HARMONIZATION OF UKRAINIAN ACCOUNTING AND FINANCIAL REPORTING STANDARDS IN ACCORDANCE WITH THE ACCOUNTING DIRECTIVE (2013/34/EU) REQUIREMENTS

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Abstract

The paper considers the possible impact of the Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings on reporting in Ukraine with reference to signing the EU-Ukraine Association Agreement. The author then suggests possible changes in the current classification of companies, formats and components of financial statements, as well as accounting methods.

Key words: new EU Accounting Directive, categories of undertakings and groups, financial reporting, management report, auditor’s report.

Introduction

Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings amended Directive 2006/43/EC of the European Parliament and of the Council and repealed Council Directives 78/660/EEC and 83/349/EEC. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 20 July 2015. Ukraine as a future associate EU member has to harmonize its national accounting standards in accordance with theEU requirements. There is a need to consider the most important aspects of the Directive that would require proper analysis and justification in order to decide how the authorities should adapt Ukrainian accounting and financial reporting standards. These include:

- the classification of undertakings and groups;
- the structure and content requirements for the companies’ and consolidated financial statements of groups allocated to the defined categories;
- the scope of International Financial Reporting Standards (IFRS) application;
- submission of management report;
- preparation of country-by-country reporting – the disclosure of payments to governments by covered mining and logging companies.

Thus, aiming to perform the tasks of the research directions, the author studies the current Ukrainian legislations and regulations together with the results of scientific research done by certain experts and professional bodies.

Comparison of the classification of companies and their reporting standards

Structure and content of the financial statements under the Directive depends on the classification of undertakings (table 1). It uses three criteria: balance sheet total, net turnover and the average number of employees during the financial year. However, there are companies for which the criteria are not relevant: those are public interest entities. According to the Directive public-interest entities (PIE) means undertakings whose transferable securities are admitted to trading on a regulated market of any Member State, and credit institutions, and insurance undertakings, and entities designated by member states as public interest (significant public relevance due to nature of business, size or number of employees). Member States may also expand the PIE definition to include other entities. This term is not applicable in Ukraine at this moment.

<table>
<thead>
<tr>
<th>Categories of undertakings</th>
<th>Components of financial statements</th>
<th>Audit report ***</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Balance sheet</td>
<td>Profit and loss account</td>
</tr>
<tr>
<td>Micro</td>
<td>Abridged **</td>
<td>Abridged **</td>
</tr>
<tr>
<td>Small</td>
<td>Abridged **</td>
<td>Abridged **</td>
</tr>
<tr>
<td>Medium</td>
<td>+</td>
<td>Abridged **</td>
</tr>
<tr>
<td>Large</td>
<td></td>
<td>+</td>
</tr>
<tr>
<td>Public interest entity*</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

*The requirements relating to separate financial statements of PIE

**The Company may provide more information on a voluntary basis

***EU Member States may establish other requirements to enhance the reliability of small businesses’ financial reporting (such as statutory audit for medium-sized companies)
The financial reporting requirements for small undertakings cannot be changed by the legislation of the Member State. However, the Member States can require additional financial statements (e.g. cash flow statement, statement of changes in owners’ equity) for medium-sized and large undertakings, as well as for public interest entities.

The comparison indicates a mismatch in the number of criteria used for the classification of enterprises in Ukraine (two in Ukraine versus three in the EU) and the difference in net turnover values for micro, medium-sized and large enterprises (table 2).

Table 2: Comparison of the criteria for the classification of undertakings (Source: Authors’ own elaboration)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net turnover, million euro</td>
<td>≤ 2</td>
<td>&lt;0.7</td>
<td>≤ 8&lt;12</td>
<td>≤ 50</td>
</tr>
<tr>
<td></td>
<td>≤ 50</td>
<td>&lt;40</td>
<td>≥ 50</td>
<td>≥ 40</td>
</tr>
<tr>
<td>Average number of employees</td>
<td>≤ 10</td>
<td>≤ 50</td>
<td>≤ 250</td>
<td>≥ 250</td>
</tr>
<tr>
<td>Balance sheet total, million euro</td>
<td>-</td>
<td>&lt;0.35</td>
<td>&gt;4&lt;6</td>
<td>&lt;20</td>
</tr>
</tbody>
</table>

