Harmonization of SME's Financial Reporting in Emerging CEE Countries

Editor

Prof. Jiri Strouhal

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Preface

According to Confucius, information is “to know what to say, when to say and how to say”. In today’s world, information has becomes the most significant resource for a developed economy, and its value has increased constantly as technology has improved.
Sector of SMEs plays a crucial role in national economies; it is a driving force of business, of growth, innovations and competitiveness. It plays a decisive role in job creation and, in general, is a factor of social stability and economic development. On the other hand, SMEs have often difficulties to obtain capital or credits which are caused by the continuing unwillingness of financial markets to take the risk and through insufficient guarantee which SMEs can offer to banks. Limited sources of financing can also make the approach to more information difficult, especially information on new technologies and potential markets.
International Accounting Standards Board (IASB) finalized in 2009 its effort on the wider spread of international accounting harmonization issuing brand-new standard IFRS for Small and Medium-Sized Entities (IFRS for SMEs). This standard in fact brought a lot of positive and reasonable simplification of rules from “full IFRS” for the necessities of SME businesses.
This book comprises from the general introduction where will be discussed the SMEs sector in general, as well as measurement issues in financial accounting. There will be also provided the introduction to IFRS for SMEs. The main part of book consist of national cases of the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia, providing the view of leading experts on financial reporting in these emerging CEE countries being a part of European Union.
Final chapter discuss the harmonization of all sets of national regulations with IFRS for SMEs using certain economic tools. The performed analysis show high level of compatibility of all Baltic accounting regulations with IFRS for SMEs.
Authors would like to thanks World Scientific and Engineering Academy and Society (WSEAS) for the kind support of this book.

We hope that this book will be a valuable guide for anyone seeking constructive engagement with regard to international harmonization of SMEs’ financial reporting in Central and Eastern European countries.

February, 2011 Jiří Strouhal

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- Financial Reporting in the Czech Republic
- International Accounting Harmonization as Part of the Worldwide Globalization Process

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Abstract: - It seemed that the single EU market needed unified legal standards and standardization in the sphere of financial reporting for SMEs. For this reason, important initiatives started at the beginning of the new millennium with a purpose to provide SMEs with the knowledge and tools necessary for crossing the local borders and entering other EU countries but also countries outside the EU and for easier export of products and services. Financial statements prepared in compliance with international standards may provide a high level of transparency and comparability. Companies which comply can achieve many benefits. Use of international standards may reduce investor uncertainty and can thus reduce the cost of capital. It can significantly improve the communication between business users and all their statements.

Key-Words: - Small and Medium Sized Enterprises (SMEs), Financial reporting, Measurement, International harmonization, International Financial Reporting Standards (IFRS), IFRS for SME.

1 Positioning of SME Businesses within European Market

Sector of SMEs plays a crucial role in national economies; it is a driving force of business, of growth, innovations and competitiveness. It plays a decisive role in job creation and, in general, is a factor of social stability and economic development. On the other hand, SMEs have often difficulties to obtain capital or credits which are caused by the continuing unwillingness of financial markets to take the risk and through insufficient guarantee which SMEs can offer to banks. Limited sources of financing can also make the approach to more information difficult, especially information on new technologies and potential markets.
European Union divides SME companies onto following three groups:

- ***micro entities***
  - with less than 10 persons employed
  - annual turnover of up to 2 million EUR or a balance sheet total up to 2 million EUR
- ***small enterprises***
  - with 10-49 persons employed
  - annual turnover of up to 10 million EUR or a balance sheet total up to 10 million EUR
- ***medium-sized enterprises***
  - with 50-249 persons employed
  - annual turnover of up to 50 million EUR or a balance sheet total up to 43 million EUR

Together with these indicators, SMEs should also fulfill a criterion of independence, which means that ***no*** other subject should participate in its basic capital or voting rights by ***more than 25 %.***

SMEs sector forms as much as 99 % of business entities around the world [6]. Table 1 provides European evidence on the share of SMEs.

Table 1. Share of SMEs among all enterprises (year 2007, in %)

	Enterprises	**Value added**	**Persons employed**
Mining & quarrying	98.9	34.6	33.8
Food & beverages	99.1	47.7	62.8
Tobacco	79.4	6.2	15.5
Textiles & leather	99.5	73.9	76.2
Wood & wood products	99.8	76.2	84.1
Pulp & paper products	97.1	41.1	54.1
Publishing & printing	99.7	61.9	72.5
Coke, petroleum & nuclear fuel	91.5	10.0	15.3
Chemicals & man-made fibres	95.7	26.2	35.5
Rubber & plastics	98.5	57.3	63.8
Other non-metallic minerals	99.1	52.0	62.6
Basic metals	95.3	24.7	33.2
Fabricated metal products	99.7	78.2	82.8
Machinery & equipment	98.7	49.7	56.4
Office machinery & computers	N/A	32.5	47.4
Electrical machinery	98.4	36.9	43.2
Radio, TV & telecoms equipment	98.5	24.3	N/A
Instruments, watches & clocks	99.4	48.8	63.9
Motor vehicles	93.9	11.6	18.1
Other transport equipment	98.3	20.4	28.6
Manufacturing	99.6	74.8	76.7
Electricity, gas & steam	97.6	23.9	18.6
Water supply	96.6	33.6	37.5
Construction	99.9	82.8	88.0
Motor trades	99.9	78.9	87.5
Wholesale trade	99.8	76.8	81.3
Retail trade	99.9	55.2	63.7
Hotels & restaurants	99.9	75.9	82.2
Land transport; pipelines	99.9	60.2	65.1
Water transport	99.4	65.2	58.2
Air transport	96.2	18.1	8.9
Support. transp.; travel agents	99.4	43.7	54.2
Communications	99.2	6.9	12.8
Real estate	99.9	87.7	86.4
Renting	99.9	74.9	N/A
Computer services	99.8	58.5	69.0
R&D	99.4	43.1	54.2
Other business activities	99.8	69.3	62.8

Source: [14]

Majority of labor force is employed in SMEs. Following tables (Table 2 and Table 3) provides evidence about the labor productivity with respect to the size of entity, and employment breakdown with respect to the size of entity in the European Union.

