

## THE ADAPTATION OF UKRAINIAN ACCOUNTING AND REPORTING SYSTEM TO THE IFRS

### АДАПТАЦІЯ СИСТЕМИ БУХГАЛТЕРСЬКОГО ОБЛІКУ І ЗВІТНОСТІ В УКРАЇНІ ВІДПОВІДНО ДО МСФЗ

*The paper explores the use of the international financial reporting standards in different countries, and using this experience as a foundation, revisits some major advantages and disadvantages of the IFRS implementation process for the purpose of corporate financial reporting in Ukraine. The paper also establishes the essential trends in adaptation of national accounting, auditing and reporting standards to IFRS, such as harmonization of the companies' financial, administrative and statistical reporting, as well as the wider use of the basic principles and approaches of IFRS in the accounting practices and financial reporting in Ukraine.*

**Key words:** accounting, financial reporting, accounting system, accounting policy, IFRS.

*У статті розглянуто досвід застосування міжнародних стандартів фінансової звітності в різних країнах, на основі якого обґрунтовано основні переваги та недоліки процесу впровадження МСФЗ із метою складання фінансової звітності для компаній в Україні. Обґрунтовано основні напрями адаптації вітчизняної системи бухгалтерського обліку, аудиту та звітності до МСФЗ, які полягають в уніфікації фінансової, управлінської та статистичної звітності підприємств,*

*а також у широкому використанні основних принципів та підходів МСФЗ під час ведення бухгалтерського обліку та складання фінансової звітності в Україні.*

**Ключові слова:** бухгалтерський облік, фінансова звітність, система бухгалтерського обліку, облікова політика, МСФЗ.

*В статье рассмотрен опыт применения международных стандартов финансовой отчетности в разных странах, на основе которого обоснованы основные преимущества и недостатки процесса внедрения МСФО в целях составления финансовой отчетности для компаний в Украине. Обоснованы основные направления адаптации отечественной системы бухгалтерского учета, аудита и отчетности по МСФО, которые заключаются в унификации финансовой, управленческой и статистической отчетности предприятий, а также в широком использовании основных принципов и подходов МСФО при ведении бухгалтерского учета и составлении финансовой отчетности в Украине.*

**Ключевые слова:** бухгалтерский учет, финансовая отчетность, система бухгалтерского учета, учетная политика, МСФО.

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**Introduction.** The reform of the system of accounting in Ukraine has gained a significant development with the adoption of the Decree of the Cabinet of Ministers of Ukraine No 1706 of 18.10.1998 'On Approval of the Roadmap for Accounting Reform in Ukraine in Accordance with the International Standards'. As a result, since then the country has paid significant attention to the introduction of the International Financial Reporting Standards (IFRS) into the accounting practices in firms, institutions, and public sector organizations. This transition period to IFRS in Ukraine is accompanied by heated debates and application of different approaches to solving this issue. In particular, the use of IFRS in the accounting and financial reporting among legal entities in Ukraine leads to a number of tasks and challenges of methodological, methodical and technical nature that require further investigation and continuous search for solutions.

**Review of recent research.** The problems of harmonization and standardization of national accounting standards to IFRS have attracted attention of numerous researchers and experts in the field. Among the Ukrainian scholars who have made a significant contribution into exploration of these issues, we should note the contributions made by Viktor G. Shvets, Frants F. Butynets and Serhiy F. Golova and others. Studies conducted by these researchers examine the experience of different countries which had switched to the IFRS, explore the importance of the interna-

tional standards and justify the need for their implementation in Ukraine.

The experience of the adoption of IFRS in transition economies suggests the inevitable emergence of certain problems associated, above all, with the approaches used for the implementation of global reforms in national systems of accounting and reporting.

Particular attention in the discussion of major issues related to the transition to the international financial reporting standards should be paid to finding relevant solutions for tackling internal issues of the local companies, such as lack of qualified staff, inadequate systems of data collection and analysis (software) and an increased number of reports (IFRS reporting and reporting in accordance with the national standards).

**The purpose of this study** is to analyze the experience of different countries regarding implementation of IFRS and using the results of this analysis to define and justify the main advantages and disadvantages of the use of IFRS in the accounting and financial reporting in Ukraine, as well as to identify key areas for adaptation of accounting and financial reporting in accordance with IFRS.

