNISIA
Materiality calls for consideration as to who are or are likely to be the users of the particular financial statements, and as to the information needs of those users. An item should be considered material if its omission, non-disclosure or misstatement would result in distortion of the information being presented in the financial statements and thereby influence current or prospective equity investors' or lenders' assessment of the outcome from holding an equity interest or loan position in the business enterprise; or influence current equity investors' evaluation of management performance. Optimal disclosure contributes to the usefulness of financial accounting information. The financial statements should disclose that which is necessary to make them not misleading but the disclosure should stress the matters which should be stressed (relevant and material matters). There are two aspects of optimal disclosure; optimal aggregation and optimal verbal descriptions and explanations.	• Costs and Benefits • Each user of accounting information will uniquely perceive the relative value to be attached to each quality of that information. Ultimately, a standard-setting body has to do its best to meet the needs of society as a whole when it promulgates a standard that sacrifices one of those qualities for another; and it must also be aware constantly of the calculus of costs and benefits. In order to justify requiring a particular disclosure, the perceived benefits to be derived from that disclosure must exceed the perceived costs associated with it. However, to say anything precise about their incidence is difficult. There are costs of using information as well as of providing it and the benefits from providing financial information accrue to preparers as well as users of that information. • Understandability • Information cannot be useful to decision makers who cannot understand it, even though it may otherwise be relevant to decision and be reliable. However, understandability of information is related to the characteristics of the information itself and, therefore, understandability cannot be evaluated in overall terms but must be judged in relation to a specific class of decision makers.		

APPENDIX ' D '

GENERAL PRESENTATION AND DISCLOSURE STANDARD: COMMENTARY

OBJECTIVES OF FINANCIAL ACCOUNTING

TABLE OF CONTENTS

1. EXPLANATORY FOREWORD

1.1 INTRODUCTION

As stated in Article 123 of the Saudi Company Law, the primary responsibility for the preparation of the financial statements of a reporting entity[1] rests with its management. Consequently, management is responsible for the proper presentation and disclosure in the financial statements. The term financial ststements covers the Statement of Financial Position, the Statement of Income, the Statement of Changes in Owners' Equity or the Statement of Retained Earnings, the Statement of Sources and Applications of Funds and any explanatory notes necssary to make the financial statements clear, understandable and not misleading.
(para 503)

Financial statements are intended to provide information for use in making decisions by current and prospective equity investors, lenders and others. Specifically, the financial statements should provide information that is useful to current and prospective equity investors and lenders in assessing the potential cash flow to them from holding an equity interest or a loan position in a reporting entity. The proposed Statement of Objectives and Limitations of Financial Statements of Business Enterprises indicates that in order for the financial statements to provide for the information need of equity investors and lenders the statements should provide information about:

i) The reporting entity's income, the components of income and their incidents;

ii) The reporting entity's assets, liabilities and owners' equity;

iii) How a reporting entity obtains and spends cash or other liquid resources, about its borrowing and repayment of borrowing and about its capital transactions, including cash dividends and other distributions of entity resources to owners.
(para 504)

In combination, those types of information contribute to equity investors and lenders evaluation of the past financial performance and present financial position of an entity and indirectly to their assessment of the potential cash flow to them from holding an equity interest or a loan position in the entity.
(para 505)

Also, those types of information contribute to current equity investors' evaluation of how management has discharged its stewardship responsibility for the use of the entity resources. The Statement of Income (together with related notes) contributes to the objectives of financial statements by providing information about the extent to which owners' equity has increased or decreased during a period from transactions and other events and circumstances, other than investments by and distributions to owners and other contributions to capital from nonequity sources. The Statement of Income provides this information by reporting the amounts of revenues, expenses, gains and losses that have been recognized during the period in a manner that would disclose the components and incidents of income for the period.
(para 506)

The Statement of Financial Position (together with related notes) contributes to the objectives of financial statements by providing information about the nature and amounts of investments in the reporting entity's assets, its present obligations to creditors, and the owners' equity in its assets. The Statement of Financial Position contributes also to the objectives of financial statements by providing information that is useful to equity investors and lenders in assessing the entity's liquidity.
(para 507)

(1) The reporting entity refers to a business enterprise for which financial statements are being prepared for issuance to external parties.

The Statement of Sources and Applications of Founds (together with any related notes) contributes to the objectives of financial statements by providing information about:

a) How the activities of the reporting entity have been financed, including the extent to which funds have been generated from operations;

b) How the funds have been used; and

c) The effects of these activities on the funds of the reporting entity.
(para 508)

The Statement of Changes in Owners' Equity (together with related notes) or the statement of retained Earnings (together with disclosure in notes or on the face of the Statement of Financial Position of changes in other categories of owners' equity) contribute to the objectives of financial statements by providing information about investments by and distributions to owners during the period, the extent to which income is being retained by the entity and other capital contributions from nonequity sources.
(para 509)

1.2 REQUIREMENTS FOR THE GENERAL PRESENTATION OF FINANCIAL STATEMENTS

1.2.1 GENERAL REQUIREMENTS

Requirements for the proper presentation of financial statements involve considerations of the proper placement and display of information about the financial position of a reporting entity, the results of its operations, changes in its owners' equity, and the sources and applications of its cash or other liquid resources. Placement of financial statement information is concerned with the question of whether information should be reported in the main body of the financial statements or in the notes to the financial statements.
(para 510)

Display of financial statement information is concerned mainly with the degree of aggregation[2] or the amount of detail that should be displayed and the manner of their display. The proposed Statement of Objectives and Limitations of Financial Statements of Business Enterprises together with the proposed Statements of Concepts of Financial Accounting for Business Enterprises provide the overall basis for decisions regarding the placement and display of items in the body of financial statements and the related notes.
(para 511)

Display involves considerations of the materiality of the items, components or classes of items in the financial statements. Materiality considerations as they relate to display of financial statement information are quantitative as well as qualitative in nature. Quantitative materiality considerations center around the relative magnitude of an item, a component or a class of items.
(para 512)

---

(2) In this standard three terms are used repeatedly to refer to different degree of aggregation. The three terms and their intended meaning are as follows:

i) An Item: The most detailed display of assets, liabilities, revenues, expenses, gains and losses, given as a separate line in the main body of the financial statements or schedules contained in the notes to the statements is referred to as an item.
For example, gain on sale of fixed assets may be an item in the statement of income.

ii) A Component: A combination of items in the Statement of Income or the Statement of Sources and Applications of Fund is referred to as a component. For example, operating income is a component in the Statement of Income and cash provided by operations is a component in the Statement of Sources and Applications of Founds.

iii) A Class: A combination of items in the Statement of Financial Position is referred to as a class. For example, current assets is a class of assets; current liabilities is a class of liabilities, etc.

Qualitative materiality considerations center around the nature, and characteristics of items, components or classes of items, their measurement bases, and their relationship to certain indicators that are considered to be useful to the primary users in evaluating the performance of the reporting entity and assessing its prospect. The General Presentation and Disclosure Standard prescribed materiality criteria for the aggregation or disaggregation of items, components or classes of items in the main body of the financial statements.
(para 513)

1.2.2 REQUIREMENTS PECULIAR TO EACH FINANCIAL STATEMENT

1.2.2.1 DISPLAY IN THE STATEMENT OF INCOME

The elements that should be included in the Statement of Income are revenues, expenses, gains, losses and net income which are defined in the proposed Statement of Concepts of Financial Accounting for Business Enterprises. It is useful to the primary users of financial statements to display revenues, expenses, gains and losses in meaningful components of net income.
(para 514)

Components of net income refer to groupings of related revenues, expenses, gains and losses. The following considerations affect the display of information in the statement of income:

i) A component of income should be separately displayed if it is relevant to the evaluation of the historical ability of the reporting entity to generate income. This calls for the separate display of income from the ongoing major operations of the reporting entity: the results of its peripheral or incidental transactions with other entities and other events and circumstances affecting it which relate to its operations; the results of its discontinued operations; and the results of other events and circumstances affecting it that are of a character significantly different from the typical or customary activities of the entity and are of such infrequent occurrence that they would not reasonably be expected to recur in the foreseeable future;

ii) Enough detail should be given to enable financial statement users to understand the main relationships among revenues, expenses, gains and losses. Accordingly, it is useful to display separately: expenses that vary with the volume of operations or with various components of net income; expenses that are discretionary; and expenses that are stable over time;

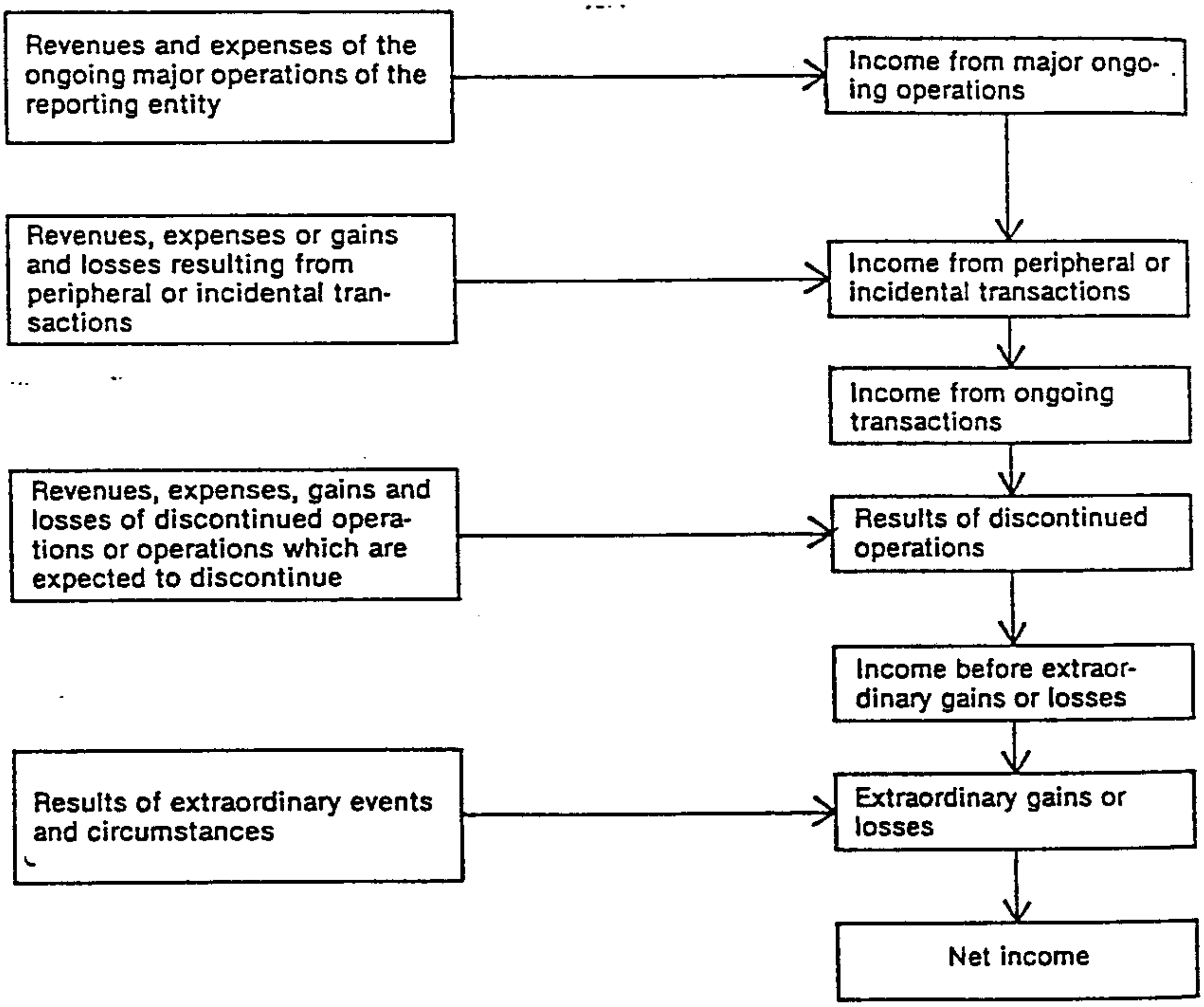
iii) It is useful to distinguish among revenues, expenses, gains and losses, the measurement of which is subject to different levels of reliability;

iv) It is not acceptable to display net amounts of items (such as gains and losses) if knowledge of the relationship between the gross amounts is likely to be useful for the evaluation of the reporting entity's performance and the assessment of its future; and

v) If the Statement of Income is to be understandable, fully descriptive labels need to be used for various items and components displayed in the statement.

The following figure summarises the main components of net income which must be presented in the Statement of Income according to their materiality.

COMPONENTS OF NET INCOME



Summarry of the Main components of Net Income which must be presented in the Statement of Income.