Table 2. Labor Productivity by Enterprise Size (year 2007, EUR 1000 per person employed)

	micro	**small**	**medium**	**SMEs**	**large**
Mining & quarrying	257.0	85.3	125.7	134.8	130.2
Food & beverages	24.1	30.4	39.7	32.5	60.0
Tobacco	10.3	80.2	62.7	61.7	172.1
Textiles & leather	17.2	25.2	24.2	23.0	26.1
Wood & wood products	21.7	31.4	36.5	29.3	48.5
Pulp & paper products	28.3	N/A	51.9	43.9	73.3
Publishing & printing	34.2	45.7	54.2	44.8	80.0
Coke, petroleum & nuclear fuel	58.0	134.3	120.1	117.9	191.7
Chemicals & man-made fibres	75.4	61.5	83.5	77.0	119.1
Rubber & plastics	32.3	39.8	45.3	41.9	54.9
Other non-metallic minerals	26.2	44.1	52.6	43.7	68.3
Basic metals	31.6	54.9	65.2	59.8	90.4
Fabricated metal products	31.5	43.2	46.4	41.3	53.0
Machinery & equipment	35.7	48.5	54.2	49.3	64.6
Office machinery & computers	36.8	47.7	54.2	43.3	80.8
Electrical machinery	31.1	44.0	48.9	44.5	53.0
Radio, TV & telecoms equipment	35.7	54.4	50.0	48.7	83.3
Instruments, watches & clocks	31.1	47.8	58.7	47.1	79.6
Motor vehicles	34.1	44.8	45.3	44.2	74.4
Other transport equipment	29.3	42.5	45.3	41.9	65.6
Manufacturing	22.9	35.1	37.4	34.1	37.9
Electricity, gas & steam	327.0	152.6	142.9	211.1	153.4
Water supply	87.0	67.0	48.3	56.1	72.5
Construction	30.2	39.4	43.9	35.8	54.4
Motor trades	26.9	38.4	52.9	35.6	66.7
Wholesale trade	39.2	57.1	67.6	52.5	68.8
Retail trade	18.1	26.9	27.8	21.3	30.4
Hotels & restaurants	16.3	20.7	25.7	19.0	27.8
Land transport; pipelines	27.2	36.2	37.3	32.4	39.8
Water transport	135.1	133.7	123.6	130.4	96.7
Air transport	N/A	151.5	198.0	155.4	68.8
Support. transport; travel agents	45.6	53.1	56.0	52.2	75.0
Communications	42.8	53.3	52.5	44.5	89.0
Real estate	96.8	86.6	103.7	95.8	86.0
Renting	110.6	93.2	162.3	N/A	N/A
Computer services	43.8	60.6	73.2	56.6	92.5
R&D	34.1	N/A	59.9	41.7	65.2
Other business activities	40.3	50.4	39.9	42.8	32.0

Source: [14]

Table 3. Employment Breakdown by Size of Enterprise (year 2007, in %)

	Size of enterprise				
	micro	**small**	**medium**	**SMEs total**	**large**
European Union	***29.5***	***20.6***	***17.0***	***67.1***	***32.9***
Austria	25.0	23.2	18.9	***67.1***	32.9
Belgium	29.5	21.4	15.5	***66.4***	33.6
Bulgaria	26.0	23.3	24.0	***73.3***	26.7
Cyprus	39.3	24.1	20.0	***83.4***	16.6
Czech Republic	*28.9*	*18.5*	*20.1*	***67.5***	*32.5*
Denmark	19.7	25.2	21.0	***66.0***	34.0
Estonia	*24.6*	*27.6*	*26.3*	***78.5***	*21.5*
Finland	23.0	19.1	17.7	***59.8***	40.2
France	24.3	20.4	15.8	***60.5***	39.5
Germany	19.1	21.6	19.6	***60.4***	39.6
Greece	57.5	17.4	10.7	***85.6***	14.4
Hungary	*35.1*	*19.3*	*16.7*	***71.2***	*28.8*
Ireland	19.4	25.7	24.1	***69.3***	30.7
Italy	46.6	22.1	12.4	***81.1***	18.9
Latvia	*22.1*	*28.4*	*26.6*	***77.2***	*22.8*
Lithuania	*23.6*	*25.6*	*26.2*	***75.4***	*24.6*
Luxembourg	18.4	24.2	23.7	***66.3***	33.7
Malta	N/A	N/A	N/A	***N/A***	N/A
Netherlands	29.3	21.7	17.2	***68.3***	31.7
Poland	*37.9*	*11.4*	*18.8*	***68.1***	*31.9*
Portugal	41.4	22.9	16.5	***80.9***	19.1
Romania	*22.0*	*20.9*	*22.5*	***65.4***	*34.6*
Slovakia	*14.7*	*20.4*	*21.6*	***56.7***	*43.3*
Slovenia	28.1	18.2	20.7	***67.0***	33.0
Spain	38.3	24.5	14.8	***77.6***	22.4
Sweden	24.4	21.0	18.3	***63.7***	36.3
United Kingdom	21.5	17.4	15.2	***54.1***	45.9

