

Chapter 2

Accounting and Auditing of Financial Derivatives: The Case of Maridive & Oil Services (MOS)

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EXECUTIVE SUMMARY

This case study discusses accounting and auditing implications resulting from the dispute among auditors and the management of Maridive & Oil Services Company (MOS) in the preparation of the company's financial statements at December 31, 2008. The dispute occurred for the accounting treatment of losses of \$ 18 million dollars expected to be realized on the swap agreement made between MOS and a number of international banks during the period 2009-2018. MOS is a publicly traded company at both Cairo and Alexandria Stock exchanges, with total assets of more than \$390 million dollars. The company entered into swap agreement with two international banks to minimize the risk associated with credit facilities received by the company to expand its marine services through the construction of a number of marine vessels. The dispute among the three international audit firms resulted in the issuance of two different sets of audit reports.

The Egyptian Capital Market Authority (CMA) examined the company's financial statements for the year ended on December 31, 2008, while the auditors' reports forced the company's management, despite the objection of two of the company's auditors, to restate its financial statements at December 31, 2008, and modify its profit appropriation statement after their publication to shareholders and the public. The research presents the problems related to the application of the International Accounting Standards no 32 and 38 "Financial assets and Derivatives," their Egyptian equivalents, and the Egyptian Standards on auditing no 700 and 702. Further, the research identifies the differences associated with auditors issuing contradictory audit reports for a company's single set of financial statements.

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INTRODUCTION

The following case is divided into three main sections. The first section provides a detailed background about Maridive & Oil Services Company, showing the development of the company from a medium size marine services company into an international company providing a variety of marine and oil support activities, including maintenance, installations, rescue aid, erections, towage whether above, outside, and/or under water, as well as land establishments. The same section also highlights the management structure and competitive strengths used to achieve the growth seen by MOS since 1978 and the company's future strategy that is required to maintain its competitive edge in the market for marine and oil services. The second section summarizes the financial information of the company for the period 2006-2008 showing its financial position, results of operations and elements of corporate governance applied to enhance MOS's management performance. While, the third section presents the nature of financial derivatives, mainly the characteristics of the swap agreements made between MOS and the two international banks and the dispute occurring between the Egyptian Capital Market Authority (CMA), management of MOS and its auditors. MOS management charged the effects of ineffective swap analysis into the company's special reserve for 18.6 million based on the Companies Act 159 for 1981 and the company's articles of incorporations. Also, the company capitalized 1.6 million representing the cost of obtaining a loan, without taking in consideration the requirements of the Egyptian Accounting Standards. Details about the accounting and auditing treatments of the swap losses and capitalization of the costs of obtaining the loan are presented. The question of whether the requirements of laws have a priority over the application of both the accounting and auditing standards is discussed showing the need for future research to investigate such issue in other accounting and auditing cases.

AN OVERVIEW OF THE DEVELOPMENT OF MARIDIVE AND OIL SERVICES

Maridive History and Main Activities

Maridive & Oil Services (MOS) was founded in 1978 as a free zone joint stock company, and now has its official headquarter in Port Said, Egypt, with offices in Cairo and Alexandria in Egypt and Abu Dhabi in the United Arab Emirates (UAE). With a history spreading over 31 years, the company is one of the leading and oldest companies in the Middle East and North Africa (MENA) region to provide offshore marine and oil support activities, including services, maintenance, installations, rescue aid, erections and towage whether above, outside and/ or under water. It also provides all activities related to the industrial services for maritime and land establishments such as cleaning, maintenance, erections, installations, transportation supply, as well as providing all necessary equipment and relevant spare parts. With the company being a highly integrated marine and offshore oil services company, it provides services to oil and gas exploration and production ("E&P") clients throughout the value chain:

- Oil and gas related Offshore Construction Services (OCS), such as pipe laying, platform installation as well as engineering, procurement and construction (EPC) for underwater projects. The OCS operates through the company's subsidiaries MOP and Valentine Maritime Ltd. (Valentine).
- Chartering Offshore Support Vessels (OSV) needed to tow offshore rigs, supply both rigs and production platforms with all material required and ensure their safety through fire-fighting and anti-pollution. The OSV segment is operated by MOS and the subsidiary Maritide Offshore Oil Services (Maritide).

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