1.2.2.2 DISPLAY IN THE STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS

The elements that should be included in the Statement of Sources and Applications of Funds are:

i) Changes in the elements of the Statement of Financial Position (i.e., changes in assets, liabilities and owners' equity) that affect funds; and

ii) Changes in the elements of the Statement of Financial Position that, although they do not affect funds, represent financing and investing transactions of the reporting entity.
(para 516)

The definition of funds determines the changes in the elements of the Statement of Financial Position that Affects funds. Funds can be defined to mean cash used in this sense, the Statement of Sources and Applications of Funds is basically the same as a Statement of Sources and Uses of Cash. Funds could also be defined to mean working capital (current assets less current liabilities). Used in this sense, the Statement of Sources and Applications of Funds is basically the same as a Statement of Sources and Uses of Working Capital.
(para 517)

The proposed Statement of Objectives of Financial Statements of Business Enterprises indicates that equity investors and lenders seek information about how the reporting entity obtains and spends cash or other liquid resources. It would appear, therefore, that funds defined to mean cash is more appropriate than funds defined to mean working capital given the information need of equity investors or lenders. However, in situations where current assets and current liabilities of a reporting entity are substantially monetary in nature it would also be appropriate to define funds to mean working capital.
(para 518)

There are certain changes in the elements of the Statement of Financial Position that do not affect funds as defined in the previous paragraph. Yet, those changes are the results of transactions that involve simultaneous financing and investing aspects. Examples would be the acquisition of a building by issuing shares of capital stock, the exchange of land for land and buildings and the conversion of long-term debt to preferred or common stock. A Statement of Sources and Applications of Funds which includes only changes in the elements of the Statement of Financial Position involving funds may fail to provide all appropriate information about the financing and investing activities of the reporting entity. Accordingly, a Statement of Sources and Applications of Funds should include, where applicable, changes in the elements of the Statement of Financial Position resulting from investing and financing transactions not involving funds.
(para 519)

To be useful to equity investors, lenders and others, the Statement of Sources and Applications of Funds should display the sources and uses of cash or working capital separate from other investing and financing transactions not involving funds. Sources and uses of cash or working capital should be displayed in meaningful components. It is useful to show a component separately if it is relevant to the evaluation of the historical ability of the reporting entity to generate cash or working capital or if it is relevant to the evaluation of its historical cash or working capital requirements. This calls for the separate display of cash or working capital generated from or used in operations, from the disposal of assets, from borrowing and from investment by owners or other capital contributions from nonequity owners. This also calls for the separate display of cash or working capital used to repay borrowings, to invest in non-cash or non-current assets and to make distributions to owners.
(para 520)

1.2.2.3 DISPLAY IN THE STATEMENT OF FINANCIAL POSITION

The elements that should be included in the Statement of Financial Position, assets, liabilities and owners' equity are defined in the proposed Statement of Concepts of Financial Accounting for Business Enterprises. It is helpful to users of financial statements if those items are displayed in meaningful classes.
(para 521)

The main consideration for determining the number of classes that should be displayed and the content of each class is that the resulting display should be helpful to the users of financial statements in assessing the nature, amounts, and liquidity of available assets, including management's intentions regarding their function in use, and the amounts and timing of obligations that require liquid resources for settlement. Within each class, assets and liabilities can be displayed as items in various ways.The main consideration for the display of elements of the Statement of Financial Position suggests the following:
(para 522)

i) Assets that are held for sale in their present form should be reported separately from assets held for use as inputs to production or other transformation process or for use in operations and those should be reported separately from assets held as investments to yield income and/or appreciation;

ii) Assets with different general liquidity characteristics should be reported as separate items or classes, for example, current vs. non-current assets;

iii) Assets with different nature should be displayed as separate items or classes;

iv) Assets with different measurement basis should be reported as separate items or classes;

v) Monetary liabilities should be segregated from nonmonetary liabilities;

vi) Liabilities with different timing requirements should be reported as separate items or classes, for example, current vs. noncurrent liabilities;

vii) Classes or items of owners' equity that are not available for distribution should be reported separately from classes or items available for distribution;

viii) Classes or items of owners' equity that represent investments by owners should be reported separately from classes or items that represent capital contributions from nonequity sources;

ix) Classes or items of owners' equity that are set aside for specific reasons, for example, legal reserve, should be reported separately from other classes or items of owners' equity; and

x) If the Statement of Financial Position is to be understandable, fully descriptive labels need to be used for various items and classes displayed in the statement.
(para 523)

1.2.2.4 DISPLAY IN THE STATEMENT OF RETAINED EARNINGS OR THE STATEMENT OF CHANGES IN OWNERS' EQUITY

Changes in assets and liabilities that affect owners' equity in most circumstances can be displayed adequately in a Statement of Retained Earnings augmented by additional disclosures in the notes to the financial statements. However, when transactions affecting owners' equity are unusual or complex a Statement of Changes in Owners' Equity may be used to set forth more fully the changes for the period in all classes or items of owners' equity. In all cases, it is helpful to the users of financial statements that changes in owners' equity during the period should be displayed either in a Statement of Retained Earnings and notes to financial statements or in a Statement of Changes in Owners' Equity in a manner that would assist them in assessing the nature and sources of those changes. This suggests the following:
(para 524)

i) Additional investments by owners should be displayed separately from other additional capital contributions from non-equity sources;

ii) Distributions to owners during the period should be displayed separately;

iii) Income retained in the enterprise should be displayed separately including separate display of amounts set aside for specific reasons; and

iv) If the Statement of Changes in Owners' Equity or the Statement of Retained Earnings is to be understandable, fully descriptive labels need to be used for various items and classes of items displayed in the statement.
(para 525)

1.3 GENERAL DISCLOSURE REQUIREMENTS

General disclosures refer to certain information of general nature that should be disclosed in order for the financial statements not to be misleading. This information pertains to the following:
(para 526)

1.3.1 IDENTITY OF THE REPORTING ENTITY

Financial statements are prepared for a particular entity as of a particular date or for a particular period. Obviously, the identity of the reporting entity should be disclosed along with a description of its legal form. In addition, the Statement of Financial Position date(s) and the period(s) covered by the financial statements should be disclosed. Finally, information about the nature of the activities or business of the reporting entity facilitates comparison with similar entities and, therefore, should be disclosed.
(para 527)

1.3.2 ACCOUNTING POLICIES

The significant accounting policies of a reporting entity encompasses the specific standards, bases and the methods of their application adopted by the management of the reporting entity to prepare and present its financial statements. The accounting policies adopted by the reporting entity can affect significantly the presentation of its financial position, results of operations and other changes in the financial position. Accordingly, the usefulness of financial statements for purposes of making decisions about the reporting entity depends significantly upon the user's understanding of the adopted accounting policies.
(para 528)

The task of interpreting financial statement is complicated by the adoption of diverse policies in many areas of accounting. There is not a single list of accepted policies to which users may refer and the diverse accounting policies that are presently available for adoption can produce significantly different sets of financial statements based on the same transactions, events and conditions.
(para 529)

1.3.3 ACCOUNTING CHANGES

Accounting changes encompass changes in accounting policies, changes in accounting estimates, correction of errors discovered in prior period financial statements and changes in the reporting entity. The details of each of these changes are as follows:
(para 530)

1.3.3.1 CHANGE IN AN ACCOUNTING POLICY

Accounting policies encompass the specific standards, bases and methods of their application adopted by management of the reporting entity to prepare and present its financial statements. A change in accounting policies involves a choice from among acceptable alternatives. Generally, changes in accounting policies affect or have a potential effect on either net income or owners' equity but may also affect working capital or other items.
(para 531)

Changes in accounting policy would include, for example, a change in the method of determining the costs applicable to items in inventory (i.e., a change from the average cost method to the first in, first out method), or a change in the method of calculating depreciation (e.g., a change from a diminishing balance method to a straight-line method).
(para 532)

Neither (a) the initial adoption or alteration of an accounting policy necessitated by transactions, events or circumstances that are clearly different in substance from those previously occurring nor (b) the initial adoption of an accounting policy in recognition of transactions, events or circumstances occurring for the first time or that previously were immaterial in their effect is considered to be a change in an accounting policy.
(para 533)

The classification of an item in the financial statements of the current period may be different from that in the financial statements of prior periods as a result of a change in the grouping of items within or among relevant categories. Such a change in classification is a matter of presentation and is, not in itself, a change in an accounting policy. However, to enhance comparability with the financial statements of the current period, the item should be reclassified in the financial statements of the prior periods to conform with the new basis.
(para 534)

Various treatments can be advocated to deal with a change in an accounting policy, including the following:

a) Prospective application. The new accounting policy is applied only to events and transactions occuring after the date of the change and to any outstanding related balances existing at the date of the change. No cumulative catch-up adjustment is made to such balances.

b) Retroactive application with no restatement of prior periods. The new accounting policy is applied to events and transactions from the date of origin of such items and a cumulative adjustment representing the effect of the change in an accounting policy on prior periods is made in the period in which the change is made. Two different treatments of the cumulative adjustment may be followed: an item in net income or an adjustment of the opening balance of retained earnings.

c) Retroactive application with restatement of prior periods. The new accounting policy is applied to events, transactions, and circumstances from the date of origin of such items. The financial statements for each prior period presented for comparative purposes are restated to reflect the new policy. The balance of retained earnings at the beginning of the earliest period presented is restated to reflect the cumulative effect of the change on periods prior to that date.
(para 535)

The basic consideration in reporting a change in an accounting policy or a method of applying an accounting policy should be the ability of the users of the financial statements to associate the results of the reporting entity with particular time periods so that they can assess the impact of changes in economic conditions on those results. In addition, the usefulness of financial statement information is increased by consistency from period to period and by comparability of measurements among entities over time. It follows that the usefulness of information about the results of the entity operations is likely to be increased if it indicates, as far as possible, the time period within which the components of net income are associated. This suggests that it would be preferable to restate past results following a change in an accounting policy that affected the reporting of past results.

When there has been a change in an accounting policy, a description of the nature of the change, its justification as well as its effect on the current and prior periods assists in understanding the significance of the change and its impact on the financial statements.
(para 536)

1.3.3.2 CHANGE IN AN ACCOUNTING ESTIMATE

The preparation of financial statements involves making estimates which are based on information available at the time when the financial statements are prepared. For example, estimates are required of uncollectible receivables, the impairment of value of recorded amounts of certain assets such as inventories, and the useful life of depreciable assets. It may be necessary to revise an estimate in a subsequent period if new information becomes available or more experience is gained or new events occur which would change the previous estimate.
(para 537)

A change in an estimate may affect the financial results of future periods, as well as those of the current period. It may be argued that, in such cases, a cumulative adjustment should be made in the current period representing the retroactive effect of the revision on prior periods so that the financial results of future periods would be on the new basis. The preferable accounting treatment is to reflect the effect of a change in an estimate in the period of the change and applicable future periods if it affects both. A change in an estimate should not be given retroactive effect since it arises from new information or developments.

Where there has been a change in an accounting estimate that is rare or unusual or that may affect the results of both current and future periods, the description of the nature of the change and its effect on the current period assists in understanding the significance of the change and its impact on the financial statements.
(para 538)

1.3.3.3 CHANGE IN THE REPORTING ENTITY

A change in the reporting entity is a special type of change in accounting policies adopted by the management of the reporting entity which results in financial statements that, in effect, are those of a different reporting entity. Examples of this type of change include presenting consolidated financial statements in place of financial statements of individual entities that make up an existing affiliated group of companies and changing specific subsidiaries comprising the group of companies for which

consolidated financial statements have been presented in the past. A change in the reporting entity does not take place when a company acquires another company and, therefore, prepares consolidated financial statements for the first time or when a parent company sells a subsidiary and, therefore, removes that subsidiary from consolidated financial statements.
(para 539)

Like any other change in an accounting policy, a change in the reporting entity should be reflected retroactively to facilitate comparison of results of the reporting entity over time. In addition, the nature and justification for the change and its effects on the results of operations should also be disclosed in order for the financial statements to be understandable.
(para 540)

1.3.3.4 CORRECTION OF AN ERROR IN PRIOR PERIODS FINANCIAL STATEMENTS

Errors in financial statements result from mathematical mistakes; mistakes in the application of accounting standards and methods; and oversight or misuse of available information and data that bear on accounting estimates and which were available at the time the financial statements were prepared.
(para 541)

An error correction should be distinguished from a change in an accounting estimate. A change in an accounting estimate results from new information or new experience or new events that was not available, was not obtained or did not occur at the time the financial statements were prepared. An estimate made as part of the normal process of accounting, which is proved by subsequent events to be inaccurate, is not considered to be an error. An error correction should be also distinguished from a change in an accounting policy. An error correction may result from a change in an accounting policy that is not acceptable to one which is acceptable. On the other hand, a change in an accounting policy is limited to a change from one that is acceptable to another which is also acceptable.
(para 542)

Correction of an error in the financial statements of a prior period discovered in the current period should be accounted for as a prior period adjustment. The financial statements of the period in which the error occurred should be restated to reflect the correction and the opening balance of retained earnings and other affected balances in subsequent periods, including the current period, should be adjusted accordingly. When the error occurred prior to the earliest period for which financial statements are presented, the opening balance of retained earnings for that period and other affected balances should be adjusted to reflect the correction. Disclosure of the nature of the correction and its effects is necessary in order for the financial statements to be understandable.
(para 543)

1.3.4 CONTINGENCIES AND COMMITMENTS

1.3.4.1 CONTINGENCIES

Contingencies are a condition or a set of conditions existing as of the date of the Statement of Financial Position and involving an uncertainty as to possible gain or loss to the reporting entity that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.
(para 544)

The recognition concept set forth in the proposed Statement of Concepts of Financial Accounting for Business Enterprises prohibits the recognition of a gain contingency until the confirming event or

events occur. The recognition concept also indicates that a loss contingency should be recognized if information available at the date of the Statement of Financial Position indicates that the future event or events confirming the impairment of an asset or the incurrence of a liability are likely to occur and there is a reasonable estimate of the amount of the loss.
(para 545)

Disclosure of unrecognizable loss contingencies in Notes to the Financial Statements if the occurrence of the event or events confirming the loss is not a remote possibility is necessary to make the financial statements not misleading. Gain contingencies need to be disclosed if the occurrence of the event or events confirming the gain is likely. Disclosure of contingencies is in accordance with the information need of external users of financial statements set forth in the «Proposed Statement of Objectives and Limitations of Financial Statements of Business Enterprises».
(para 546)

1.3.4.2 COMMITMENTS

Commitments are unperformed executory agreements between the reporting entity and other entities or agreements that restrict the action that can be taken by the entity. In the normal course of business, a reporting entity typically has a number of unfulfilled commitments. Ordinarily, these need not be disclosed because they represent normal commitments. However, certain commitments by their nature and/or amount require disclosure because they represent unusual agreements or restrictions on the activities of the entity and/or they are unusually large in amount. Disclosure of these types of commitments is in accordance with the information need of the external users of financial statements. Accordingly, disclosure is necessary for the following and similar types of commitments:
(para 547)

- To purchase large amount of fixed assets;
- To maintain certain level of working capital;
- To reduce debt by a specific amount;
- To limit additional debt;
- To restrict dividends or distributions to owners;
- To acquire (or be acquired) or to merge with another company;
- Not to merge with, or acquire, another company;
- To issue additional shares of capital stock, cash or other assets in connection with a business combination;
- To enter into long term leases;
- To purchase (or sell) a large amount of inventory (especially at a fixed price for goods whose market price fluctuates frequently or dramatically);
- To enter into unusual employment contracts or into agreements not to compete;
- To purchase shares or equity interests from a stockholder or an owner; and
- To purchase or sell foreign currency.
  (para 548)

1.3.5 SUBSEQUENT EVENTS

Events which occur afterthe date of Statement of Financial Position and the date on whichthe financial statements are authorized for issuance outside the reporting entity may indicate the need for adjustments to assets or liabilities or may require disclosure. In general, there are two types of subsequent events:

a) Those which provide further evidence of conditions which existed at financial statement date; and

b) Those which are indicative of conditions which arose subsequent to the financial statement date.
(para 549)

The impact on the financial statements of each subsequent event depends on the nature of that event. Subsequent events may involve additional information with respect to certain items in the financial statements. Such information must be available to the reporting entity prior to the issuance of financial statements in order for this entity to evaluate the degree of accuracy of estimates made and adjust the financial statements where necessary.
(para 550)

Adjustments to assets and liabilities are required for events occurring after the Statement of Financial Position date which provide further evidence of conditions which existed at the Statement of Financial Position date. For example, adjustments may be made for a loss on a trade receivable account which is confirmed by the bankruptcy of a customer which occur after the Statement of Financial Position date.
(para 551)

Adjustments to assets and liabilities are not appropriate for events occurring after the Statement of Financial Position date, if such events do not relate to conditions existing at that date. An example is the destruction of a major production plant by fire after the Statement of Financial Position date. However, disclosure should be made of events occurring after the Statement of Financial Position date that are indicative of conditions that arose subsequent to that date if their non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.
(para 552)

Examples of subsequent events that require only disclosure (but not adjustments) are:

- Long-term debt incurred or refinanced;
- Additional investments by owners;
- Distributions to owners;
- Initiation or settlement of a claim which the event giving rise to the claim occurred after the date of the Statement of Financial Position;
- Large or unusual commitments to purchase fixed assets;
- Large or unusual commitments to purchase inventory;
- A long-term lease agreement;
- Casualties;
- The purchase of a business;
- Sale of fixed assets; and
- Loss on receivables resulting from conditions arising after the date of the Statement of Financial Position.
(para 553)

1.4 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements are intended to present the financial position, results of operations, changes in owners' equity and the sources and applications of funds of a parent company and its subsidiaries essentially as if the group were a single reporting entity comprised of branches or divisions.
(para 554)

The resulting accounting entity is an economic rather than a legal unit, and its financial statements are considered to reflect the substance of the combined economic relationships to an extent not possible by merely providing the separate financial statements of the legal entities comprising the group.
(para 555)

Consolidated financial statements should adhere to the general presentation and disclosure requirements for all financial statements. However, there are also certain general presentation and disclosure requirements which are peculiar to consolidated financial statements. These relate to the following:

i) Difference in the fiscal periods of a parent and a subsidiary;
ii) Minority interest; and
iii) Reciprocal shareholdings, that is, the presentation of shares of the parent company held by a subsidiary company.