Source: [14]

SMEs have fewer resources to use on influencing financial standards and the system is arguably less responsive to their needs. The tightening of professional accounting standards and the proliferation of extensive and complex accounting pronouncements governing financial reporting have added complexities to the preparation of financial statements and have further exacerbated their financial reporting problem. The need to establish appropriate accounting standards for SMEs is one which invariably draws common agreement but generally, there is no consensus achieved on the recommended solutions. The biggest obstacle is existence of 27 different systems of accounting within the European Union, which have to be harmonized. The question about whether or not accounting standards should apply equally to large and small companies has been the subject of much debate and concern by accountancy bodies in many countries [25] and has become known as the “Big GAAP/Little GAAP” debate [9].

Size is an important determinant for accounting differentiation. The empirical research studies leaving still a considerable gap of ignorance about the influence of an entity’s size on the attitudes of its representative and its stakeholders with regard to financial reporting. Some studies have concentrated on the particularities of SMEs with regard to the objectives, purposes and users of financial statements of SMEs. Those are, e.g. [1, 5, 7, 10, 28, 30]. Other studies focused on the attitudes and behavior of SMEs with regard to financial statements’ publication and audit [11].

However, the arguments for differential reporting seem to be stronger the important argument now appears to be, not whether this is an appropriate approach but rather how accounting standards for large entities and SMEs should differ [13]. It must be decided what criteria will be used for distinguishing different classes of reporting entities and these should reflect cost/benefit considerations [13].

Specific accounting standards created for a category of enterprises that is so difficult and subjective to define and identify might be ineffective, difficult to interpret and also, difficult to regulate and to maintain [15].
One the main arguments for extending IFRS implementation to SMEs' accounts is that global financial reporting standard (if applied consistently) will enhance international comparability and understandability [27], as well as, the transparency and accountability of SMEs accounting reports [15]. Greater information relevance, which is also beneficial for management and market efficiency are other suggested benefits for SMEs by the extension of IFRS [26].

Within further text will be firstly discussed measurement issues on general level and after that we will focus on the special standard for reporting of small-and-medium sized enterprises, i.e. IFRS for SMEs.

2 Measurement Issues in Financial Reporting

SMEs prepare their financial statement according to local reporting framework. Financial reporting in various jurisdictions may vary by:

- system of accounting regulation
- interaction between accounting and taxation
- application of accounting methods and accounting principles

Dominant factor affecting a system of accounting regulation is **legal system**. Continental Europe is still rather based on ***Rome Civil Law***, i.e. there could be seen a direct regulation of accounting throughout acts, decrees and various accounting standards. For this direct regulation is obvious a linkage between accounting and taxes. Financial accounting is in such a case unified and cannot bring some additional effects for specific financial statement users.
Anglo-Saxon approach is oriented on common law. Regulation is principle based and the requirements are formulated obviously by professional institution in the form of accounting standards. In such a case state does not play such crucial role like under direct system of accounting regulation. This approach is intensive for the training and education of professional accountants and expects a constructive approach to accounting practices.

Among **characteristics of accounting system** shall be stated:

- accounting principles (defined explicitly or implicitly)
- definition of balance sheet items (assets, liabilities, equity) and their classification within a balance sheet
- definition of P/L statement items (expenses, costs, revenues, gains, losses) and system of classification of expenses (by nature or by function)
- measurement approaches
- definition of obligatory financial statements and notes

Among most discussed areas between researchers and practitioners could be stated measurement of balance sheet items. Application of various measurement bases leads to very important discrepancies and inconsistencies in presented information. Therefore we will provide within next text the general insight on various measurement approaches and after that we will focus on the analysis of measurement approach used in IFRS for SMEs.

2.1 Brief Introduction

A significant characteristic of accounting systems, which substantially determines the explanatory power of accounting information, is the measurement method of particular segments of the financial statements. Accounting theory and practice has developed quite a wide range of possible approaches to the measurement in accounting. In the interest of reliability, clarity, and comparability of accounting data are approaches to measurement in accounting a significant part of the regulation of accounting both at the national level and within international accounting harmonization. Whether it is to standardize the output of accounting, which is characteristic for Anglo-Saxon area, or whether it is to standardize current accounting practices and the related regulation of financial reporting used in continental Europe, there are always specific rules set, adjusting the measurement used for accounting of transactions during the reporting period as well as the measurement for the preparation of financial statements.

Before we proceed to interpret the measurement bases, their comparison and consideration of their advantages and disadvantages, it is important to remember that before setting out specific rules for measurement for accounting practice, the standard setters must deal with the following issues:

- *Should a single measurement approach be used for measurement or rather mixed measurement approaches that appear optimal (or more appropriate) for a certain situation?*
- *Should financial reporting provide users with information based on several measurement methods simultaneously (e.g. multi-column reporting), if any measurement basis could be considered optimal or sufficient in all cases? Or should an alternative measurement approach be allowed? In this case, it must be decided whether the choice of a specific measurement approach is left to the entities or whether rules (algorithm) should be established for selecting a particular method of measurement.*
- *Which criteria should the measurement basis meet?*
- *On what perspective should the measurement be based (should it reflect the entity specific measurement, or the bases objectified by the market)?*
- *Is the current currency able to perform the role of the scale of values considering the inflation rate?*

Accounting rules theoretically can be based on the choice of setting a ***single measurement basis***, which would be universally used in measurements in all situations, or may use ***mixed measurement approaches***.