In addition, the Law of Ukraine "On Accounting and Financial Reporting in Ukraine" does not contain a clear correlation between each category of enterprises and the composition of their financial statements, as it is proposed by the Directive. Thus, Ukrainian enterprises must first resolve the issue of the standards according to which they prepare their reports. The document clearly defines the range of enterprises which are required to prepare financial statements in accordance with IFRS. All other entities may voluntary choose IFRS as their reporting framework. For the companies that use national standards while preparing and presenting their financial statements the National Accounting Standard 25 “Financial Report of a Small Business Entity” (hereinafter – NAS 25) provides a choice between complete and abridged set of financial statements. For small business entities there are two versions of simplified reports. Legal entities which provide commercial activity according to the Ukrainian legislation (except those who prepare and submit the second set of financial statements) and representative offices (hereinafter – RO) of foreign entities in Ukraine may opt for the first type of simplified reporting. The second set of financial statements is an option for the companies which are eligible for the zero rate of income tax according to Item 154.6 of Article 154 of the Tax Code of Ukraine and can use simplified accounting of income and expenses, as well as small companies that meet the criteria for micro-entities. The Tax Code also contains a significant list of activities which are prohibited in case of preparing simplified financial statements.

Table 3: Components of financial statements for Ukrainian enterprises (Source: Authors’ own elaboration)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Businesses that are required (or voluntarily decided) to prepare financial statements under IFRS</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Small enterprises*</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Representatives of foreign business entities</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other enterprises which use NAS</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

* NAS 25 provides two versions of simplified statements

The Directive requires classification not only for undertakings, but also for groups. As part of the consolidated financial statements, the Directive provides two statements, the notes to the consolidated financial statements, and the consolidated management report. It also clarifies that small groups should be exempt from the obligation to prepare consolidated financial statements and management report.

Ukrainian legislation does not stipulate categories for the groups of enterprises by their size. In some cases there is a need to prepare consolidated financial statements which are foreseen in the Law of Ukraine "On Accounting and Financial Reporting in Ukraine". Two other regulations, in particular NAS 2 "Consolidated Financial Statements" and NAS 19 "Business Combinations", provide guidelines for the presentation of the separate items of those statements. The definition of control complies with IFRS 10 "Consolidated Financial Statements".

Scope of IFRS application
The IAS Regulation No 1606/2002 clearly outlines the scope of IFRS application in the EU. It states that all listed EU companies must prepare their consolidated financial statements in accordance with the IFRS. Most Member States require banks to use IFRS. The Commission did not approve IFRS for SMEs as unnecessarily burdensome and complex ones.

The legislation of Ukraine provides more opportunities to use IFRS than EU legislation. Public corporations, banks, insurers should prepare financial statements and consolidated financial statements according to IFRS. Other undertakings may use IFRS on a voluntary basis. IFRS for SMEs are translated and published on the website of the Ministry of Finance of Ukraine; however the list of its users is not identified. In practice, it causes some confusion. One of the contradictions between IFRS for SMEs and the Law of Ukraine “On Accounting and Financial Reporting in Ukraine” would be the content of financial statements: the law requires entities to submit a balance sheet and a profit and loss account without any notes.

**General financial reporting principles**

Please, note that some of the principles outlined in the Directive (i.e. separate evaluation of the components of asset and liability items; no set-off between asset and liability items; correspondence between the opening balance sheet for each financial year and the closing balance sheet for the preceding financial year; the relevance of materiality for recognition, measurement, presentation, disclosure and consolidation) are actually used in Ukraine, but not considered to be the principles of financial reporting. The Directive, in its turn, does not contain some principles provided by Ukrainian legislation, in particular full coverage, autonomy, single units of measurement and frequency. The collective opinion of the European experts expressed by professional bodies outlines that all states shall use all of the principles listed in the Directive without any exception at their national level.

According to NAS the scope of fair value measurement and measurement of assets at revalued amounts is similar to the designated Directive.