The General Presentation and Disclosure Standard sets forth the requirements for the presentation of the minority interest and reciprocal shareholdings and the disclosures necessary when differences exist in the fiscal periods of a parent and a subsidiary. The standard does not set forth requirements for the preparation of consolidated financial statements including the conditions under which consolidated financial statements should be presented.
(para 556)

1.5 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO DEVELOPMENT STAGE COMPANIES

A development stage company is a business enterprise which is devoting substantially all of its efforts to establishing a new business and, accordingly, its planned major ongoing operations have not commenced or its planned major operations have commenced but there has been no significant revenue therefrom. The provision of useful financial statement information to equity investors and lenders is applicable to business enterprises in the development stage. However, the financial statements of a business enterprise in that stage should be identified as those of a development stage company or enterprise. In addition, the cumulative amounts of expenditures, cash flows, revenues, if any, expenses, gains and losses during the development stage need to be disclosed so that equity investors, lenders and others would obtain a clear understanding of the magnitude of that stage.
(para 557)

(Next paragraph is No. 806)

2. COMMENTARY

COMMENTARY

INTRODUCTION

Financial statements are the primary means of providing primary external users with the essential financial information to assist them in evaluating the performance of a business enterprise and taking the appropriate decisions accordingly. The evaluation of performance of a business enterprise involves, besides other considerations, three major aspects of comparisons.

A) Compare the enterprise's performance for the current accounting period with that of previous period(s).

B) Compare the enterprise's performance for the current period with that of other similar enterprises.

C) Compare the performance of the enterprise with the volume and nature of available economic resources, with particular attention to events and circumstances affecting those resources. (para 806)

In order for users of financial statements to make the above referenced comparisons in a proper manner and arrive at accurate estimates on the performance of the business enterprise, standards of financial accounting should specify a sound basis for the presentation of such information in the financial statements and attached notations which properly disclose the circumstances of the enterprise. This is the reason for choosing the General Presentation and Disclosure Standard to be the first standard of financial accounting in Saudi Arabia.
(para 807)

The General Presentation and Disclosure Standard has been prepared prior to setting forth the standards which govern the measurement of each element of the financial statements and define notes that have to be disclosed in those statements, for the following reasons:

A) Setting standards for each element of the financial statements is a process of continuous nature to cope with the transactions, events and circumstances that would affect those elements. This is evident from the experience of other countries which preceded Saudi Arabia in the development of similar standards of financial accounting. Most of the international financial accounting standards which were issued initially have dealt with matters relevant to general presentation and disclosure.

B) Saudi business enterprises organized in accordance with Saudi Company Law will continue to issue their financial statements in accordance with provisions of this law without due respect to the specific standards which cover each element of those financial statements. Users of the financial statements in Saudi Arabia will also continue to rely on those statements in their appraisal of the performance of business enterprises concerned and in taking their decisions without consideration of specific standards relevant to each element of those financial statements. Within this environment the importance of the General Presention and Disclosure Standard emerges as the first of financial accounting standards, because of their effect on organising the presentation of elements of the financial statements and defining the information to be disclosed in order for those statements to be informative rather than misleading.

C) The recommended Statement of Objectives and Limitations of Financial Accounting and Financial Concepts depend on the main lines which determine the requirements of presentation and disclosure in the financial statements.

D) The General Presentation and Disclosure Standard is mainly concerned with important issues which do not depend in their treatment on specific measurement and disclosure standards that

are peculiar to each individual element of the financial statements. For example, theGeneral Presentation and Disclosure Standard meets the requirements of accounting treatment and disclosure of changes in accounting policies, the nature of activity of the accounting entity, subsequent events, policy adopted by the enterprise's management as a basis for the preparation of financial statements, financial commitments, contingencies, and the degree of details in the information that should be presented in the financial statements.
(para 808)

2.2 BENEFICIARIES FROM THE GENERAL PRESENTATION AND DISCLOSURE STANDARD

Benefit from the General Presentation and Disclosure Standard mainly goes to the users of financial statements. Observance by a business enterprise of the requirements of this standard in preparing financial statements will facilitate the job of external users of these financial statements who are concerned with the evaluation of the performance of this enterprise and comparing this performance with that of similar enterprises.
(para 809)

The General Presentation and Disclosure Standard also has some advantages to chartered accountants operating in Saudi Arabia, as this standard will assist them in the fulfilment of their obligations and expressing their opinion on the financial statements of business enterprises being audited. At the present time, the method of general presentation and disclosure varies from one enterprise to another in the degree of detail, nature and types of notes on significant matters in those financial statements. Irrespective of varying degrees noticed in the notes to the financial statements, reservation is rarely noticed with respect to the degree of detail in those statements or the sufficiency of general presentation. This, in our opinion, is due to the absence of a well defined standard which determines the method of presentation and disclosure in financial statements which will put the chartered accountant in a weak position in case he insists on maintaining a different degree of detail in the financial statements or if he insists on certain general disclosures which the enterprise's management may not wish to disclose.
(para 810)

The ultimate advantage of the issuance of General Presentation and Disclosure Standards goes to the external users of financial statements who are interested in evaluating the performance of the business enterprise and taking proper decisions to invest in enterprises which have the capacity to employ the sources of funds available to them in a proper manner.
(para 811)

2.3 COMPONENTS OF THE GENERAL PRESENTATION AND DISCLOSURE STANDARD

The General Presentation and Disclosure Standard covers the following:

1. The financial statements which need to be prepared to present external users with the required information to enable them to evaluate the enterprise's performance and its ability to realise the objectives of investors, lenders, and other beneficiaries. The type and nature of this information needed by those beneficiaries has already been defined in the recommended Statement of Objectives and Limitations of Financial Accounting.

2. Requirements of presentation in the financial statements in conformity with the type and nature of information needed by external users inclusive of the requirements of presentation of consolidated financial statements and financial statements of development stage enterprises.

3. Requirements relevant to the definition of an accounting entity, nature of activity, significant accounting policies, subsequent events, contingencies, and financial obligations of the business enterprise.

4. Requirements of general presentation and disclosure relevant to consolidated financial statements and financial statements of development stage enterprises. (para 812)

This standard has been developed to meet the recommended Statement of Objectives and Concepts of Financial Statements as set forth in conformity with the circumstances of Saudi Arabia, as compared to the requirements of general presentation and disclosure in the U.S.A., West Germany, and Tunisia, the three countries which have been included in the comparative study conducted during the first stage of the project.

2.3.1 REQUIRED FINANCIAL STATEMENTS

The General Presentation and Disclosure Standard specifies the financial statements which need to be prepared in order to reflect the whole picture of the financial position, results of operations, and sources and application of funds of a business enterprise. These statements are as follows:

1) Statement of Financial Position (referred to as Balance Sheet in the Saudi Company Law).

2) Statement of Income (referred to as Profit and Loss Account in Saudi Company Law).

3) Statement of Changes in Owners' Equity, or Statement of Retained Earnings.

4) Statement of Sources and Application of Funds (currently not required by Saudi Company Law). (para 813)

The Saudi Company Law did not, in fact, specify a limit on the financial statements which business enterprises are requested to present. Besides, it is believed that requirements of the external users of the financial statements, as defined in the recommended Statement of Financial Accounting Objectives, are not fulfilled by the information usually stated in the Statement of Financial Position (Balance Sheet) or the Income Statement (Profit and Loss Account). The recommended Statement of Objectives and Limitations states that in order for financial statements to meet the requirements of external users for information, such statements must cover the following information:

A) Results of operations of the business enterprise, inclusive of components of income, their sources and continuity.

B) Asstes, liabilties and owners' equity of the business enterprise.

C) Sources and application of funds of the business enterprise.

Naturally, it is impossible to present all the above-mentioned information if the financial statements were limited to the Statement of Financial Position and Statement of Income. Taking the level of experience of Saudi external users of financial statements in financial and accounting matters and due to the lack of professional financial analysts on whom they may rely in the collection and analysis of information, it would be imperative for financial accounting to offer as much information as possible in order to serve the objectives of external users in Saudi Arabia. In our opinion, limitation of the financial statements to the Statement of Financial Position and the Income Statement will deprive the external user in Saudi Arabia of significant information which he cannot possibly derive from those statements, because such information are related to the sources and application of funds as well as changes in owner's equity during the accounting period of the respective business enterprise. (para 814)

In comparing the financial statements required by the recommended General Presentation and Disclosure Standard with those required by similar standards in the U.S.A., West Germany and Tunisia, the following may be noted:

1) The financial statements stipulated in the recommended General Presentation and Disclosure Standard are in conformity, to a great extent, with the requirements of the Generally Accepted Accounting Priniciples in the U.S.A., which specify the preparation of the following statements as a minimum requirement to properly present the financial position, results of operations, and sources and application of funds of a given business enterprise:

A) Statement of Financial Position.

B) Statement of Income.

C) Statement of Retained Earnings, or Statement of Changes in Owners' Equity.

D) Statement of Changes in the Financial Position (equivalent to the recommended Statement of Changes in the Sources and Application of Funds).

The main difference between the requirements of Generally Accepted Accounting Principles in the U.S.A. and those of the recommended General Presentation and Disclosure Standard is related to the Statement of Changes in the Financial Position. The standard which governs the contents of this statement in the U.S.A. emphasises the necessity of presenting all the changes which occur in the financial position of a given enterprise in this statement. On the other hand, the recommended General Presentation and Disclosure Standard emphasises the necessity of disclosing the changes which affect the enterprise's investment and financial transactions at the same time.

2) The German Company Law issued in 1976 (which contains provisions of regulating financial statements) has emphasised the necessity of preparing the following financial statements:

A) Balance Sheet.

B) Profit and Loss Account.

C) Retained Earnings (as part of Profit and Loss Account).

Reference has been made to the detailed contents of these financial statements in the first stage of the project. It is further evident that although Company Law in West Germany did not refer to the necessity of preparing the Statement of Sources and Application of Funds or any equivalent statement, it is one of the commonly prepared financial statements in that country.

3) The Tunisian Plan Compatable General set forth in 1966 which is considered to be the official source of financial accounting standards has stipulated the preparation of the following financial statements:

A) Balance Sheet.

B) Operations Account.

C) Utilization Account.

D) Allocation of the Results of Gross Utilization Account.

E) Allocation of the results of Net Utilization Account.

F) Statement of Allocation and Distribution of Funds for the year. (para 815)

More details on the contents of these financial statements were given in the comparative survey conducted during the first phase of this project. However, it is worth mentioning at this point that financial statements in Tunisia have been prepared on the basis of established financial accounting objectives in that country which emphasised the presentation of necessary information needed to enable planners for the national economy prepare such statements for purposes of national planning in Tunisia. This, in fact, is the reason for the variation of financial statements required in Tunisia from those stipulated in the General Presentation and Disclosure Standard.

2.3.2 REQUIREMENTS OF PRESENTATION OF INFORMATION IN THE FINANCIAL STATEMENTS

The General Presentation and Disclosure Standard is characterised by grouping all the requirements of presentation in the financial statements in a single standard and by defining clear and unified principles for such presentation. The purpose of this general standard is to minimize the variation in the degree of details presently noticed in financial statements issued in Saudi Arabia. This general standard is also characterised by relating the requirements of detailed presentation and the classification of those details to the needs of external users as set forth in the Statement of Objectives. The requirements of presentation, according to this general standard, are classified into the following two categories:
(para 816)

A) General Presentation Requirements.
B) Specific Presentation Requirements for Individual Financial Statements.