**Findings and Discussion.** Implementation of the Ukraine's foreign policy aimed at the integration into the European community calls for adaptation of all economic data to the international requirements and

standards and, above all, it involves the accounting data. One of the prerequisites for successful integration is to bring the national reporting methodology and accounting techniques into accordance with the standards and requirements of IFRS, regardless their purely advisory nature.

Numerous countries, following the current trends in the world economy, had chosen a path that aims to unify and comply with the common principles of accounting and financial reporting. In order to bring the national system of accounting and reporting in compliance with IFRS, it is necessary to carry out transformation in the following areas:

- 1) harmonizing the system of legal regulations for accounting and reporting;
- 2) developing an adequate system of national accounting standards;
- 3) methodological support of accounting and reporting (instructions, recommendations, notes);
- 4) training qualified staff.

International accounting standards are characterized by common methodological approaches to data assessment and disclosure; and conceptual provisions of IFRS tend to serve as the basis for the development of a country's own accounting standards, which specify and complement relevant IFRS by taking into account level of socio-economic development of the country.

The globalization of the world economy has the following implications for the harmonization of accounting: increased capital mobility and, as a result, investors' requirement for a unified approach to measurement, evaluation and maintenance of investments that, in turn, helps taking the well-informed decisions. Moreover, it is expected that the use of IFRS can help improve the quality of financial reporting and provide a more comprehensive picture of the firm's performance.

Today there is a wide variety of approaches used in the adoption and application of IFRS. However, in all cases, introduction of the international standards leads to a lower probability of manipulation and concealment of companies' profits and overall financial performance. The analysis of the implementation of IFRS into the accounting practices around the world confirms strengthening of these trends over recent years and signals positive effects of the use of the international standards.

There is another approach to classifying the countries, namely by the degree of their implementation of IFRS, proposed by a Russian scholar Tatiana B. Krylova in her analytical note in 2008. According to this classification, six groups are identified by the following characteristics:

- direct permission for listed companies by means of special procedures (the EU countries);
- convergence of national standards with IFRS for listed companies (the USA, Japan);

- convergence of national standards with IFRS for all companies (the UK);
- the IFRS conversion into national standards (New Zealand, Australia, Hong Kong, Singapore);
- development of new national standards and improvement of existing national standards towards their compliance with IFRS with preservation of national characteristics (India);
- efforts towards the recognition of national standards as equivalent to IFRS (in the EU for Canada, Japan and the United States);
- direct introduction of IFRS as national standards, including those for legal entities and unlisted companies [1].

It should be noted that some countries shifting to IFRS (e.g. Kenya), argue that this decision has allowed them to save money on the development of national standards and use the saved resources for the standards practical implementation.

Somewhat different vision to the division of the countries is declared by the Committee for International Financial Reporting Standards, which defines four categories of countries according to their current implementation of IFRS:

- 1) Full implementation of IFRS for all companies, regardless of whether they are included in the stock market listings or not. This category is represented by 36 countries;
- 2) Mandatory compliance with IFRS for companies listed in the stock exchanges. China, Estonia, Hong Kong and Latvia belong to this category;
- 3) Countries where the law permits the use of IFRS or any other internationally recognized accounting principles (e.g., GAAP USA) instead of national standards. This category includes such countries as Denmark, Germany, Hungary and the Netherlands;
- 4) Countries where national accounting standards are close to IFRS, such as Egypt, Malaysia, Singapore and South Africa, and the degree of the approximation of national standards to the IFRS may vary.

Of the greatest interest for our study is the experience of countries that have completely shifted to the international accounting standards and now use the International Financial Reporting Standards. However, the study of the degree of the implementation of international accounting standards in the accounting practice of foreign companies shows that only 35 countries have declared the mandatory application of IFRS for listed companies and, to some extent, for companies not included in the stock listings. These countries are divided into four groups [2]:

- Middle East countries (Bahrain, Kuwait, etc.);
- countries of South America (Peru, Honduras, etc.);
- the former British colonies (Barbados, Cyprus, Kenya, etc.);
- transition countries (Georgia, Croatia, etc.).

But probably the most important experience for the effective implementation of IFRS in Ukraine is the experience of transition economies and of the CIS countries. It may be explained by the historical aspects of the economy and similar conditions for business operations. Similarity of economic problems in the area of the former Soviet Union encourages CIS governments to seek common approaches in the formation of accounting and financial reporting.