**Presentation of the balance sheet and the profit and loss account**

The annexes to the Directive set out two prescribed layouts for each of the reports: horizontal and vertical for the balance sheet; by nature of expense and by function of expense for the profit and loss account. For the presentation of the balance sheet, Member States shall prescribe one or both of the layouts however they should permit undertakings to choose which of the prescribed layouts to adopt. Member States also may refine the indicators of financial statements taking into account branch characteristics and needs.

In Ukraine, all enterprises shall prescribe the horizontal layout of the balance sheet. The usual Ukrainian layout of the balance sheet differs from the one suggested by the Directive in its approach to the allocation of subscribed capital, capitalization of organization costs as assets, real property rights in the article "Land and Buildings", unissued capital (treasury shares) as a part of short-term investments etc. The ordinary presentation of these statement items in Ukraine is similar to IFRS requirements.

The profit and loss account for small enterprises uses a simplified type of the functional classification of expenses, while all other undertakings shall provide both classifications simultaneously: functional classification (Section IV “Financial results”), and classification by nature (Section III “Operating Expenses”). This research did not examine the practical implementation of the classification of expenses in the relevant field for Ukrainian enterprises in the given market in order to ensure its comparability.

Member States may permit small and medium-sized undertakings to draw up abridged statements for the publication at the national level. Even though that this approach is unlikely to contribute significantly to cost reduction, it foresees showing only some items of the statements.

**General publication requirement**

The period of time for the publication of the financial statements shall not exceed 12 months after the balance sheet date due to the fact that a long period reduces the value of the reporting. Prior to the Directive implementation it used to vary from 3 to 13 months. The European experts believe that the most appropriate term shall be 7 months. In Ukraine the undertakings should publish within a period that varies from 4 to 6 months after the balance sheet date.

**Special provisions relating to certain financial statement items**

According to the Directive 2013/34/EU the balance sheet of the EU includes the following options of assets’ and liabilities’ evaluation, in particular:

- revalued amount of fixed assets and intangible assets;
- fair value for financial instruments and other assets, since this information is more valuable to users;
- FIFO, LIFO, average estimated costs for the disposal of inventories and other fungible assets (including investment);
- interest capitalization during the period of acquisition (production) of non-current and current assets;
- assessment of the useful life of goodwill and development (if their appraisal cannot be reliable) within 5-10 years;
- assessment of the provisions set aside for the probable future costs;
- assessment of the obligations so that their value matches the cost of provision.

The list includes the last-in, first-out (LIFO). IFRS prohibits the use of LIFO and thus Ukrainian accounting does the same. By the way, professional bodies also do not recommend Member States to provide this evaluation option at the national level.

However, the Directive does not stipulate the harmonization of accounting methods doe a number of sites, including the following: rent; pension obligations; revenue recognition for construction and long-term contracts; foreign currency translation; deferred income tax; changes in accounting policies and corrections of errors in previous years; combined financial instruments; investment property; non-current assets held for sale and others. In any case this situation will continue to significantly impede the comparability of financial reporting for the European companies.

The requirements of NAS of Ukraine in such cases are very close to the IFRS options.

In case of consolidated financial statements, one should pay special attention to these differences in the consolidation methods which are allowed by the Directive and the corresponding Ukrainian regulations.

Table 4: Comparison of the permitted consolidation methods (Source: Authors’ own elaboration)

<table>
<thead>
<tr>
<th></th>
<th>Group accounts</th>
<th>Joint control</th>
<th>Significant influence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directive 2013/34/EU</td>
<td>Acquisition method,</td>
<td>Proportional consolidation</td>
<td>Equity method</td>
</tr>
<tr>
<td></td>
<td>merger accounting*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ukrainian standards</td>
<td>Acquisition method</td>
<td>Equity method</td>
<td>Equity method</td>
</tr>
</tbody>
</table>

* The application of the merger is allowed in case of so-called transactions under common control (UCC transactions)

The need for consolidation and the details for the use of each method require further study.

Content of the notes to the financial statements

The scope and content of the notes to the financial statements have always been a weakness for Ukrainian enterprises. Small business entities haven’t provided any notes before and they do not do that at the moment within the framework of the effective law. Therefore, the Directive requirements will result in a significant increase of information disclosure for them. At the same time European experts state that there is a need to allow going beyond the fully prescribed small entity disclosures if need be for true and fair view.