2.3.2.1 GENERAL PRESENTATION REQUIREMENTS

By defining the elements to be presented in financial statements, the General Presentation and Disclosure Standard has in fact, emphasised on the basic principles which determine the method by which information are presented in the financial statements; the order of their presentation; the necessity of presenting comparative data; the need for giving a title to each financial statement which defines the name of the issuing firm, legal status, as well as date or period covered; the necessity of giving clear titles for notes attached to financial statements assigning numbers and cross referencing those notes in the various relevant financial statements. This general standard has also stipulated the necessity of selecting the appropriate format, terminology and the classification of items, components and groups in a manner that would facilitate the comprehension of significant data covered by those statements.
(para 817)

General presentation requirements have also defined the main considerations for presenting any given item, element or group of items independently in the financial statements or in the attached notes according to their level of materiality. The general standard has further classified these considerations into qualitative and quantitative, and stipulated that qualitative considerations must supersede the quantitative ones. By this token, if a given item, element or group cannot be characterised as peculiar of its kind, there will be no need to present it independently and vice versa, provided that such item, element or group of items meet the requirements of materiality. In this respect, general presentation requirements have specified the method by which the level of materiality of a given item, element or groups of items is determined as well as indicators which will distinguish between material and immaterial information.
(para 818)

In comparing the requirements of the recommended General Presentation and Disclosure Standard with those of the U.S.A., West Germany or Tunisia it will be evident that these three countries have not tackled the general requirements of presentation of information in the financial statements with the same degree of comprehension shown in the recommended General Presentation and Disclosure Standard. Accountants in the U.S.A., for example, resort to prevailing customs as relates to the re-

quirements of general presentation. This is due to the fact that Generally Accepted Accounting Principles in the U.S.A. do not contain clear cut provisions; with the exception of publication No. (43) which emphasised the advantages of comparative financial statements, the standards, of the three referenced countries do not have specific guidelines for determining the level of materiality for a given item, element or component for the purpose of their independent presentation in the financial statements or the attached notes.
(para 819)

The requirements tackled by the General Presentation and Disclosure Standard recommended for Saudi Arabia are considered to be a matter of formalities which go beyond the general scope of accounting standards. However, the current situation in Saudi Arabia which is characterised by the variety of backgrounds of accountants and auditors and the emergence of different methods of presentation with varying degrees of coverage and classification, the stipulation of general presentation requirement has become imperative for this country. In our opinion, the ultimate objective of setting standards of financial accounting is to assist external users of the financial statements in the evaluation of performance of a business enterprise and in taking the appropriate decisions. Accounting standards will achieve this objective only when they take into account the needs of external users for those statements both in terms of form and content. Matters of form not governed by the standards of accounting may affect the capability of external users of the financial statements in delineating information which meet their specific needs. Furthermore, modern information theories emphasise the significance of form of any report and its effect on the readers' ability to comprehend and utilize its contents.
(para 820)

2.3.2.2 SPECIFIC PRESENTATION REQUIREMENTS FOR INDIVIDUAL FINANCIAL STATEMENTS

The General Presentation and Disclosure Standard referred to these requirements under a variety of headings with respect to each type of financial statements with particular emphasis to qualitative considerations of classification of information within each such financial statement. The qualitative considerations stated in the referenced standard and considered to be the basis for the classification of information in each financial statement are based on our concept of material information which must be presented in these statements. Such concept of what is deemed to be material information is closely related to the stated objectives of the financial statements which specify the need of external users for information and the type and nature of such information which must be presented in the financial statements to meet this need. The Statement of Objectives, for example, specified the need of external users for information which would assist them in evaluating the enterprise's ability to generate favourable cash flow sufficient to meet the enterprise's financial obligations when they are due and to distribute profits without limiting the enterprise's present volume of operations. The Statement of Objectives further stated that the ability of the enterprise to generate favourable cash flow depends to a great extent on its ability to create sufficient income which can be changed into cash flow. In order for the external users to evaluate the ability of the business enterprise to generate cash flow, the recommended Statement of Objectives emphasised the necessity of incorporating information on the enterprise's components, sources and continuity of income. It further specified the main principles for the classification of this information in the Statment of Income, with particular reference to the following elements:
(para 821)

1. Results of operations of the going concern, detailed as major operations, secondary or incidental operations.

2. The results of operations of a discontinued concern, detailing the results of discontinued operations and gains (or losses) generated from disposal of the assets and payment of obligations.

3. Incidental gains or losses that are not related to the transaction of going or discontinued concerns.

It must be noted at this point that the specific requirements of presentation peculiar to each financial statement in conformity with the recommended Statement of Objectives of Financial Accounting (particularly with respect to the nature of needs of external users for specific types of information) is considered to be the first official attempt of its kind to determine such requirements on the basis of specific and clear objectives of financial accounting that have taken into consideration the specific environment of Saudi Arabia.
(para 822)

In comparing the requirements of presentation for each financial statement with similar requirements in the U.S.A., West Germany and Tunisia, the following will be noted:

1. U.S.A.

In the U.S.A. there is no single standard which specifies all the requirements of presentation relevant to each financial statement. Prevailing customs, however, play a major role in the classification of information that need to be detailed in financial statements. Official requirements of this sort have been issued by the following agencies which are officially recognized as the agencies concerned with setting such standards:
(para 823)

A) Accounting Research Bulletin (ARB) No. 43, issued by the Financial Accounting Procedures Committee (FAPC) of the American Institute for Certified Public Accountants (AICPA), Chapter 3, Section (A) which defined current assets and liabilities.

B) Opinion of the Accounting Principles Board (APB) of the AICPA Nos. 9 and 30 which defined the requirements of presentation of results of operation.

C) Opinion of the APB, AICPA, No. 19 which defined the requirements of presentation in the Statement of Changes in the Financial Position.

D) Opinion No. 28 of the APB/AICPA which sets forth the considerations relevant to the preparation and presentation of information in the financial statements which cover periods of time shorter than one fiscal year.

E) Statement No. 4 of the Financial Accounting Standards Board (FASB) which specified the method of presentation of gains and losses resulting from the amortization of long term loans.

F) Statement No. 6 of the FASB which specifies the method of classification of short term loans that are expected to be financed by the business enterprise in the long run.

G) Statement No. 16 of FASB which defines the method of presentation of changes relevant to previous accounting periods.

H) Statement No. 33 of the FASB which determines the requirements of presentation of information relevant to the effect of changes of the price structure (resulting from inflation or depression) on the enterprise's results of operation and financial position.

I) Statement No. 37 of FASB which determined the method of classifying deferred income taxes in the Statement of Financial Position.
(para 824)

In addition to the above, other accounting measurement and presentation standards with respect to various components of the financial statements and relevant interpretation contain further requirements with regard to the method of presenting certain elements in the financial statements. For example, Statement No. (12) of FASB stipulated that unrealised losses resulting from long term investment in current securities should be classified as part of owners' equity in the Statement of Financial Position. If we take into consideration the Generally Accepted Accounting Principles as applicable in the U.S.A. and the above mentioned bulletins, opinions and statements and with further consideration to prevailing accounting customs, we will find out that provisions of the General Presentation and Disclosure Standard are consistent with the requirements of Generally Accepted Accounting Principles in the U.S.A. in certain respects and different in others. However, it is important to note at this point that these aspects of similarity or difference are not a result of abidance by or departure from GAAP in the U.S.A. Rather it is the result of an in-depth study of the requirements relevant to those principles and standards in the other countries involved in this comparative survey in order to specify aspects that are consistent with the recommended Objectives and Concepts of Financial Accounting which take into account the prevalent circumstances in the Kingdom of Saudi Arabia. Following is a summary of the similarities and differences between the recommended General Presentation and Disclosure Standard in Saudi Arabia and Generally Accepted Accounting Principles applicable in the U.S.A.

GENERAL PRESENTATION AND DISCLOSURE STANDARD COMPARED WITH SIMILAR STANDARDS IN THE U.S.A.

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
1. Income Statement	1) Formal.	Multi-phase statement	Multi-phase statement	
	2) Phases contained in statement.	1) Results of the going concern 2) Results of discontinued concern. 3) Incidental gains/losses.	1) Results of the going concern. 2) Results of discontinued concern 3) Extraordinary gains/losses. 4) Cumulative effect of changes in accounting policies. (APB Opinion No. 30)	The difference is attributed to the different treatment of the effect of changes in accounting policies as recommended in the General Presentation and Disclosure Standard (G.P.D.S.) in Saudi Arabia as compared to GAAP in U.S.A. GAAP stipulate that previous years' financial statements should not be adjusted to reflect changes in accounting policies. They also require that the cumulative effect of changes in accounting policies on previous years must be reflected in the Income Statement in which the change has occurred and to be presented as the last component of net income for that year. (Opinion No. 20 of APB). The Saudi GPDS did not follow GAAP with regard to the treatment of accounting changes as GPDS stipulates that previous years' financial statements affected by changes in accounting policies must be adjusted accordingly. This provision aims at helping external users in the evaluation of the business enterprise's performance from one accounting period to another, which requires the presentation of comparative figures based on the same policies applicable for the current year and the adjustment of previous years' financial statements to cope with the changes in accounting policies.
	3) Major details of the results of a going concern.	1) Results of major transactions of a going concern. 2) Results of secondary transactions or activities (whether going or incidental) and the effect of circumstances on the enterprise, except for incidental items.	Results of transactions of the going concern with disclosure of extraordinary items that are not expected to recur in the near future if found to be relatively significant. (Opinion 30, APB).	The recommended GPDS requires more details in the presentation of results of transactions of a going concern as compared to Opinion No. 30 of APB in the U.S.A. This is due to the Saudi GPDS concern with supplying external users of the financial statements with information on the sources of income and the degree of their continuity. It also aims at emphasising the importance of separating the results of major transactions from those of secondary or incidental activities and the effect of circumstances on a given enterprise.
1) Income Statement (contd)	4) Results of discontinued or suspended operations with respect to a given line of the enterprise's activities.	Must be presented as a separate element of net income to disclose the results of transactions of the discontinued line of activity and the gains or losses resultant from the disposal of the assets and the settlement of obligations as independent items in the income statement or relevant notes.	Must be presented as an independent element of net income to disclose the result of transactions of the discontinued line of activity and the gains or losses resultant from the disposal of the assets and the settlement of obligations as independent items in the income statement or relevant notes (Opinion 30, APB).	The recommended Saudi GPDS is in conformity with Opinion No. 30 of APB with respect to emphasising the importance of results of discontinued or suspended transactions concerned with a specific line of the enterprise's activities. The provisions stipulated in the GPDS aim at providing external users of the financial statements with sufficient information for the evaluation of the enterprise's performance in the past and to determine their future relationship with this enterprise.
	5) Incidental gains/Losses	Must be presented, if found to be material, as an independent element of net income.	Must be presented, if found to be material, as an independent element of net income. (Opinion No. 30, APB).	

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
1) Income Statement (contd.)	6) Incidental gains/losses defined.	They are defined as material gains or losses which result from catastrophes or force majeure outside the scope of the enterprise's activity.	They are defined as material gains or losses which result from extraordinary incidents or circumstances that were not expected to occur in the foreseeable future. They are determined in light of the enterprise's circumstances, geographical location and fields of activity, ... etc. (Opinion No. 30, APB). In addition to the above, the following gains/losses are considered to be incidental: a) Gain/loss resulting from amortisation of long term debts. (Opinion No. 26 of APB and Statement No. 4, FASB).	Incidental gains/losses are defined differently in both countries. Definition stated in Saudi GPDS is more precise than that of the U.S.A. For Saudi Arabia, an incidental gain/loss develops as a function of the relationship of events or circumstances with the normal transactions of the enterprise, if such gain/loss occurs totally outside the scope of objectives of the business enterprise. The U.S. standard, on the other hand, requires that each case shall be determined independently after taking into consideration the circumstances of the business enterprise. For example, losses incurred of a flood which hits Florida is treated as normal loss while such loss is treated as incidental in case it occurred under the same circumstances in Arizona which scarcely suffers from floods as compared to Florida.
			b) Gain resulting from lowering tax dues because of accounting for tax loss carried from a previous year to the effect of lowering current year's taxes. (Opinion No. 11, APB). c) Gain/loss resulting from the sale of the assets of an amalgamated enterprise if such sale has taken place within two years of the date of such amalgamation. (Opinion 16, APB).	
	7) Qualitative considerations for the presentation of certain items within the major components of net income.	The recommended GPDS has defined qualitative considerations which determine if certain items must be presented within the components of net income. For example, time related expenses are separated from expenses related to products and their volume.	GAAP in the U.S.A. did not define qualitative considerations for determining if certain items must be presented within the components of net income. In the U.S.A. this mainly depends on the prevailing customs and nature of the enterprise's activity. In this respect, it is worth mentioning that some standards in the U.S.A. have stipulated that certain items must be presented in the Income Statement.	

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
2) Statement of Financial Position	1) Type of Statement	Classified unless the classification of current assets and liabilities is deemed relatively immaterial.	Classified unless the classification of current assets and liabilities is deemed to be relatively immaterial due to the nature of the enterprise's activity as in the case of banks. Assets and liabilities are mainly classified as current and fixed. GAAP did not specify any other classification. However, the prevailing accounting customs classify fixed assets into homogeneous categories in accordance with the nature of the activities of the enterprise. (ARB No. 43).	The main objective of GPDS, as relates to the classification of financial position statement, is to provide the external reader with information on the assets and liabilities that would assist him in the evaluation of the enterprise's ability to generate cash flow which is sufficient to meet the financial obligations of the enterprise, and to distribute profits without limitation to the current volume of operations of the enterprise.
	2) Definition of current assets and liabilities.	* Assets which can be turned into cash sold or consumed within one year of the date of Financial Position Statement. * Liabilities that are due for payment within one year of the date of Financial Position Statement.	* Assets that are liquidated, sold or consumed within one year of the date of Financial Position Statement or within the duration of the operation cycle, whichever is longer. * Liabilities that are due for payment within one year of the date of the Financial Position Statement or during the cycle of operation, which ever is longer. (ARB No. 43)	Current assets and liabilities as defined in terms of the possibility of liquidation, sale, consumption, or being due within one year irrespective of the duration of the operation cycle, will assist in the standardisation of item classification among various business enterprises in a manner that would assist external users of the financial statements in comparing and evaluating the financial positions of various enterprises on the same basis.
	3) Presentation of asset/liability items or groups within the main classifications of the Financial Position Statement	The recommended standard defined the main considerations for the presentation of asset/liability items/groups within the main classifications for assets/liabilities. For example, various assets are separately presented in accordance with the nature of each such item. Cash assets are separated from non-cash assets. Furthermore, assets subjected to different principles of treatment in the measurement of their value or assets subject to varying degrees of confidence in estimating their value are also separated. In the same token, the standard provided for the detailed presentation of main items or groups of liabilities. For example, long term loans were separated from other long term obligations. It also stipulated that amounts due to managers/senior personnel, members of the board of directors, equity investors, subsidiaries, holding companies as well as liabilities secured by mortgage must be properly presented and disclosed.		