For local accounting practices as well as for International Financial Reporting Standards (IFRS) is characteristic the use of mixed measurement approaches. In recent years, there is an apparent effort of the International Accounting Standard Board (IASB) to establish a single measurement approach. According to [12] there is growing concern that the current mixed measurement model, which combines fair value and cost within financial statements, is not the most preferred or perhaps reliable basis of accounting. Finding an appropriate solution is proving difficult.

2.1.1 Single Measurement Approach

Only one starting point can be provided for the purpose of measurement that (according to the standard setters) best satisfies the criteria of the financial accounting and reporting measurement. These measurement bases are "pure" base of measurement as **historical cost**, **replacement cost**, **value in use** or **fair value**.

The objective would always be to estimate the selected measurement basis, other bases being allowed only as proxies where direct measurement was impossible [39].

The consistency of the measurement, comparability and meaningful aggregation of the accounting data are the advantages of this approach. The adoption of single measurement method is predicated on the belief that such a measurement will be always the most relevant and will be reliably measurable. Such a "perfect" measurement basis has not yet been found. [24] believes that it is impossible to prove that any individual measurement approach is Pareto superior to others for external users—ideally they probably need a range of alternative measures in order to triangulate the information they receive from various sources.

IASB attempts to find and defend such a base in its projects dealing with measurements [17]. According to the IASB's projects the fair value measurement should be such a base, however, in our opinion in many cases not even fair value meets the criteria, which a measurement in financial accounting should meet.

2.1.2 Mixed Measurement Approaches

As stated above, virtually all systems of accounting regulation (without exception of IFRS) do not currently use a single measurement approach, required and preferred in all cases, but the mix of measurement approaches. The advantage of this approach is that it is not necessary to use a single measurement approach for all situations, which, considering the information needs of users, but also for example the reliability of establishing such measurement might not be appropriate in a particular situation.

"Different Measures for Different Purposes" is appropriate for financial accounting [4, 8, 39]. Cost measures may provide useful margins on turnover for predicting operating cash flows in a going concern business, whereas fair value may be a more direct and reliable means of valuing a portfolio of marketable investments.

However, disadvantages of using mix measurement approaches are obvious – it leads to aggregation of the data measured by different approaches, the explanatory power of such aggregation is weak, plus the use of different measurement approaches entails various risks. To report the items which are measured by different measurement approaches separately is therefore a minimum requirement, which should be held. Separate

reporting of items bound to various estimating risks enables the users of financial information their independent analysis and assessment.
Measurement approaches are in practice differentiated according to both the moment at which the measurement is performed (e.g. initial recognition of the particular item or subsequent measurement) and according to nature of the subject of the measurement (e.g. long-term assets in terms of meeting the prerequisites of going concern, inventories and derivatives or securities held for trading are measured differently.)
By accepting this approach the measurement problem has been limited to the search of an appropriate measurement base for the measurement of particular items in a particular situation. Only one method of measurement would be associated with a particular item, different item would, or could, be measured using different methods, if those methods best represented the economic properties of the particular item [39].
However, even in this case the choice of the only measurement approach may not be simple or straightforward considering the criteria which the selected measurement should meet. The question therefore arises whether the output information from financial accounting (e.g. balance sheet items) should not be measured by more alternative ways at the same time (multiple-column reporting).

2.1.3 Multiple-Column Reporting

Disclosure of information using multiple options of measurement for a single item has been so far applied in accounting rather exceptionally in notes to the financial statements and not on a systematic basis. If, for example, an item cannot be reliably measured, an interval, in which the likely value of the item is located, is indicated through various measurement approaches. Normally, the results of measurements based on a parallel usage of various measurement bases are not used; the reason is the high cost and laboriousness of such a procedure. [39] comments: *…many alternative measures might be potentially useful as information to some user, but it would be impractical, expensive and possibly confusing to report many alternatives measures*. For this reason, multiple-column reporting, advocated by Stamp, has never found favor in practice. There is therefore a need to provide some principle that will limit the range of the measurement required under an informational approach.

2.1.4 An Alternative Measurement Approach (Based on Choice of an Entity or a Defined Algorithm)

Thus, if we admit that it is not possible to find and define a single "correct" solution even in the measurement of a particular item in a particular situation and the disclosure of measurements in several alternatives is expensive and laborious, the question arises whether to accept the choice of several options in a single accounting system. Of course, any alternative in the measurement further deteriorates the comparability of financial information. If an alternative measurement is allowed within the accounting system, it is necessary to consider other consequences.
It must be decided whether in certain specific cases retain the right to choose the method of the measurement from the options given to the accounting entity, or whether to develop a procedure (algorithm) of setting a single measurement resulting from the comparison of several measurement bases. In practice these two commonly options are used.
If the right to choose the measurement policy is left to the accounting entity, the entity may choose the approach that best suits the circumstances. However, at the same time the possibility of subjective manipulations with the measurement (e.g. the choice of LIFO or FIFO method of the measurement of inventories) is opened to the entity.
Setting of certain rules or hierarchy for the choice of a measurement from various measurement approaches (used e.g. for deprival value) can help to bring a uniform order to the procedure of measurement and enable the choice of an appropriate measurement which is inter-company comparable. The disadvantage of this approach is its labor intensity (the entity must identify the measurement of an item for example in three different ways to determine the final measurement of an item in the balance sheet, required by the rules).