Based on the experience gained from the first stage of the IFRS implementation in transition countries we have singled out some major shortcomings of the process of applying the international standards in accounting and financial reporting:

**1. Lack of standardized requirements for the application of national accounting standards and the IFRS**, as well as lack of regulations that stipulate the mandatory use of IFRS, in practice leads to different deviations. Correspondingly, there might be difficulties in comparing financial statements prepared using two different approaches.

For example, in Poland the structure of national financial reporting standards is very similar to IFRS, but there are in fact various conceptual differences. This can prevent the achievement of one of the main purposes of IFRS, i.e. comparability of financial reporting across different countries.

**2. Shortage of qualified professionals** for reporting under IFRS and lack of local expertise for training enough specialists.

In countries that have adopted the IFRS for accounting and financial reporting there is a great need for accountants and auditors qualified for performing and evaluating all the necessary financial statements in accordance with IFRS. Many countries with transition economies (Georgia, Armenia, Romania) have faced the issue of shortage of qualified professionals which, in turn, has greatly hindered the process of adoption of IFRS.

IFRS envisages assessment of certain events and transactions reflected in the financial statements; the accountants qualified for work in the conditions of the planned economy and detailed regulation have no or very limited experience of assessing and evaluating the accounting events.

One solution for dealing with this problem for larger companies may consist in involving auditing firms to prepare financial statements under IFRS. However, in this case, the question may arise with regard to the independence of auditors. Obviously, efforts need to be made for training (and/or retraining) accounting professionals who would be able to acquire all the necessary skills for preparing financial statements under IFRS.

**3. Availability of independent auditing services and professional organizations of accountants and auditors.** One means to safeguard the reliability of financial reporting is the existence of indepen-

dent external auditors able to verify and confirm the compliance of prepared statements. The question is to what extent we can expect auditors to remain independent of their clients, especially in countries with transition economies.

One should also pay attention to the liability of auditors; in countries with a low level of responsibility of local auditors there is a problem with them neglecting their duties.

Any attempt to implement the IFRS should be supported by the local accounting and auditing community. The key to successful implementation of IFRS lies in cooperation of the Big Four companies with local professional organizations of accountants and auditors in order to improve the efficiency of the latter. The Big Four professionals have a great opportunity to use their extensive experience that had been acquired in their multinational divisional system, in preparing and reviewing local auditing and financial statements in accordance with the IFRS.

**4. Availability of special regulations and procedures with regard to the IFRS implementation.** Another issue in the implementation of IFRS is the absence of a clear regulatory framework for this transition, particularly with regard to the legal validity of IFRS.

Once there appears a regulation on the implementation of IFRS, it implies a question of how changes and amendments of IFRS can be clearly and unambiguously put into the practice of the national financial reporting.

One more issue in the implementation of IFRS is the lack of standard or unified rules as to the application of the international standards. IFRS were developed on the basis of guiding principles and there is no detailed instruction for their use. In this case, countries should consider the establishment of a central national authority that would pledge the management of the implementation process and its subsequent application of IFRS. However, for the sake of avoiding any misinterpretations of IFRS in different countries, this central national authority should be in close and constant contact with the IAS Board with regard to IFRS interpretations.

**5. Small and medium-sized businesses.** One of the tasks that must be tackled during the transition to IFRS is the issue of the small and medium enterprises' transition process. Usually the SME have neither adequate resources, nor the need to apply IFRS in preparing their financial statements. Thus, the introduction of IFRS for such businesses may be irrelevant.

For example, in Croatia all companies, including small businesses, have been required to prepare financial statements under IFRS since 1992. However, most companies do not comply with this requirement, preferring the requirements of tax legislation. It is likely that ignoring IFRS is explained by the complexity of their compliance and enforcement.

The IAS Board is considering the development of guidelines on application of IFRS for small businesses. Some countries are also trying to solve this problem. For example, in the UK there is a special standard for small businesses. In New Zealand, where the national financial reporting standards are quite close to IFRS, there is also a Conceptual Framework for Differential Reporting. It allows small businesses to prepare modified versions of the financial statements. Such modification is allowed in terms of data disclosure, not its recognition or assessment.