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
	4) Details of shareholders' equity	This standard requires a detailed presentation of shareholders' equity, as follows: A) Share capital fully paid in accordance with the various equity rights. B) Capital grants. C) Legal Reserve and other allowances. D) Unallocated retained earnings.	GAAP require that the nominal value of share capital duly paid should be distinguished from issue premium and other capital participation besides presenting retained earnings as an independent item Because companies are not legally obliged to form any legal reserves, no provisions are stipulated to give a detailed presentation in the Statement of Financial Position. However, GAAP emphasise the necessity of clear presentation and disclosure of allocated retained earnings. (ARB No. 43) (FASB Statement No. 5)	
	5) Arrangement of information to be presented in the Statement of Financial Position.	The recommended standard provides for the presentation of assets in accordance with their degree of liquidity, as follows: A) Current Assets B) Investments and Financial Assets. C) Fixed Assets. D) Intangible Assets. This standard also stipulates that liabilities must be presented according to their due dates as follows. A) Current Liabilities. B) Non-current liabilities. Finally, the General Presentation and Disclosure Standard provides for the presentation of shareholders' equity as an addendum to the assets and liabilities whereby the components of shareholders equity will be presented as independent items or groups of items within this addendum.	GAAP do not specify any given format for the presentation of information in the Statement of Financial Position. However, according to prevailing custom such information is arranged in a manner similar to the requirements stipulated by the recomended standards for Saudi Arabia	The arrangement required by the recommended General Presentation and Disclosure Standard emphasises the importance of presenting information in a manner which would assist external users of the financial statements in evaluating the degree of liquidity and credit worthiness of the business enterprise
3) Statement of Sources and Application of Funds	1) Title.	Sources and Applications of Funds	Statement of Changes in Financial Position (Opinion No. 19, APB)	
	2) Contents.	1) Changes in the Statement of Financial Position to the effect of increase (sources) or decrease (application) of funds. 2) Financing and investment operations which do not affect funds	All changes in the Statement of Financial Position, excluding equity distribution in terms of shares and other transfers between shareholders' equity accounts(Opinion No. 19, APB)	In the recommended General Presentation and Disclosure Standard, emphasis on the changes in the sources and application of funds is due to the importance of information relevant to cash flow for the external users of financial statements in Saudi Arabia

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
	3) When Issued?	It must be issued for each accounting period which requires the issue of an Income Statement	It must be issued for each accounting period which requires the issue of an Income Statement (Opinion No. 19, APB)	
	4) Definition of Funds.	1) Cash Funds; or 2) WorkingCapital if most of the current assets and liabilities are of financial nature.	Changes in the sources and application of funds are deemed to form part of the changes in the financial position. GAAP allow a business enterprise to define funds in the manner which suits the nature of its activities, inclusive of cash funds, operating capital, liquid assets, current assets, and short term investment in negotiable securities, provided that the relevant statement or attached tables contain all other changes which occurred in the Statement of Financial Position. (Opinion No. 19, APB)	
	5) Statement Format and arrangement of information presented therein.	* The recommended general standard does not specify any given format for the Statement of Sources and Applications of Funds. This statement may be presented as a balanced or an unbalanced statement. * Information is preferably presented in this statement as follows: Funds resulting from or applied in operations. Other sources of funds. Application of funds. Investment and Financing operations which do not affect funds.	GAAP do not specify a given format for the Statement of Changes in Financial Positionbut left the business enterprise with the option to determine the format which suits its purposes. GAAP did not also specify any given arrangement for the presentation of changes in the Statement of Financial Position. However, they emphasised the necessity of presenting funds resulting or applied in operations as items independent from elements of changes in the Financial Position. (Opinion No. 19, APB)	This difference is due to the fact that in the U.S.A. all changes in the financial position are emphasised, while the Saudi recommended General Presentation and Disclosure Standard has only emphasised the changes which affect funds.
	6) Tables attached to the statement.	The standard did not require tables to be attached to the Statement of Sources and Application of Funds whether these funds are defined as cash liquidity or working capital.	GAAP require that a table should be attached to the statement which will present changes in the components of working capital, in the event that the business enterprise defines funds to refer to working capital.	
4) Statement of Retained Earnings and changes in owners equity	1) Contents.	The recommended standard gave a detailed account of the contents of the Statement of Retained Earnings or changes in shareholders equity. Business enterprises may use either statement. If the Statement of Retained Earnings is used as a basis for the presentation of changes in shareholders equity, such statement must contain opening balances, additions, disposals & closing balances for allocated and unallocated earnings separately. But if the business enterprise concerned	Although Opinion No. 19 of the APB stated that the Statement of Income and statement of Retained Earnings as the minimum requirement for the presentation of results of transactions, it did not specify any detailed contents to be presented in the Statement of Retained Earnings. Furthermore, GAAP did not refer to the Statement of Changes in Shareholders' Equity as an alternative to the Statement of Retained Earnings. However, prevailing custom accepted the use of both	

STATEMENT	DESCRIPTION	KINGDOM OF SAUDI ARABIA	U.S.A.	REMARKS
		chooses to use the Statement of Changes in Shareholders' Equity, this statement must contain opening balances, additions, disposals, closing balances for each item of shareholders' equity separately.	statements interchangeably, whereby the Statement of Changes in Shareholders' Equity is used in case of the existence of a variety of changes and items effected by such changes during the accounting period. Prevailing customs also indicate that both statements should contain similar information to that required by the recommended General Presentation and Disclosure Standard.	

2. WEST GERMANY

Provisions of presentation in the financial statements in West Germany are contained in the Corporate Law issued in 31.12.1966. Article 149 of this law emphasised the necessity of preparing financial statements on an annual basis in accordance with valid accounting principles and in conformity with evaluation principles stated in the Corporate Law as well as the provisions of commercial law with respect to bookkeeping and financial statement preparation. The Corporate Law defined annual financial statements as follows:
(para 825)

A) Profit and Loss Account
B) Balance Sheet

A) Profit and Loss Account (Article 157)

From analysis of the contents of the Profit and Loss Account as specified by the Corporate Law in West Germany, it is noted that this statement covers the following two statements which are required by the recommended General Presentation and Disclosure Standard:
(para 826)

a) Income Statement
b) Statement of Retained Earnings

Article 157 of the referenced law stated that P/L account should be prepared in various stages to reflect details of the main components of net income as follow:

1) Income/Earnings

a) Gross Profit
b) Income from investments and participations
c) Income from financial assets
d) Income from interests
e) Earnings from the sale of fixed assets
f) Income from decrease of allowance for doubtful debts
g) Income from decrease in allocations for due liabilities
h) Incidental Income
i) Income from Loss bearing contracts
(para 827)

2) Expenses/Losses

a) Salaries/wages
b) Social Insurance contributions
c) Social and the elderly welfare contributions
d) Depreciation, amortisation, and allowances for depreciation of fixed and intangible assets
e) Amortisation and allowance for depreciation of financial assets, excluding allowance for doubtful debts
f) Losses from reduction in value of current assets excluding inventory and allowance for doubtful debts
g) Losses from sale or disposal of fixed assets or securities
h) Interest and other charges
i) Income and other taxes
j) Charges of loss bearing contracts
k) Other expenses

l) Profits deferred (posted) in accordance with profit sharing plans.
m) Net Profit/Loss for the year (net income/loss)
(para 828)

From the study of the above mentioned main components of financial statements, it is noted that presentation in the Profit and Loss Account in accordance with the provisions of the Corporate Law depends on the following two principles:

a) Income/Earnings are presented on the basis of sources of such income/earnings irrespective of their continuity

b) Expenses/Losses are presented on the basis of the nature of the expense/loss irrespective of the nature of activity or the circumstances which contributed to the expense/loss (e.g. major continuous activity, suspended/discontinued activity, incidental/minor activities, circumstances related to a going concern, or extraordinary circumstances)
(para 829)

In comparing the requirements of presentation in the Profit and Loss Account in West Germany with the requirements of presentation in the Statement of Income recommended for Saudi Arabia we find out that Saudi presentation requirements have taken into consideration the need of external users of the financial statements for historical information which defines the relationship between the business enterprise's performance in the past and its prospective performance. These recommended requirements have, therefore, emphasised the importance of presenting the degree of continuity pertaining to components of income through the classification of those components as continued activities (major, secondary, or incidental), noncontinued activities or incidental gain/loss. This, in fact, is a substantial difference between the requirements of presentation of information in the Profit and Loss Account in West Germany and those of recommended Income Statement in Saudi Arabia.

It is worth mentioning at this point that Article (157) of the Corporate Law in West Germany has exempted companies not registered in the securities clearing house from presenting the components of gross profit in their P/L account if the total amount of its Balance Sheet does not exceed 3m. DM. This exemption is also applied to family owned companies whose Balance Sheets do not exceed 3m DM provided that each shareholder shall have the right to have a P/L account in conformity with the provisions of Article 157 if such a statement is deemed necessary for purposes of the general meeting held to discuss the year end financial statements of the company. Such an exemption is considered to be another substantial deviation of the West German presentation requirements from those recommended for Saudi Arabia. Presentation requirements recommended for Saudi Arabia do not differentiate between business enterprises according to their size, negotiability of shareholders equity or owners. This, in fact, is due to our belief in the significance of financial statements for current and prospective investors and lenders.
(para 830)

3. Retained Earnings

Article 153 of the Corporate Law stipulates that changes in the retained earnings, legal reserve, and other resources shall be presented for each accounting period, in the Profit and Loss Account. In this respect there is no substantial difference between the provisions of presentation of retained earnings in West Germany and those of presentation in the Statement of Retained Earnings recommended for Saudi Arabia. Article

149 of the Corporate Law stipulates that the opening balance of retained earnings should be presented in the P/L account and added to net profit/loss for the current period together with disclosure of changes in the legal reserve and other reserves in order to arrive at the balance of unallocated retained earnings at the end of the current period.
(para 831)

B) Statement of Financial Position (Balance Sheet)

Article 151 of the Corporate Law stated the components of the Balance Sheet and their method of classification. It also stated that underlined captions represent the minimum limit of asset and liability categories that shall be presented in the Balance Sheet unless such caption(s) is not available in the respective company.
(para 832)

ASSET SIDE:

1. Uncollected capital participations (requested but unpaid to date)

2. Fixed Assets and Securities:
(para 833)

A) Fixed and Intangible Assets:

1. Head Office buildings, plant, and other buildings assigned for operation
2. Housing Units
3. Land
4. Buildings on owned property not classified under (1) or (2) above
5. Machines and installations
6. Office machines and equipment
7. Assets under construction and advance payments for the purchase of fixed assets
8. Concessions, patents etc., and licenses required to utilize such rights

B) Financial Assets (Securities):

1. Participations in other organisations
2. Investments in securities, not classified under (1) above
3. Loans of a minimum term of four years pinpointing those secured by the mortgage or collateral

3. CURRENT ASSETS

A) INVENTORY :

1. Raw Materials
2. Goods in process
3. Processed (finished) goods

B) OTHER CURRENT ASSETS:

1. Advance payments not classified under (A.7)
2. Trade receivables with receivables due after one year properly disclosed
3. Notes receivable, with notes that can be discounted properly disclosed
4. Check in process
5. Cash in hand, in central bank and deferred checks

6. Banks accounts
7. Securities not classified under 3, 4, 8, 9 or under financial assets
8. Stocks purchased, with par value properly disclosed
9. Participations in holding companies or in prospecting companies
10. Related company receivables
11. Receivables due from directors and members of the supervisory board
12. Other assets

C) OTHER DEFERRED REVENUE EXPENSES
D) ACCUMULATED LOSS
(para 834)

LIABILITIES SIDE:

1. Capital
2. Reserves:
   a) Legal reserve
   b) Other optional reserve
3. Allocations for diminution in the value of assets
4. Allocation for liabilities due:
   a) Pension
   b) Other due liabilities
5. Liabilities due within four years
   A) Loans pledged with mortgage or equivalent
   B) Bank loans, loans pledged with mortgage properly disclosed
   C) Other liabilities, with those pledged with mortgages, or equivalent properly disclosed. In addition to the above, amounts of loans, and liabilities shown in A, B, and C above which will be due in less than four years should be properly disclosed.
6. Other Liabilities:
   A) Accounts payable resulting from purchases or services
   B) Notes payable
   C) Bank accounts payable not classified in (5.B)
   D) Prepayments
   E) Amounts due to related companies
   F) Other liabilities
7. Deferred revenues or deferred income
8. Retained Earnings

In comparing the requirements of presentation in the Balance Sheet as stated in Article 151 of the Corporate Law with the requirements of presentation in the Statement of Financial Position as stated in the recommended General Presentation and Disclosure Standard the following major differences are noted.
(para 835)

A) CLASSIFICATION OF LIABILITIES:

The General Presentation and Disclosure Standard requires that current liabilities must be classified according to amounts due within one year of the date of the Statement of Financial Position. On the other hand, classification of liabilities as approved by Article 151 of the German Law does not cover a classification parallel to that of the current liabilities (in the Saudi recommended general standard) because liabilities according to this article are classified according to their nature with the exception of liabilities which mature after four years. The classification of current liabilities as stated in the General Presentation and Disclosure Standard is due to the belief in the significance of supplying external users of the financial statements with information that would help them estimate the requirements of cash flow at the date of the Statement of Financial Position in order to cover the upcoming accounting cycle and to enable the accounting entity to meet these requirements of positive cash flow that has to be generated within the same accounting period.

B) WHAT IS A CURRENT ASSET:

From the study of the items classified under current assets in accordance with Article 151 of the Corporate Law, it becomes clear that current assets in Germany are not limited to assets which can be turned into cash liquidity or can be sold or used within one year of the date of the Statement of Financial Position. On the other hand,the recommended Saudi General Presentation and Disclosure Standard has already defined those current assets. The definition of current assets as stated in the General Presentation and Disclosure Standard has clearly defined those current assets. This definition of current assets as stated in the General Presentation and Disclosure Standard is intended to provide the external users of financial statements with sufficient information to estimate positive cash flow expected at the date of the Statement of Financial Position which will be available to meet the requirements for financial liquidity during the same accounting period.

C) PRESENTATION OF SHAREHOLDERS' EQUITY:

Article 151 of the Corporate Law differentiates between capital and reserves (Legal and Optional) and between retained earnings or accumulated loss as components of shareholders equity and in terms of the location of their presentation in the Balance Sheet. Article 151 considers retained earnings or accumulated loss as complementary accounting elements to the other elements in the Balance Sheet inclusive of capital and reserves. This article also requires the presentation of capital and reserves as independent items on top of the liability side; the retained earnings are presented as an independent item at the bottom of the asset side; while accumulated loss is presented as an independent item at the end of the asset side of the Balance Sheet. This presentation is due to legal considerations, peculiar to West Germany that are different from the legal concept of shareholders' equity as applicable in Saudi Arabia. The requirements of General Presentation and Disclosure Standard reflects the difference as it requires the presentation of all shareholders equity in one group in the Statement of Financial Position as a complementary accounting element to assets and liabilities while paid capital, legal reserve, other optional reserves, retained earnings or accumulated losses are presented as independent items within this group.