2.1.5 Criteria for the Selection of the Measurement Approach

The criteria for the choice of the measurement approach are determined by standard setters. The starting point should always be the information needs of the users of financial information. However, there are different groups of the accounting information users that have different interests and different needs. The final selection of the criteria is always dependent on the decision of the standard setters, who may and in fact must give priority to the interests of certain groups of the accounting information users.

If the ***accounting regulator is the state*** – a state institution (what is common in continental Europe) and if there is a close relation between accounting and taxation in the country given, the criteria for the selection of the measurement approach may be strongly influenced by the fiscal interests of the state (accounting is then subordinate to the tax aspects) and other needs of the state administration (a crucial source of demand for accounting information is the state), and the interests of other users of accounting information may not be adequately taken into account. This method of accounting regulation is often characterized by the usually not explicitly formulated basic objectives of financial reporting or conceptual framework.
Continental Europe is also characterized by the ***strong influence of the prudence principle*** in choosing the appropriate measurement approach (approaches). It was this principle together with the possibility to partly ignore the interests of the users of accounting information (investors, etc.) which is given by the fact that accounting rules are set by a government organization, which significantly influenced the criteria for selecting measurement bases and blocked or hindered the penetration of the measurement in fair value (see below) to accounting (as an example we can mention accounting in Germany or France, but also in the countries that are the subject of research in this publication).

Another situation arises in case that setting the accounting rules is carried out by a ***professional organization*** (typical of the Anglo-Saxon area). This organization starts from the interests of different groups of users (who in fact create a demand for accounting information) and tries to meet them appropriately when creating accounting policies (including the definitions of measurement approaches). The standard setters are, however even in this case before the difficult task of deciding which needs and interests of users of accounting information it is necessary to prefer and how they are optimally met.

The representative of the regulation (harmonization) of accounting, which is not subordinate to the state power, is e.g. IASB (as well as the Financial Accounting Standards Board - FASB, UK Accounting Standards Board – ASB etc.) The **conceptual framework of the IFRS**, based on the fact that the financial statements are intended primarily to external users, analyzes the information needs of different groups and states: While not all of the information needs of users can be met by financial statements, there are needs that are common to all users. As investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.
The conceptual framework of IFRS is based on the fact that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

The measurement must be also subordinate to these goals. In summary, the **primary criteria** for evaluating possible measurement bases, derived from the conceptual frameworks, are:

- Decision usefulness
- Qualitative characteristics of useful information
    - Understandability
    - Relevance — predictive value, feedback value, timeliness
    - Reliability — representational faithfulness, neutrality, verifiability
    - Comparability
- Concepts of assets and liabilities
    - How the expected cash-equivalent flow attribute of assets and liabilities is measured
- Cost/benefit considerations

Researchers obviously incline to formulations of financial reporting objectives close to the IFRS and the criteria for selecting measurement approaches resulting from them. The criteria for selection of the measurement approach as under [39] are relevance and representational faithfulness. The specific fulfillment of these criteria by selecting the appropriate measurement approach is though under a far-reaching discussion and opinions are by no means uniform.

2.1.6 Market versus Entity-Specific Measurement Objectives

Measurement in accounting may be based on the entity-specific measurement objective or on the market value measurement objective.

Entity specific measurement objective

The entity specific measurement objective reflects specific conditions under which the entity acquires an asset (or for which it incurs a liability) and individual benefits (benefit outflow), which are expected from the asset (liability) due to the expected use. The specific terms of the entity for the measurement of the acquired asset reflect the purchase costs or production costs, with the subsequently measurement of the asset also value-in-use, the selling (exit) price net realizable value (selling price less cost to sell), replacement costs etc. More detailed explanation of the above approaches to measurement will be discussed below.

Market measurement objective (fair value)

The measurement based on the market prices, which may be achieved at the market when buying or selling the asset in arm´s length transaction at the measurement date, is independent of the individual conditions of the entity. [12] states: *"Market based valuations within that set have taken many forms: for example, exit price (selling), entry price (replacement price), deprival value and a catch-all fair value accounting."*

Requirements for a market-based measurement, which is independent of the specific conditions and intentions of the entity, are reflected e.g. by the **fair value definition** used in the currently applicable IFRS:

> *Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.*

This measurement is based on the measurement of an asset based on current market base, but it is not (or may not be) a particular market value, it is the price that could be negotiated between freely and without pressure acting parties in the market. An active market price is always preferred for the determination of fair value (if such a market exists).

This price may differ already at the point of the acquisition of asset from the cost (specific market price), which the company must pay to acquire the asset.

The answer to the question, which of the above two approaches better reflects the needs of users of accounting information, is fundamental to the concept of measurement. This issue is discussed not only by the standard-setters, but also by the wider public.

The current project of the IASB and the FASB to develop a joint conceptual framework started by Discussions paper *Measurement Bases for Financial Accounting – Measurement on Initial Recognition* [17], prepared by staff of the Canadian Accounting Standards Board. The paper compares the market and the entity-specific measurement objectives. A market measurement reflects the price in an open and active competitive market, it reflects market expectations. On the contrary an entity-specific measurement is based on the expectations and preferences of the management of an entity.

For external financial reporting purposes, the market value measurement objective has important qualities that make it more relevant than entity-specific measurement objectives on the initial recognition of assets and liabilities. An entity-specific measurement objective looks to the expectations of the reporting entity, which may differ significantly from those implicit in a market price.

The reasons for the preference of the measurement at fair value to the entity-specific measurement are obvious from the discussion material IASB. Fair value is considered to be a more relevant and reliable measurement because in the opinion of the creators of this material it prevents the penetration of subjective effects to the measurement.