France has proposed to create an integrated system of financial reporting for small businesses, which would correspond to IFRS, even if these companies are not required to prepare their financial statements in accordance with IFRS.

Initially, the development and approval of IFRS was meant to provide all the stakeholders (including investors) with neutral and objective information on the companies' performance. Transition to IFRS opens up new opportunities for the business and the country as a whole.

Advantages of using IFRS in preparing financial statements in Ukraine relate to both micro and macro levels of the economy.

The advantages at the microeconomic level of the economy are:

- growth of market capitalization;
- access to international capital markets and reduce the price of capital raised;
- increased efficiency of information used for decision-making.

The advantages at the macroeconomic level of the economy are:

- attraction of foreign investment in the country;
- greater transparency and accountability of domestic companies and, as a result, the improved image of the Ukrainian businesses abroad;
- deeper integration of the economy into the global economic system;
- improved quality of the statistical information, its comparison and analysis.

The use of IFRS may be also useful for those Ukrainian companies that are not planning to enter the global financial markets. The effect is to provide the decision-makers with information that improves managerial efficiency, strengthens the system of corporate behavior, and, therefore, increases confidence in the company management. The most beneficial effect of IFRS will be seen in the companies where the owner has no representatives in the company management and has to be content with the information received from the financial statements.

Bringing national accounting system and reporting standards in accordance with IFRS should be accompanied by measures aimed at reforming the accounting system and the introduction of international accounting standards in the public sector.

Adaptation of accounting standards in the public sector to the international standards is an important prerequisite for efficient operation and international recognition of accounting practices in Ukrainian budgetary institutions and organizations. Ukraine's cooperation with the international organizations, credit and financial institutions on the currency, stock and investment markets puts increased demands as for transparency of economic information and its comprehensibility.

The transition to the international financial reporting standards in the public sector is primarily needed to improve the transparency of state and local finances, to enhance the quality and reliability of budget accounting, to ensure the most comprehensive accounting of all the financial transactions, to create conditions for the analysis of the dynamics of budgetary arrears and the evaluation of the effectiveness of budgetary services provided.

The reform of the accounting system is impossible without major adjustments in the legislation, particularly in tax and civil law, therefore, the accounting reforms should be carried out in conjunction with the appropriate changes to the relevant fields in legislation.

A key element in the reform of accounting and financial reporting under IFRS is the development of new and refinement of the previously approved regulations (standards) in accounting, and their subsequent implementation in practices. The reform also seeks to increase the role of professional organizations in the development of methodological support for the organization of accounting and the development of the profession (training accountants, consultants, financial managers, etc.).

A shift of the national accounting system to the international standards implies the appropriate changes in training and retraining professionals in accounting. The system of training for accounting personnel should meet all the national educational standards and qualifications and the international cooperation outlays the need for the creation and implementation of long-term programs of international cooperation in training, retraining and advanced training in accounting and reporting.

**Conclusions.** The efforts to adapt the existing Ukrainian accounting practices and reporting standards to IFRS stem from the worldwide processes of globalization, the entry of local businesses to the new capital markets, and the need for attracting foreign investment.

The analysis of the current state of the implementation of the international financial reporting standards by the Ukrainian entities has shown that the search for foreign investors and the desire to attract foreign investment motivates Ukrainian companies to prepare financial statements in accordance with IFRS; primarily to ensure the availability of accurate and truthful information about the company for

effective and economically justified decision-making. Meanwhile there is an unresolved issue of the use of IFRS by small and medium-sized enterprises. All SMEs that seek development and try to increase their operations find the procedure of preparing financial statements in accordance with the IFRS cumbersome and almost impossible due to significant costs the reporting implies. Thus, a close cooperation of the Ministry of Finance of Ukraine with the International Financial Reporting Standards is needed for a coordinated development of regulations (standards) for small and medium enterprises.

Public authorities and public professional organizations are equally important for the effective implementation and use of IFRS in Ukraine; their role is to prepare for the introduction of international financial reporting standards and to promote the application and implementation of these standards.

Overall, these seemingly ad-hoc issues in the accounting practices and financial reporting are in reality one of the important conditions for successful economic reforms in the country. Thus, the introduction of IFRS in Ukraine will help create a transparent and comprehensive system of accounting, reporting and control over the operations of various economic agents.

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