D) PRESENTATION OF DATA IN THE STATEMENT OF FINANCIAL POSITION:

The General Presentation and Disclosure Standard stipulates that assets should be presented in accordance with the degree of their liquidity as follows:

1) Current Assets
2) Investments and financial assets
3) Fixed Assets
4) Intangible Assets

This standard also requires the presentation of liabilities in accordance with their accrual as follows:

1) Current Liabilities
2) Non-current Liabilities

Finally, this standard requires the presentation of shareholders' equity as an independent group complementary to assets and liabilities with their elements presented as independent items within this group, in the following order:

1. Paid-in capital
2. Donated capital
3. Reserves
4. Retained earnings or accumulated losses

The requirements for the order of presentation of data in the Statement of Financial Position in accordance with the General Presentation and Disclosure Standard is due to the belief in the importance of data relevant to cash flow requirements to the external users of the financial statements.

Article 151 of the Corporate Law on the other hand, has taken a different orientation from the Saudi recommended standard, particularly as relates to the presentation of information in the Statement of Financial Position.

3. TUNISIA

Presentation requirements with respect to financial statements in Tunisia are stated in the Plan Compatable issued in 1966. This plan is considered to be the official source of financial accounting standards in Tunisia. It stipulates that business enterprises should use standardised statements of account which classify the financial operations of various business enterprises in a standard manner and in accordance with the same rules. This plan has also imposed a standard method for the measurement and presentation of results of operations.

The Tunisian Plan Compatable stipulates that each business enterprise should prepare the following financial statements:

1. Balance Sheet
2. Production Account
3. Utilization Account
4. Appropriation Account of Results of Utilization
5. Appropriation Account of Results of Net Utilization
6. Statement of Distribution and Appropriation of the current year's profits. (para 836)

At the end of this section there is an appendix which contains sample financial statements required by the Tunisian Plan Compatable. Comparison between the requirements of presentation in the referenced financial statements with those of the General Presentation and Disclosure Standard is in fact useless due to substantial differences between the objectives of financial statements in Tunisia and those of Saudi Arabia. For example, one of the major objectives of financial statements in Tunisia is to assist authorities concerned with the planning of national economy in the preparation of nationwide accounts and determining the effect of the business enterprises on the national economic plan. The recommended Objectives of Financial Statements in Saudi Arabia, on the other hand, have emphasised the need of investors, lenders, and other external users of the financial staterr ›nts for authentic information that would assist them in evaluating the performance of business enterprises in terms of their ability to generate sufficient cash flow.

2.3.3 GENERAL DISCLOSURE REQUIREMENTS

General disclosure is usually concerned with information of general nature that is not related to a specific element of the financial statements which must be presented in the financial statements or relevant notes. This general information is classified into certain areas for which a specific standard is applied to detail what should be presented. These standards cover the following:

1. Nature of the business enterprise
2. Accounting policies
3. Accounting changes, which include:

   A) Changes in accounting policies
   B) Changes in accounting estimates
   C) Changes in the accounting entity for which financial statements are prepared
   D) Correction of errors which might have occurred in previous accounting periods

4. Contingencies
5. Commitments
6. Subsequent events
   (para 837)

The necessity to account for changes in the accounting policy and contingencies has been established with respect to the standard which covers these two subjects. Following is an account of our understanding of the importance of these subjects, justifications of the requirements of the standard relevant to each of them and a comparison of these requirements with similar requirements applicable, if any, in the U.S.A., West Germany and Tunisia. It is worth mentioning at this point that Generally Accepted Accounting Principles applicable in other countries do not have one specific standard which determines the requirements of general disclosure. For example, in the United States, general disclosure requirements have been issued by different areas concerned with financial accounting standards, as follows:
(para 838)

A) Opinion No. 20 of APB of the AICPA which defined the treatment of accounting changes and their relevant notes.

B) Opinion No. 22 of APB of the AICPA which specified the requirement for the disclosure of important accounting policies.

C) Statement No. 3 of financial accounting standards issued by FASB which determined the requirements of treatment and presentation of accounting changes in the financial statements for accounting cycles of less than one year in duration.

D) Statement No. 5 of the financial accounting standards issued by FASB, which determined the requirements of treatment and presentation of contingencies and commitments of the reporting entity.

E) Statement No. 14, FASB, which specified the requirements for the disclosure of the nature of activity of the reporting entity.

In addition to the above, the requirements for the disclosure of subsequent events in the U.S.A. have been stated in the Statements of Auditing Standards. Requirements for the disclosure of certain subsequent events have also been stated in a number of measurement standards that cover certain captions of the financial statements or certain types of activities or events. For example, Opinion No. 16 APB with respect to accounting measurement and treatment of amalgamation and relevant notes emphasised the necessity of disclosing amalgamations which take place during the period from the

date of theStatement of Financial Position and the date of publication of such statement. Statement No. 12 of Financial Accounting Standards concerned with accounting measurement and treatment of investment in equities has emphasised the necessity to disclose changes in the market value of this investment during the period between the date ofStatementofFinancial Position and the date of publication of such financial statements.
(para 839)

2.3.3.1 DISCLOSURE OF THE NATURE OF ACTIVITY OF THE REPORTING ENTITY

It has been stated in the introduction to this section that the evaluation of the performance of the reporting entity on part of the external users of the financial statements involves, besides other important considerations, the following three major comparisons:

1. Compare the performance of the business enterprise for the current period with that of previous accounting period(s).

2. Compare the performance of the business enterprise for the current period with that of similar business enterprises.

3. Compare the performance of the business enterprise with the volume and nature of available economic resources, events and circumstances affecting such performance.
   (para 840)

The importance of acquaintance with the nature of the activities of a given business enterprise cannot be further emphasised. Such information will assist in determining business enterprises of similar nature and the changes that take place in the nature of the enterprise's activities over time, which will be taken into account in comparing the performance of the same business enterprise in different accounting periods. On this basis, theGeneral Presentation andDisclosure Standard emphasises the necessity of disclosing the nature of business of the reporting entity.
(para 841)

In comparing the requirements of General Presentation and Disclosure Standards with respect to the disclosure of the nature of activity of the reporting entity with similar requirements as stipulated in other countries, we find out, for example, that GAAP in the U.S.A. stipulate the disclosure of nature of business of the reporting entity while similar standards in West Germany and Tunisia do not require such disclosure.

2.3.3.2 DISCLOSURE OF THE ACCOUNTING POLICIES OF THE REPORTING ENTITY

The accounting policies adopted by the management of the business enterprise in the preparation of financial statements have an important effect on the overall picture that such financial statements will leave on the enterprise's financial position, results of operation and changes in the financial position. In this manner, the utility of the financial statements in taking decisions that would affect the business enterprise will depend to a great extent on the understanding on part of the users of the financial statements and their appreciation of the accounting policies on the basis of which these statements were prepared. The importance of disclosing accounting policies is further emphasised in light of the fact of non existence of Generally Accepted Accounting Policies in Saudi Arabia to be followed by business enterprises in the country and used as a reference by the users of financial statements. The availability of a variety of accounting policies that may be adopted in the preparation of financial statements will lead to substantial differences in the presentation of financial statements that are based on the same events and circumstances. The General Presentation and Disclosure Standard has therefore emphasised the necessity of disclosing significant accounting policies on the basis of which the business enterprise prepares its financial statements. Examples of accounting policies that should be disclosed are the following:
(para 842)

1. Basis for the consolidation of financial statements.
2. Method of costing and evaluation of inventory.
3. Accounting basis for the recognition of revenues.
4. Methods of depreciation and amortisation.
5. Accounting basis for the recognition of voyage revenues in case of maritime organizations.
6. Accounting treatment of preoperating expenses.
7. Accounting treatment of financing construction loans.
8. Accounting treatment of earnings or losses resulting from the translation of foreign currencies.
9. Accounting basis for the preparation of the financial statements (i.e. accrual basis or cash basis .... etc.)
10. Accounting treatment of research and study expenses.
11. Accounting treatment of area development, permanent agricultural expenses or crops not reaped at the close of a given accounting period.

From the study of general disclosure requirements in other countries, it is evident that GAAP in the U.S.A., contrary to both West Germany and Tunisia, oblige business enterprises to disclose their accounting policies which are adopted by their managements as the basis for the preparation of financial statements. Following is a comparison between the requirements with respect to the disclosure of accounting policies as stated in GAAP in the U.S.A. and those of the recommended General Presentation and Disclosure Standard in Saudi Arabia.
(para 843)

2.3.3.3 DISCLOSURE AND TREATMENT OF CHANGES IN ACCOUNTING POLICIES

1. Change in Accounting Policies

Changes in accounting policies take place when the management of the reporting entity decides to replace an acceptable accounting policy with another acceptable policy for the treatment of certain outstanding transactions or balances that took place in a previous accounting period. Such changes may also occur as a result of approval of a new accounting policy for the treatment of transactions or balances which pertain to the current accounting period, because such transactions did not take place in the previous accounting period. In this case, the previous accounting policies will continue in effect with respect to existing transactions or balances which were generated in a previous accounting period.
(para 844)

It is clear that changes in accounting policies, if not properly treated and completely disclosed, will impact the ability of external users of the financial statements to compare the performance of the business enterprise for the current period with that of previous periods. For this reason, the recommended General Presentation and Disclosure Standard covered the requirements of treatment of changes in the accounting policies and their disclosure. To achieve this objective, the following alternative methods for the treatment of such changes have been considered as follows:
(para 845)

A) Future Application

This means that the newly approved accounting policy will be applied to transactions and events that take place after the date of that change and to balances outstanding at the date of change without adjustment to these balances in a manner that would reflect the effect of the new policy on previous accounting periods. This alternative has been discarded because it does not meet the need for comparing the performance of the reporting entity from one accounting period to another.
(para 846)

Subject	Kingdom of Saudi Arabia	U.S.A.	Remarks
Definition of Accounting Policies	Accounting policies cover specific standards, principles and methods of application selected by the management of the reporting entity in the preparation of financial statements.	Accounting policies cover the principles, rules and methods of application selected by the management of reporting entity in the preparation of its financial statements.	Principles referred to in the U.S.A. are equivalent to the standards applicable in Saudi Arabia.
Cases in which disclosure becomes imperative	1. In the event of selection among acceptable criteria and methods of application. 2. In the event of existence of accounting standards or specific methods of application peculiar to a given activity even if it is applied by most enterprises with that same kind of activity. 3. In the event that financial statements are prepared on a basis that is different from one or more of the recommended concepts of financial accounting.	1. In the event of selection among acceptable alternatives. 2. In the event of existence of accounting standards or specific methods of application peculiar to a given activity even if it is applied by most enterprises with that same kind of activity. 3. Unusual applications or new applications to the principles of financial accounting.	The difference between the U.S.A. and Saudi Arabia is due to the fact that requirements of disclosure in the U.S.A. have been issued on the basis of the understanding that the reporting entity's applications of GAAP implies the abidance by certain specific concepts of measurement and disclosure. In Saudi Arabia, on the other hand, no accounting standards have been issued which commit the reporting entities to follow standard concepts of measurement and disclosure.
Note Location	Note number «1» to the financial statements or as a separate summary which will be referred to in the financial statements.	Note number «1» to the financial statements or as a separate summary which will be referred to in the financial statements.	

B) Application with Retroactive Effect without Adjustment to Previous Accounting Periods that are affected by the Change

The new accounting policy is applied to transactions and events as of their date of inception provided that they have outstanding balances on the date of change and adjustment is made to reflect the effect of changing this accounting policy on previous years' accounts and the presentation of such adjustment in the financial statements for the year during which this change has taken place. Adjustment to the current year's financial statements to reflect this change can be done as follows:

1. As an independent caption in the Statement of Income; or
2. As an adjustment to the opening balance of retained earnings.
(para 847)

This alternative has also been discarded because it does not meet the comparison requirements of the reporting entity from one accounting period to another. Rather, it provides for the preparation of financial statements for the year in which the change has taken place in accordance with the new accounting policy and presents the comparative financial statements for previous years in accordance with the old financial statements. Additionally, the presentation of accumulated adjustment as an independent item in the Statement of Income for the year which witnessed such change will lead to the disclosure of an item in the Statement of Income that is irrelevant to the results of operations of the current year.
(para 848)

C) Application of Changes with Retroactive Effect and Adjustment of Financial Statements for the Accounting Periods that Are Affected by Such Changes

According to this method, the new accounting policy will be applied to relevant transactions and events from the date of their inception provided that they have outstanding balances at the date this change took place. Financial statements for the previous years are also adjusted to reflect this change and the opening balance of retained earnings are presented in a manner that would reflect the cumulative effect of changing the accounting policies on years preceding the date of putting such change into effect. The recommended General Presentation and Disclosure Standard has adopted this alternative because it meets the objective of comparing the performance of the enterprise for various accounting periods through the presentation of financial statements for previous year(s) in line with the new accounting policy. This, in fact, will eliminate any misinterpretation of the reporting entity's performance for the whole period irrespective of the different accounting policies adopted for prior accounting periods. The basic consideration for the adoption of this alternative is to enable external users of the financial statements establish a relationship between the results of operations of the reporting entity over specific accounting periods in order for them to evaluate the effect of changes in the economic circustances of the reporting entity on the results of its operations. It is evident that information presented on the results of operations of the reporting entity will be more useful when components of net income are connected to specified periods of time. It is, therefore, preferable to adjust the results of operations for previous periods to cope with the changes in accounting policies whenever the results of such operations are affected by those changes.
(para 849)

In addition to the accounting treatment of changes in the accounting policies, the recommended general standard also stipulated the following disclosure requirements in the event of changes in accounting policies:

A) Description of change
B) Justification of change
C) Effect of the change on the relevant accounting period

The recommended standard further provided for a reference to the adjustment of prior period(s) financial statements in order to reflect the effect of such change on the results of operations for those periods.

The standard also provides alternative requirements in the event that it is deemed possible to adjust the prior period(s) financial statement to cope with changes in accounting policies.

In comparing the requirements of the General Presentation and Disclosure Standard with respect to changes in accounting policies with similar requirements applicable in the U.S.A., West Germany and Tunisia, the following is noted:
(para 850)

1. GAAP of the U.S.A.tackled the issue of changes in accounting policies in an official manner through Opinion No. 20 of APB which provided for the accounting treatment of changes in accounting policies and relevant notes. On the other hand, the Corporate Law of West Germany and the Plan Compatable of Tunisia did not touch on this subject.