Management report as a component of the financial statements

According to the Directive Management Report is an important element of financial reporting and should be submitted by medium-sized, large undertakings and PIE. This requirement resulted in the need for changes in the content of the auditor’s report. The auditor shall express an opinion on the consistency of management report and financial statements, as well as on the compliance of the management report with the applicable legal requirements. Basing on knowledge and understanding the auditor shall confirm if there is any material misstatement in the management report.

In Ukraine, the management report is not an integral part of the financial statements. As for the report on corporate governance, the relevant regulating bodies (the National Bank of Ukraine, Securities and Stock Market State Commission and others) define specific requirements for it. Therefore, there are only certain requirements related to the presentation of the report on corporate governance in Ukraine which are elaborated for those entities which are classified as a PIE in the Directive.

Conclusions

The Directive 2013/34/EU aims to harmonize the structure and content of the reports submitted by European companies and, simultaneously, to reduce administrative burdens on small business stemming from complicated reporting procedures.

The implementation of the given Directive outlines the classification of undertakings and groups according to defined criteria and its close connection with the set of financial statements. The categories of businesses consist of PIE and others which in their turn include small (together with micro), medium-sized and large undertakings. Furthermore, the last ones are defined and distinguished by reference to balance sheet total, net turnover and the average number of employees during the financial year.
The regulatory authorities in the field of accounting and financial reporting for undertakings and groups in Ukraine (the Ministry of Finance etc.) should transpose the European requirements into the national law and standards. First of all, the process should start with the discussion regarding the PIE definition and possible extension of the PIE list.

While deciding whether to adopt certain provisions of the Directive one should apply the following criteria recommended by the European Federation of Accountants and Auditors for SMEs (EFAA) – better accounting, comparability, relevance, minimizing costs of changing, in particular the adoption of IFRS for SMEs, international harmonization, transparency, and market efficiency. The ultimate purpose of improving accountability is to meet the information needs of a wide range of users.

The Directive does not contain requirements to accounting of a number of items attempting to harmonize those accounting procedures with the EU. In these cases, the state should use IFRS approach or national standards.

The Directive does not provide for the direct application of IFRS for SMEs, but this option is possible. Nevertheless, in Ukraine there is a need to clearly define the scope of its application.

Medium-sized, large undertakings and PIE should prepare and submit a management report as a part of the financial statements which will be subject to audit. Consequently, the undertakings will have to submit the amendments to the content and form of the auditor’s report. Please, note trends in corporate social responsibility that lead to growth and diversification of non-financial information reporting operating in the EU.

References


UKRAINOS APSKAITOS IR FINANSINĖS ATSKAITOMybės STANDARTŲ SUDERINIMAS SU APSKAITOS DIREKTYVOS (2013/34/EU) REIKALAVIMAI

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Santrauka

Atliekant tyrimą analizuota Ukrainos įmonių sudaromų finansinių ataskaitų sudėtis ir turinys, vertinant jų atitikimą ES direktyvos 2013/34/EU reikalavimais. Ukraina planuoja tapti ES narė, todėl jos nacionaliniai apskaitos reglamentai turi būti suderinti su minėtos Direktyvos reikalavimais. Tyrimo metu atlikti įmonių grupavimo kriterijų, įmonių grupių charakteristikų ir priskirimo vietoje intereso įmonių grupei principų analizė. Pritaikus Direktyvos reikalavimus, pasiekis įmonių priskirimo mažų įmonių grupės reikalavimai, šių įmonių skaičius ir jų pelno (nuostoli) ataskaitoje pateikiamai informacija. Mažosios Ukrainos įmonės turėtų rengti aukškamamą raštą, o vidutinės ir didžiosios įmonės kartu su finansinėmis ataskaitomis pateikti valdybos ataskaitą. Direktyvoje pateikti apskaitos metodai suderinti su smulkų ir vidutinių įmonių buhalterių ir auditorių asociacijos rekomendacijomis.

Reiškimiai Žodžiai: ES Apskaitos direktyva, finansinės ataskaitos, valdybos ataskaita, auditoriaus ataskaita.