This justification is controversial. [38] believes that the adoption of a single measurement method (fair value) is predicated on the belief that such a measure will be always the most relevant and will be reliably measurable. This will be the case if markets are complete and in perfectly competitive equilibrium. In such a situation, a unique market value can be attributed to every asset and liability, so a single measurement method, consistent with fair value is appropriate. Such properties as consistency and comparability can then be achieved in a very precise sense. Unfortunately, in reality, markets are not perfect and complete, so that this ideal information is not available.

Fluctuations, the uncertainty of the findings or the unavailability of market prices due to the absence of active markets is particularly striking at non-financial assets. Fair value must be in these cases often established on the basis of subjective estimates based on judgments and decisions of managers. In the case of these estimates the measurement is based not on the fair market conditions, it is de facto an entity-specific measurement objective and the declaration that the assets were in these cases measured at fair value is thus for the users of accounting information rather misleading without further specifications. The risks associated with estimates of fair value when no active market price is available, are noted for example by [31]: *“... measures, derived as they are from current observed market prices, can be objectively determined and hence would meet the threshold of reliability… estimations of fair value based on predictable relationships among the observed input prices and the value of the asset or liability being measured. The degree of reliability one can attach to these derived measures would depend on the goodness of the fit between the observed input prices and the estimated value. Measurement errors and mis-specified models may compromise the precision of the derived estimates…. In the latter, unobservable inputs, subjectively determined by the firm’s management, and subject to random errors and moral hazard, may cause significant distortions both in the balance sheet and in the income statement. Moreover, discounting cash flows to derive a fair value invites deception.”* This assessment is indeed very hard, but in many cases, particularly with regard to the practice, accurate.

On the other hand, it is also important to consider that in many cases an entity-specific measurement provides greater predictive information than market measurements that do not reflect specific managerial intentions and therefore the entity-specific measurement can be more relevant for the users of accounting information. [24] stated: *“...as based on my own auditing experiences of long ago—the following ideas are based on several behavioral premises: Information that is useful for and used by managers is more likely to be reliable than information that is only produced to satisfy external reporting requirements. However, this has to be tempered by the fear that management may manipulate data: hence bodies like the FASB/IASB seek “objective statistics” (e.g., based on the original “myth” of fair value derived from financial economics). It is important to triangulate management-prepared values against external market evidence wherever available—and especially now given recent experiences (post-2001) with Enron, WorldCom, etc., and even more recently, given the matters emerging in the aftermath of the global financial crisis.”*

During the financial crisis it can be doubted whether the measurement of fair value is more reliable and more relevant than the entity-specific measurement of not only non-financial assets but also of financial instruments. [24] states to it: *“That said, the major question now is whether, in the current markets even the Level 1 fair values (NB.: Level 1 fair values = market price for identical assets or liabilities which are readily available from active markets) are now reliable. It is worth contemplating this in the light of the recent developments regarding FASB’s new FSP 157-4; and also FAS 115-2, FAS 124-2 regarding impairments.”*

2.1.7 Measurement and Inflation

It is necessary to mention at least briefly also the connection of measurement and inflation at the end of the selection of the most debated issues of financial accounting. A high inflation rate greatly affects the ability of the monetary unit, which is affected by inflation to act as a benchmark of values. National systems usually deal with this problem just at the moment when the economy suffers by high rates of inflation and in relation to other economic measures. IFRS give this issue a separate standard.

In general it is possible (without dealing with the issue of hyperinflation) to respond to the inflationary depreciation by the conversion of accounting data to the fixed purchasing power. However, inflation conversions are not carried out commonly and the IFRS standard which dealt with this issue was already abolished years ago. Its application has never been mandatory either. The probable reason why conversions to the fixed purchasing power are not normally performed in accounting is their laboriousness and expensiveness. It is therefore always necessary to consider the ratio cost/benefit.

2.1.8 Definition of Measurement Bases

Before we proceed further interpretation, it is necessary to mention the definitions of the basic concepts that will be used in the text:

- **Historical cost**
    - Assets are recorded at the fair value of the consideration given to acquire them.
- **Reproduction cost (of an asset)**
    - The most economic current cost of replacing an existing asset with an identical one.
- **Replacement cost (of an asset)**
    - The most economic current cost of replacing an existing asset with an asset of equivalent productive capacity or service potential.
- **Net realizable value (of an asset)**
    - The estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

- **Value in use (of an asset)**
  - The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.
- **Fair value**
  - The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm’s length transaction (IAS 39).
  - This definition is neither an explicit exit price nor an explicit entry price, but is an arm’s length exchange price between unrelated parties [18]. Fair value can also be defined as follows: Fair value is the price for which property would exchange between a willing buyer and a willing seller, each having reasonable knowledge of all relevant facts, neither under compulsion to buy or sell, nor with equity to both. This definition accents more the mutual independence of the buyer and the seller. This aspect of fair value is very important. Indeed, a lot of transactions take place between related parties (e.g. between entities related proprietarily), where the possibility of one party exerting pressure on the other one cannot be excluded.

Especially in connection with the definition (or definitions) of fair value the terms entry price and exit price are usually used.

- **Entry price (value):**
  - The price at which an asset could be acquired.
- **Exit price (selling price):**
  - The price at which an asset could be sold.

“The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received for the asset or paid to transfer the liability at the measurement date, that is, an exit price.” [17].