2. A comparison of the requirements stated in GAAP of theU.S.A.with those stated in the recommended General Presentation and Disclosure Standard in Saudi Arabia with respect to changes in accounting policies will disclose a great deal of similarity in terms of disclosure of such changes but are different in terms of the accounting treatment of these changes. For example, Opinion No. 20 of GAAP stipulates that the reporting entity should disclose the following with respect to changes in accounting policies:

   A) Description of change
   B) Justification of change
   C) Effect of this change on the financial statements for the respective accounting period

The above referenced opinion provides for the treatment of changes in accounting policies in all respects, with some stated exceptions, with retroactive effect without adjustment of financial statements for prior periods that are affected by this change to the effect of disclosing accumulated adjustment that reflects the effect of this change on prior periods as an independent item in the Statement of Income for the accounting period in which the change took place. This opinion further requires the presentation of explanatory notes to be attached to each Statement of Income which show the net income for each accounting period before and after contingent earnings and losses. In this manner, the new accounting policy will also cover prior years that are affected by such policy. The adoption of this method of accounting treatment in the U.S.A. is due to the following two factors that were considered by APB in issuing its Opinion No. (20):

<u>First Factor</u>: It is the belief of APB that financial statements covering prior accounting periods, when issued, should not be adjusted as a result to changes in accounting policies. The reason for that is that competent readers of the financial statements may lose confidence in these statements. This has led to the issue of Opinion No. 20 of APB which prevented the adjustment of financial statements for prior periods except in certain specific circumstances.

<u>Second Factor</u>: It is the belief of APB in the significance of providing external users of the financial statements with a means to compare the performance of the reporting entity from one period to another without any misrepresentation that may be due to changes in accounting policies. This factor has led to the issuance of APB decision which emphasised the necessity of attaching explanatory notes to each Statement of Income presented that shows net income for each accounting period before and after contingent earnings or losses. In this manner, the new accounting policy will apply to the prior year(s) period that is actually affected by this policy.

In our opinion, the method of treatment of changes in accounting policies as approved by APB's Opinion No. 20 is considered to be too complicated for the circumstances in Saudi Arabia particularly if we take into consideration the provisions of Article 124 of the Saudi Company Law which emphasised the necessity of presenting the financial statements in accordance with the same principles of evaluation and classification adopted in prior years, unless the general meeting of the shareholders approves the change on the basis of the recommendations to this effect from the respective auditor in charge. We further do not expect that users of the financial statements in Saudi Arabia will lose confidence in those statements in the event of their adjustment to cope with the adjustments in financial policies, especially if we take into account the conditions stated by the Company Law to effect such change which is further elaborated by the General Presentation and Disclosure Standard that prescribes the requirements and justifications for such change. Our main concern was therefore, with the selection of the appropriate method of treatment that would assist external users of the financial statements in making a comparison of the performance of the reporting entity, from one accounting period to another without difficulty.

2. Change in Accounting Estimates

A change in accounting estimates may result from new information that has an effect on such estimates but was not available at the time these estimates were established. This change may also result from the accumulated experience of the reporting entity or may be in response to the occurrence of new events. Changes in accounting estimates as a result of availability of new information is treated as error correction and, in this sense, shall not be subject to the requirements of treatment and disclosure stated in the General Presentaion and Disclosure Standard.It is evident that a change in accounting estimates if not properly accounted for and completely disclosed may affect the ability of external users of the financial statements to differentiate between the effect of changes in accounting estimates and changes resulting from economic circumstances on the performance of the reporting entity.

(para 851)

For this reason it is deemed necessary to devise the following requirements for the treatment and disclosure of changes in accounting estimates:

A) Application of the new estimates to the period during which this change takes place if such change applies only to this period or they should be applied to the current and future periods if the effect of this change extends to future accounting periods. It should be noted at this point that application of the new estimates with retroactive effect is not possible because the change in these estimates usually results from the development of new information, experience, events or circumstances that are different from the circumstances existing at the time of financial statement(s) preparation for prior period(s).

B) Disclosure of the nature and effect on net income before extraordinary items and net income of the current period for a change in an accounting estimate that is rare or unusual or that may affect the results of both current and future periods, should be made in the notes to the financial statements. However, General Presentation and Disclosure Standard does not require the presentation of changes in routine annual estimates the effect of which is confined to the current accounting period, such as changing the rate of provision for doubtful debts from one accounting period to another as a result of change in circumstances.
(para 852)

In comparing the requirements of the recommended General Presentation and Disclosure Standard with respect to changes in accounting estimates, with similar requirements in the U.S.A., West Germany and Tunisia, we note the following:

1. GAAP in the U.S.A. treated the issue of changes in accounting estimates in an official manner through the issuance of Opinion No. 20 of APB which stated that such changes and relevant notes must be accounted for. On the other hand both the Corporate Law of West Germany and the Tunisian Plan Compatable did not tackle this subject.

2. The requirements stipulated in GAAP of the U.S.A. and those stipulated in the General Presentation and Disclosure Standard with respect to the treatment and disclosure of changes in accounting estimates are identical.

3. Change in the Reporting Entity

This change is usually based on a decision by the management of business enterprise to change its accounting policy with respect to the legal entities represented by the financial statements. For example, a decision made by the management of a holding company not to consolidate the financial statements of its subsidiaries any further is considered to be a change in the reporting entity from a holding company and subsidiaries to a holding company only. However, it should be noted that change in the reporting entity does not result from the deletion of certain subsidiaries from the consolidated financial statements due to the sale of the holding company of its shares in such subsidiary companies. This change does not also result from the addition to the consolidated financial statements of one or more subsidiaries due to the acquisition on part of the holding company or any of its subsidiaries of this company or companies.
(para 854)

This change in the reporting entity as a result of its management's decision to change its accounting policy with respect to addition or deletion of subsidiaries from the consolidated financial statements will, no doubt, have a significant impact on the ability of the external users of the financial statements to evaluate the performance of the reporting entity. Such change should, therefore, be treated and disclosed to facilitate the reading of financial statements by external users in a manner consistent with the requirements relevant to the treatment and disclosure of changes in other accounting policies. Accordingly, the General Presentation and Disclosure Standard requires the treatment of changes in the reporting entity with retroactive effect which results in the adjustment of prior period(s) financial statements presented for comparison in a manner that would reflect the financial position and the results of operations of the new reporting entity.

Additionally, these requirements stipulate the disclosure of the following information in the financial statements for the period during which a change has occurred in the reporting entity: (para 855)

A) Description of the nature of change in the structure of the reporting entity.

B) The effect of the change on income before extraordinary items and on net income should be disclosed for all periods presented.

By comparing these requirements with similar requirements as applicable in the U.S.A., West Germany and Tunisia we note the following:

1) GAAP in the USA treated the issue of changes in the reporting entity in an official manner through the issuance of Opinion No. 20 of APB which stated that such changes and relevant notes must be accounted for. On the other hand, both the Corporate Law of West Germany and the Tunisian Plan Compatable did not tackle this subject.

2) The requirements stipulated in GAAP of the U.S.A. and those stipulated in the General Presentation and Disclosure Standard with respect to the treatment and disclosure of changes in the reporting entity are identical.
(para 856)

4. Correction of Errors in Prior Period Financial Statements

Correction of errors in prior period financial statements is considered to be another type of accounting changes that need to be properly treated and disclosed. Such errors may occur in prior period(s) due to mathematical errors, in the application of accounting standards, negligence, or misinterpretation of available data which will affect the estimates needed for the preparation of financial statements. In all of the above cases the error must be corrected in a manner consistent with the concepts of accounting period and comparison which state that each accounting period should be charged with the revenues, earnings, expenses or losses incurred within that period and that any errors, if any, must be corrected in the financial year during which the error has occurred (retroactively). This means that the financial statements of all prior periods presented for comparative purposes should be restated as necessary. To facilitate the understanding of this correction by the external users of the financial statements, the following information should be disclosed:

a) A description of the error;

b) Effect of the correction of the error on the financial statements of the current and prior periods;

c) Reference should also be made to the fact that the financial statements of prior periods that are presented have been restated.

By comparing the requirements of the recommended General Presentation and Disclosure Standard with respect to correction of errors in the financial statements, with similar requirements in the U.S.A., West Germany and Tunisia, we note the following:

1) GAAP in the U.S.A. treated the issue of errors in the financial statements in an official manner through the issuance of Opinion No. 20 of APB which stated that such changes and relevant notes must be accounted for. On the other hand both the Corporate Law of West Germany and the Tunisian Plan Compatable did not tackle this subject.

2) The requirements stipulated in GAAP of the U.S.A. and those stipulated in the General Presentation and Disclosure Standard with respect to the treatment and disclosure of errors in the financial statements are identical.
(para 857)

2.3.3.4 DISCLOSURE AND TREATMENT OF CONTINGENT GAINS OR LOSSES

Contingent gains or losses result from circumstances or events that occur at the date of the Statement of Financial Position.These circumstances or events may involve the possibility of gain or loss which cannot be determined until certain events are realised or not realised in the future. On the basis of the concept of recognition, the recommended General Presentation and Disclosure Standard has specified the prerequisites for the recognition of such contingent gains or losses.
(para 858)

The recommended general standard states that a contingent loss should be recognised at the date of the financial statements when both of the following conditions are met:

a) It is likely that a future event will confirm that an asset had been impaired or a liability incurred at the date of the financial statements; and

b) The amount of the loss can be reasonably estimated.

The recommended General Presentation and Disclosure Standard further states that a contingent loss should not be recognised at the date of the financial statements unless one of the above mentioned two conditions are realised. In this case the recommended standard emphasises the necessity of disclosing the contingent loss unless the possibility of occurrence of future event(s) which confirm such contingency is considered to be remote.

The standard further states that contingent gains should not be recognised until they are realised in the future. When such contingent gains do exist they should be disclosed in a note to the financial statements.
(para 859)

The trend adopted in the recommended General Presentation and Disclosure Standard with respect to contingencies is in conformity with the objectives of financial accounting which are manifested in the supply of reliable information to the external users of financial statements which will assist them in the evaluation of the performance of the reporting entity. This, in our opinion, requires a higher degree of reliability in the recognition of contingent gain than that of the recognition of contingent loss.
(para 860)

By comparing the requirements of the General Presentation and Disclosure Standard with respect to contingencies with similar requirements as applicable in the U.S.A., West Germany and Tunisia, we note the following:

1. GAAP in the U.S.A. treated contingencies in a formal manner through Statement of Financial Accounting Standards No. 5 issued by FASB. This statement stated the required accounting treatment and specified disclosure requirements with respect to contingent gains or losses. The standard further emphasised the necessity to specify the degree of occurrence of events which will lead to contingent loss in the future as follows:

   a) Probable
   b) Reasonably Possible
   c) Remote
   (para 861)

   This statement emphasised the importance of accrual of contingent loss whether confirming events are determinable or not if the amount of loss can be reasonably estimated. The statement further stipulated that no accrual is made of a loss contingency until the above (two) conditions are met, in which case the loss contingency is disclosed in the Notes to the Financial Statements. However, if future events that confirm the likelihood of accrual of loss contingency are remote, disclosure of loss contingency is not required. Contingent gains, on the other hand, should be accrued only on the date of their recognition. The existence of a contingent gain should be disclosed in a note to the financial statements when it is likely that a future event will confirm its accrual at the date of the financial statements. The statement further specified the conditions of disclosure for all types of contingencies.
   (para 862)

2. The German Corporate Law treated contingent losses in a formal manner. Article 152 of this law allowed provisions for contingent losses. However, the German Corporate Law did not specify the degree of probability required for the accrual of loss. It did not also specify any disclosure requirements for any contingent gains.
   (para 863)

3. The Tunisian Plan Compatable allowed the creation of provisions for contingent losses or expenses that cannot be forecasted at the end of a given accounting period. However, this plan did not specify the degree of probability required for the accrual of loss. It did not also specify any disclosure requirements for any contingent gains.

2.3.3.5 DISCLOSURE OF COMMITMENTS

General Presentation and Disclosure Standard states that significant financial commitments of the reporting entity should be disclosed (in notes to the financial statements). In our opinion, it is imperative for external users of the financial statements to be acquainted with these commitments in their evaluation of the performance of the reporting entity which will assist in the determination of future trends and in taking appropriate decisions whereof. Without disclosure of these commitments, financial statements may be rendered misleading. For example, without the disclosure of the reporting entity's commitment with respect to the purchase of fixed assets for a large amount of money or large financial commitment due to a long term lease agreement, the purchase or sale of a large quantity of inventories, the reader of financial statements may develop a wrong impression on the reporting entity's ability to generate sufficient positive cash flow. The recommended General Presentation and Disclosure Standard describes the information that should be disclosed about large or unusual commitments.
(para 864)

By comparing the disclosure requirements of significant financial commitments of the reporting entity as stated in the recommended General Presentation and Disclosure Standard with similar requirements in the U.S.A., West Germany and Tunisia, we note the following:

1. GAAP treated this subject in a formal manner. Statement No. 5 of Financial Accounting Standards issued by FASB emphasised the necessity of disclosing significant financial commitments of the reporting entity. This statement also specified the information that has to be disclosed.

2. The German Corporate Law and Tunisian Plan Compatable on the other hand, did not tackle this subject.

3. The recommended requirements with respect to the disclosure of material financial commitments are in agreement with similar disclosure requirements in the U.S.A.
(para 865)

2.3.3.6 DISCLOSURE OF SUBSEQUENT EVENTS

Subsequent events are those events occurring between the date of the financial statements and the date of their issuance. The recommended General Presentation and Disclosure Standard states that disclosure should be made of subsequent events which cause significant changes to assets or liabilities in the subsequent period; or will or may, have a significant effect on the future operations of the entity. The recommended statement stated that disclosure of a subsequent event should include the following:

a) A description of the nature of the event; and
b) An estimate of the financial effect, when practicable, or a statement that such an estimate cannot be made.

The recommended General Presentation and Disclosure Standard emphasised the disclosure of subsequent events for external users in their evaluation of the performance of the reporting entity in order to determine future trends and to take appropriate decisions whereof. Without disclosure of these subsequent events; financial statements may become misleading. For example, without the disclosure in the Notes to the Financial Statements of the fact that the reporting entity has stopped its

operations after the date of the financial statements as a result of a fire accident which destroyed the only factory of this entity, these financial statements may be misleading.
(para 866)

By comparing the recommended General Presentation and Disclosure requirements with respect to subsequent events with similar requirements in the U.S.A., West Germany, and Tunisia, we note the following:

1. Although GAAP do not contain a statement on subsequent events, a variety of accounting measurement standards, however, have specified the required disclosure of specific subsequent events. Additionally, GAAP emphasised the importance of disclosing subsequent events as a main factor for the fair presentation of information in the financial statements.