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 defines fair value as exit (selling) price, which of course complies with the other conditions of the fair value definition. The Board (FASB) concluded that an exit price objective is appropriate because it embodies current expectations about the future inflows associated with the asset and the future outflows associated with the liability from the perspective of market participants. The emphasis on inflows and outflows is consistent with the definitions of assets and liabilities.

The differences between the fair value definitions used in the analysis of existing IFRS standards is analyzed in Discussion Paper Fair Value Measurements Part 1 [17]:

- the definition in SFAS 157 is explicitly an exit (selling) price. The definition in IFRSs is neither explicitly an exit price nor an entry (buying) price with some slight variations in different IFRS standards;
- the definition in SFAS 157 explicitly refers to market participants. The definition in IFRSs refers to knowledgeable, willing parties in an arm’s length transaction; and
- for liabilities, the definition of fair value in SFAS 157 rests on the notion that the liability is transferred (the liability to the counterparty continues – it is not settled). The definition in IFRSs refers to the amount at which a liability could be settled between knowledgeable, willing parties in an arm’s length transaction.

The IASB recognized the need for guidance on measuring fair value in IFRSs and for increased convergence with US GAAP. Consequently, the IASB decided to use the FASB’s standard as the starting point for its deliberations. From the Discussions Paper [17] and also from related discussions in the IASB it is obvious that the IASB inclines to the definition of fair value close to (or identical with) the definition used in SFAS 157, where fair value is defined as an exit price.

Deprival value (also known as value to the business) is considered as a loss that an entity would suffer if it were deprived of an asset. It is the lower of replacement cost and recoverable amount on the measurement date, with recoverable amount being the higher of value in use and net realizable value. Parallel basis for liabilities is relief value. The relief value measurement basis for a liability is defined as the higher of its current

consideration amount and repayment amount, with repayment amount being defined as the lower of the current cost of performance and the current cost of release from the liability. This reflects the conclusions in [23], Liabilities and how to account for them: an exploratory essay, paragraphs 32-33, except that the term „repayment amount" is used in the place of "settlement amount" to avoid potential confusion with differing meanings of the term "settlement" in authoritative accounting literature. [23] also provides insights into the application of net realizable value, value in use and deprival value concepts to liabilities.
Some do not consider deprival value to be a separate measurement basis, but rather a decision rule for selecting between three of the above measurement bases (replacement cost, net realizable value, and value in use). However, deprival value is based on an overarching theory of management behavior that, it may be argued, adds an important dimension that integrates the three bases into a distinct measurement approach.
It is necessary to note that deprival value has not been used for accounting practice so far.

The specifics of the measurement problems are based not only on the measurement approach used, but also on the moment in which the measurement is performed and the nature of the asset or liability. The key moments when there is a measurement are:

- measurement for acquisition (purchase) of assets or incurrence of a liability
- measurement while holding assets and during the existence of liabilities (especially on the reporting date);
- measurement on disposal of assets or liabilities for payment

In the following text we will deal with measurement approaches in relation to the point at which the measurement occurs. We will only deal with the relevant measurement approaches that are (may be) meaningfully used in accounting systems.

2.2 Measurement upon Initial Recognition

Individual purchase prices or production costs – that means measurements based on historical cost which is based on entity specific measurement objective, are mostly used for the measurement of assets and liabilities for acquisition. The advantage of this measurement is that it is an evidenced amount supported by a specific performed market transaction, which is properly documented. The measurement in this case is based on realized transactions and reflects specific conditions of the asset acquisition (liability incurrence).
The measurement based on fair value is not required on initial recognition by accounting rules (or standards) so often. Fair value also usually coincides with the actually incurred purchase price. But unless the purchase of the asset was realized at a price that is consistent with the definition of fair value (this can happen in a transaction between related parties), the two measurements may vary even on initial recognition. Already at this point it should be noted that the less the market where the asset is acquired conforms to the definition of an active market, the more difficult it can be to prove that the asset was acquired at a price equivalent to fair value.
Fair value setting can be based already on first recognition theoretically either on the entry price or on the exit price. Assuming a perfectly functioning market, these prices will be equal (if leaving aside the transaction costs) - this situation may arise in financial instruments traded in active markets. Obviously it will be otherwise for goods procured by the trader. Here, the prices at the market in which the trader buys and the market in which the trader sells, are different (depending on the gross profit margin). In this case, therefore, the fair value defined as entry price will be different from the fair value defined as exit price. When using the fair value measurement on initial recognition, it makes sense to base the measurement of non-financial assets on the entry price at an (if possible) active, to the entity relevant market. The usage of exit price of non-financial assets - inventories in particular - would mean to measure the stock including the anticipated sales margin, which is very risky. Therefore, the IASB discussion paper dealing with the measurement on the initial recognition is based on the use of entry price, too. Another discussion paper dealing with the measurement in fair value [17] does not deal with the issue of the measurement upon initial recognition; it rather deals with the subsequent measurement in fair value and defines fair value as the exit price (see above). It should be noted that this approach to the measurement on initial recognition is risky and very controversial for non-financial assets.
Currently the use of fair value is required upon initial recognition especially by IFRS and that only for financial instruments and biological assets.

When measuring at fair values it is to decide whether to include the transaction costs into the measurement. Both options are possible and common under IFRS – e.g. for financial instruments included in the portfolio of instruments revaluated at fair value with the effect "fair value through profit or loss" the fair value is not increased by the transaction costs incurred, for other portfolios of financial instruments, however, transaction costs are added.
As stated above, the measurement in fair value is for the measurement on first recognition used rather exceptionally and that is why it will not be dealt with further in this part. Fair value is far more applicable for the measurement subsequent to initial recognition (or revaluation) ongoing especially on the balance sheet date and in this context it will be discussed further in detail.