2. The German Corporate Law and the Plan Compatable of Tunisia did not touch on the subject of subsequent events.
(para 867)

2.3.4 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO CONSOLIDATED FINANCIAL STATEMENTS

These requirements are concerned with some matters of general nature which result from the consolidation of financial statements. The recommended General Presentation and Disclosure Standard states that consolidated financial statements should adhere to the general presentation and disclosure requirements applicable to unconsolidated financial statements. Consolidated financial statements should also disclose the following:

a) The policy used by the parent company to consolidate the financial statements of its subsidiaries,e.g., the volume of investment in the subsidiary which is required to consolidate its accounts, and the deletion of profits or losses resulting from exchange transactions among the group of companies, etc.

b) The identity of and the percentages of ownership interest held by the parent company in the subsidiaries that are consolidated;

c) The identity of and the percentages of ownership interest held by the parent company in the subsidiaries that are not consolidated; and

d) The basis of accounting for unconsolidated subsidiaries in the consolidated financial statements.

e) When, for purpose of consolidation, it is not possible to use financial statements for a period which substantially coincides with that of the parent's financial statements, this fact, and the period covered by the financial statements used, should be disclosed.

f) Subsequent events occurring after the date of the financial statements of a subsidiary company in the event that such date does not coincide with the date of the consolidated financial statements.

g) Minority interest in consolidated subsidiary companies should be shown separately on the Statement of Financial Position between liabilities and owners' equity.

h) The disclosure of minority interests in consolidated Statement of Income as an independent item before contingent gains or losses.

i) Where a subsidiary company holds shares in the parent company, the issued share capital of the parent should be stated in full, with the cost of the shares held by the subsidiary shown as a deduction from shareholders' equity.

The above stated requirements provide a logical solution that would meet the needs of external users of the financial statements for information which would assist them in the proper evaluation of the performance of the reporting entity. These requirements are also consistent with the other requirements of General Presentation and Disclosure Standard and other relevant accounting principles. For example, the disclosure of consolidation policy and policy of accounting treatment of subsidiaries not covered by the consolidated financial statements are in conformity with disclosure requirements of significant accounting policies. The disclosure of events subsequent to the date of the Statement of Financial Position of a subsidiary which is different from the date of consolidated financial statement for both the holding company and subsidiaries is in conformity with the requirements of disclosure relevant to accounting policies. Finally, the disclosure of minority interests as a separate item in the consolidated Income Statement and consolidated Statement of Financial Position is consistent with the requirements of presentation of information in these two statements as stated in the recommended General Presentation and Disclosure Standard.
(para 868)

By comparing the requirements stated in the General Presentation and Disclosure Standard with respect to consolidated financial statements with similar requirements in the U.S.A., West Germany and Tunisia, we note the following:

1) GAAP of the U.S.A. tackled the subject of financial statements consolidation together with relevant general presentation and disclosure requirements. ARB No. 51 issued by FAPC of AICPA provided a detailed statement of the standard for the consolidation of financial statements. However, this bulletin does not emphasise the necessity of preparing consolidated financial statements but refers to the fact that consolidated financial statements better reflect the financial position and results of operation of the reporting entity as a result of the existence of dominating relationship between two or more companies.

   This bulletin has, therefore, emphasised the following:

   a) It referred to the conditions whereby the consolidated financial statements are deemed to be more useful than non-consolidated statements.

   b) It detailed the steps for the consolidation of financial statements.

   c) It specified the requirements of general presentation and disclosure with respect to consolidated financial statements.

   In comparing the requirements of general presentation and disclosure with respect to consolidated financial statements with those stated in ARB No. 51, we note the following:

   a) The proposed requirements did not address the circumstances necessary for the preparation of consolidated financial statements. This, in fact, is a basic difference between these requirements and the contents of ARB No. 51. This variation is due to our belief that determination of the conditions for the preparation of consolidated financial statements falls outside the scope of General Presentation and Disclosure Standard. The determination of such conditions further requires the approval of the method of accounting with respect to the participation of one company in another. This, in fact, involves a selection among a variety of alternatives such as cost, book value, consolidation ... etc.

b) ARB No. 51 has established guidelines for the requirements of presentation and disclosure with respect to consolidated financial statements. The recommendedGeneral Presentation and Disclosure Standard, on the other hand, is more specific as regards to the subject of general presentation and disclosure relevant to consolidated financial statements. Irrespective of this difference in the degree of specification, the recommended requirements of general presentation and disclosure are not contradictory with the guidelines stated in ARP No. 52.
(para 869)

2) The German Corporate Law stipulates that public corporations must prepare consolidated financial statements that cover all national subsidiaries, if any. This Law defines a subsidiary as any company in which another company has invested more than 50% of its share capital or any company that is subject to the economic control of another company for reasons other than the ownership of stocks. This law does not, in fact, require the consolidation of the financial statements of foreign subsidiaries. However, it requires the disclosure of minority interests; legal and commercial entity of any group that owns 25% or more of the capital of consolidated companies besides other commitments and dues relevant to these groups. The German Corporate Law stipulates that the above information should be presented on the face of the consolidated Statement of Financial Position which should be prepared in accordance with the rules stated in Article 51 of the German Corporate Law. This Law has also given a simple format of the consolidated Profit and Loss Account as compared with that of non-consolidated companies. With respect to the requirements of preparation of consolidated financial statements, the main emphasis in this Law was on obliging joint stock holding companies to prepare consolidated financial statements. However, the German Corporate Law did not treat the subject of general presentation and disclosure as it is the case with the recommended General Presentation and Disclosure Standard with respect to thepreparationof consolidated financial statements in Saudi Arabia.

3) The Plan Compatable of Tunisia, on the other hand, did not touch on the requirements of general presentation and disclosure with respect to the preparation of consolidated financial statements.
(para 870)

2.3.5 GENERAL PRESENTATION AND DISCLOSURE REQUIREMENTS PECULIAR TO DEVELOPMENT STAGE COMPANIES

Development stage companies are companies which devote all their efforts for the establishment of a new business. In other words, these companies have not started to implement their major operation plans or if they have started such operation, they have not achieved any material revenues therefrom.

Requirements of presentation and disclosure of the financial statements for development stage enterprises should be in conformity with the objectives set forth for financial statements and the following concepts of financial accounting:

a) The concept of relevance of information presented in the financial statements to the needs of the users of these financial statements.

b) The concept of comparability of information presented in the financial statements.
(para 871)

The recommended Statement of Objectives of Financial Statements and the above-mentioned concepts, assert the fact that the financial statement of a development stage company should disclose the following:

i) Identification of the financial statements as those of a development stage company, in order to assist users of these financial statements in their evaluation and comparison of the reporting entity's performance in a proper manner.

ii) A description of the development stage activities in which the company is engaged, in order to assist users of the financial statements in judging the reasonability of the volume of resources utilized in this stage and comparing them with the resources utilized by similar enterprises.

iii) A description of the volume of available resources and resources expended during development stage, in order to assist users of the financial statements in determining the relationship between these resources and the achievements realised during this stage.

In addition to meeting the other requirements of general presentation and disclosure, development stage financial statements should also include the following:

a) Accumulated losses incurred during the development stage of the enterprise.

b) Cumulative amounts of revenue, expenses, gains and losses from the company's inception to the date of the last issued statement of financial position.

c) Cumulative amounts of sources and applications of funds from the company's inception to the date of the last issued Statement of Financial Position.

d) Detailed Statement of Owner's Equity from the company's inception until the date of the last issued Statement of Financial Position.

Finally, it is important to notify users of the financial statements that the enterprise has been through with the development stage and is now considered an operating company. This will assist the users in the proper evaluation and comparison of the performance of the enterprise.

The recommended requirements of general presentation and disclosure of development stage company financial statements have taken the above stated consideration into account. In comparing these requirements with similar requirements in the U.S.A., West Germany and Tunisia we note the following:

A) GAAP in the U.S.A. handled this subject in FASB Statement No. 7. This statement details the principles of financial accounting that have to be applied by development stage companies. It also states the general presentation and disclosure requirements relevant to the preparation of the financial statements of development stage companies. By comparing the requirements of statement No. 7 of FASB with the requirements stated in the recommended General Presentation and Disclosure Standard with respect to the preparation of development stage company financial statements, we note the following:

   i) The recommended requirements did not touch on the accounting principles that should be applied by development stage companies, because this is deemed to be outside the scope of the General Presentation and Disclosure Standard.

   ii) The recommended requirements of general presentation and disclosure with respect to development stage companies are in conformity with the general presentation and disclosure requirements stated in FASB Statement No. 7.

B) The German Corporate Law and the PlanCompatable of Tunisia did not mention the requirements of general presentation and disclosure relevant to the preparation of financial statements for development stage companies.
(para 872)

FINANCIAL STATEMENTS FORMS ACCORDING TO THE TUNISIAN PLAN COMPATABLE

		ASSETS	TOTAL	TOTAL AMOUNT	DEPRECIATIONS & PROVISION AMOUNT FOR	NET AMOUNT			LIABILITIES			AMOUNT
		Bond Issuance Discount and other preparation expenses							Collective and personal capital (or appropriations including reallocation reserves as recorded in capital)			
		Land Buildings Tools and Equipment Means of transportation Furniture & Office equipment Undisposable packing devices Other assets Intangible Assets Fixed Assets under construction							Owners' Current Account Statutory Reserve Special Reserves for exempted reinvestment Special Reserves for revaluation of extraordinary items Renovation Reserve Other Reserves Retained Earnings Premiums		Total	
									Subsidies for installations and equipment	Acquired	Recorded in P/L A/C	
		Borrowing exceeding one year Participations Real Estate (mortgage) and warranties submitted	Total Total						Provisions for risks Provision for expenses to be amortized over several years Provision of legal origin Provision for employee pension scheme Other provisions		Total	
		Goods Raw Materials & consumables Semifinished Goods Finished goods Products and Work in progress Commercial wrapping devices Miscellaneous goods	Total						Bonds (loans) and promissory notes of terms exceeding one year Housing loans of terms exceeding one year. Other debts outstanding for more than one year Payments for capital increase		Total	
		Advances to suppliers and advance payments on orders Accounts receivable Partners' Current Accounts Partners' unpaid share capital Group companies Undisposable Wrapping devices and tools Other receivables Assets settlement accounts							( ) Suppliers Prepayments for orders in process Partners' current accounts Group companies Accrued payments from unpaid capital Wrapping devices and tools Other accounts payable Liability settlement account			
		(Assets) Short term borrowing Notes Receivable and Real Estate Checks and coupons Placements Bank and post office accounts Cash Petty cash		Total					Loans (short term/bonds and notes) Other short term lending Notes payable-bank loansuppliers Loans (short term/bonds and notes) Other short term lending Notes payable for suppliers Facilities against discounted bills Banks		Total	
		Deferred depreciation Loss for fiscal year							Current year profit	Grand Total		
		Amount of guaranteed warranties Discounted notes							Amount of warranties			

PRODUCTION ACCOUNT FOR THE FINANCIAL YEAR FROM ______ TO

DESCRIPTION		Local	Foreign		Net	Total	DESCRIPTION					
OPENING STOCK: Goods Raw Materials Consumables Packing materials Miscellaneous materials **CLOSING STOCK:** Goods Raw materials Consumables Packing materials Miscellaneous materials **PURCHASES:** Goods Raw materials Consumables Packing materials Purchasing expenses **WORK, TOOLS, EXTERNAL SERVICES:** Rent and relevant charges Maintenance & Repairs Products finished outside the enterprise Minor tools Products manufactured for the enterprise Patents Studies & Research Brokers' fees Insurance expenses Transportation & travel Other production expenses Financial operation expenses Production outcome (Gross Added value)	Total No. 1 Total No. 2 Changes in Inventory (1-2) Total No. 3 Purchases 3 (1-2)	Comparative	Outgoing total —			Balance	**OPENING STOCK:** SUBPRODUCTS AND SCRAP MATERIALS Semifinished goods Finished goods Goods and services in process **CLOSING STOCK:** Subproducts and scrap materials Semifinished goods Goods and services in process SALES, WORKS AND SERVICES: Sales of goods Sales of self manufactured products Lease of operating tools Works Tares for sales, works and services Sales of subproducts and scrap materials Subproducts and non-disposable packing materials Net Sales (Less) discount allowable on sales Other Production income revenues Financial income Earned Discount Self manufactured products (expenses not related to the fiscal year's operations)	Total No. 1 Total No. 2 Changes in Inventory (2-1) Total No. 3 Additional sales (3-72)	Local	External Total		
				GRAND TOTAL						GRAND TOTAL		

APPROPRIATION ACCOUNT OF NET OPERATION RESULTS
(NET PROFIT AND LOSS ACCOUNT)
FOR THE FISCAL YEAR FROM TO

DEBIT		CREDIT	
Net operating result		Net operating result	
Prior years' loss		Prior years' profits	
Extraordinary grants paid			
Extraordinary loss		Extraordinary profits	
Allowance for non-operating or extraordinary provisions		Profits from preparation subsidies	
Profit taxes (including instalments)		Prior years' extraordinary loss covered by provisions	
TOTAL		TOTAL	
Net result of the fiscal year (Profit)		Net result of the fiscal year (Loss)	
GRAND TOTAL		GRAND TOTAL	

OPERATION ACCOUNT
(GROSS PROFIT AND LOSS ACCOUNT)
FOR THE FISCAL YEAR FROM TO

CREDIT		DEBIT	
EMPLOYEE EXPENSES		PRODUCTION RESULT	
Wages and salaries			
Related expenses and additional charges		Other operating revenue	
TAXES AND INDIRECT DUTIES			
Custom duties on imports			
Production tax			
Consumption tax			
Duties on services rendered		Operating subsidies	
Depreciation fee			
Other fees and duties			
Other operating expenses			
TOTAL		TOTAL	
Gross Operating Result (or total cash liquidity)		Gross operating result (or total cash liquidity)	
Positive		Negative	
GRAND TOTAL		GRAND TOTAL	

APPROPRIATION ACCOUNT OF GROSS OPERATION
(DISTRIBUTION OF GROSS PROFITS AND LOSSES)
FOR THE FISCAL YEAR FROM TO

CREDIT		DEBIT	
Gross Operating result		Gross operating result	
Financing Expenses		Financing revenues	
Direct Taxes and Duties			
Real Estate Taxes			
Registration Fees			
Other Taxes and Duties (excluding profit tax)			
Provision/or Depreciation (benefit)			
Provision for Reserves			
TOTAL		TOTAL	
Net Operating Result (positive)		Net operating result (negative)	

<u>DISTRIBUTION AND APPROPRIATION OF EARNINGS GENERATED DURING THE FISCAL YEAR FROM TO</u>

Earnings Appropriated		Earnings Disposed of	
Prior years' retained earnings		Shareholders' equity	
		Directors' remuneration	
		Dividends	
		Appropriated revenues	
		Reserves	
Withdrawal from reserves		Return on duty-exempted investments	
		Other applications	
TOTAL		TOTAL	