We will return to the issue of the measurement of assets based on historical cost. The measurement methods and problems that occur during the procedure (and can be solved in different versions), are connected with the way in which the asset has been acquired.
Assets may be acquired:

- by purchase;
- in exchange for other non-monetary asset;
- free of charge, or
- by production.

2.2.1 Measurement of Purchased Assets

The costs of purchase are expenses expenditures that must be expended in order to use the effect potentially included in the asset purchased. The capitalization of specific items may be modified on the basis of this principle. The items that should be capitalized may be determined under accounting rules simply by listing. The approach to the determination of the cost of purchase can vary under legal regulations of accounting.
The costs of purchase of inventories comprise the purchase price and transaction costs: import duty and other taxes, transport, handling and other costs directly attributable to the acquisition of finished asset. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase. When acquiring long - term assets the costs of installation of machinery, the cost of the required test operation, inspection prior to placing the asset into use, the cost of installing the software, etc. accrue. In the case of an acquisition of a building, the cost of the project, geological survey of the building site and costs incurred in preparing a construction site become parts of secondary acquisition costs. Typical transaction costs of investment in the event of purchasing financial assets - securities are the stock exchange fees, the broker´s fees etc. With the purchase of financial assets, these costs may be in relation to specific legal regulation either included in the cost of investment or can be recognized as expenses in the period they were incurred (such approach is not used for non-financial assets).
The recognition of all costs necessary for the asset to be eligible to bring benefit may be a problem.
Besides the items, the capitalization of which is mostly undoubtable, there may be also disputable cases. One of them is the training costs of the newly acquired asset. These costs are not usually included in the cost of acquisition, because their future usefulness to the unit is uncertain. A very similar problem is the capitalization of business trips expenses, which were undertaken in order to investigate offers and acquire assets. These expenses are not included in the cost of acquisition either, because they do not concern just the only (finally acquired) asset.
Further, questionable is for example the issue of borrowing costs. A specific standard is given to solving this issue for example within IFRS. The basic idea behind the standard is compliance with the matching principle. If an asset is being acquired for a significantly long time (for example more than a year), it is necessary to capitalize (i.e. include in the measurement) the borrowing costs on loans rose by the need to finance the long-term process of the asset acquisition (in addition to other costs for the construction of the asset). The rules of the borrowing costs capitalization may differ under specific national accounting regulations. E.g., the accounting rules in the Czech Republic, unlike IFRS, do not deal with the substance of this problem and leave the decision to capitalize the interest paid to the moment of the inclusion of the long-term asset into use on the entity.

2.2.2 Measurement of Assets Acquired in Exchange

According to the IFRS it is necessary to consider whether an exchange transaction will bring the entity a profit or a loss. If so (an exchange transaction is in this case known as a commercial transaction), the result of the transaction (the profit or loss achieved by the exchange) should be reported immediately after the acquisition of assets. The profit or loss from the exchange follows from the difference of fair value of the asset transferred at the exchange (or from the fair value of the asset acquired in the exchange) and the carrying amount of the asset transferred. Individual national regulations of accounting systems may differ from this approach. An accounting solution can be based for example on the assumption that no profit or loss is achieved by the exchange of one asset for another. Then the asset acquired in the exchange is measured by the carrying amount of the asset lost in the exchange.

2.2.3 Measurement of Assets Acquired Free of Charge

The free acquisition of assets can occur in different ways – for example as a gift, by the contribution of the owner to the equity etc. The assets acquired free of charge are measured on the basis of the estimated market value at the date of acquisition. Estimation brings necessarily a subjective element to the measurement. In some cases the business law may require to substantiate the measurement by an expert opinion.

2.2.4 Measurement of Assets Produced

Work in progress or products shall be measured at the production costs which the entity has expended for their production.
The key problem for the measurement of assets in production costs is:

- allocation of overhead costs, and
- prevention of subjective manipulation of the measurement of assets produced.

The measurement of produced assets, partially inventories, is a very sensitive area. If the cost is overvalued, the entity may unlawfully improve the economic result – profit in the reporting period when the assets were produced (unless they were also sold in the same period). If there is wasteful spending in production costs (wasting, generating an unnecessary amount of waste or scrap, the poor use of production capacities, etc.), the wasted costs should not increase the measurement of the assets produced - the consequences of mismanagement should be reflected in the period when the mismanagement occurred and not in subsequent reporting periods.
Individual national accounting regulations may vary in the “level of rigor and consistency” with which they modify the measurement of assets produced and whether the rules are set to prevent overvaluation of the accounting measurement of these assets. Differences may also arise as to whether the national rules allow the use of standard cost method or whether only the measurement of actual costs is authorized for entities.

2.2.5 Specifics of Measurement of Receivables and Payables

The approaches to the measurement of receivables and payables which the entity intends to hold to maturity may differ in individual national legislations.
This is particularly the problem whether the measurement of receivables and liabilities (particularly long-term) takes the time factor into account. The standard requirements should be the measurement of long-term receivables at the present value; by far not all national legislations require or even allow discounting the future payments.
If liabilities are not measured at present value, but at the value of the future payment, the interest on delayed payments increases the value of the purchased asset.

2.3 Subsequent Measurement

The balance sheet date is an important moment during the possession of assets and the existence of liabilities, when it is necessary to deal with the issue of measurement. The quality of the measurement of assets and liabilities is a key issue here. Measurement may be based on historical costs or it may use current market figures – in this case measurement is usually based on fair value.

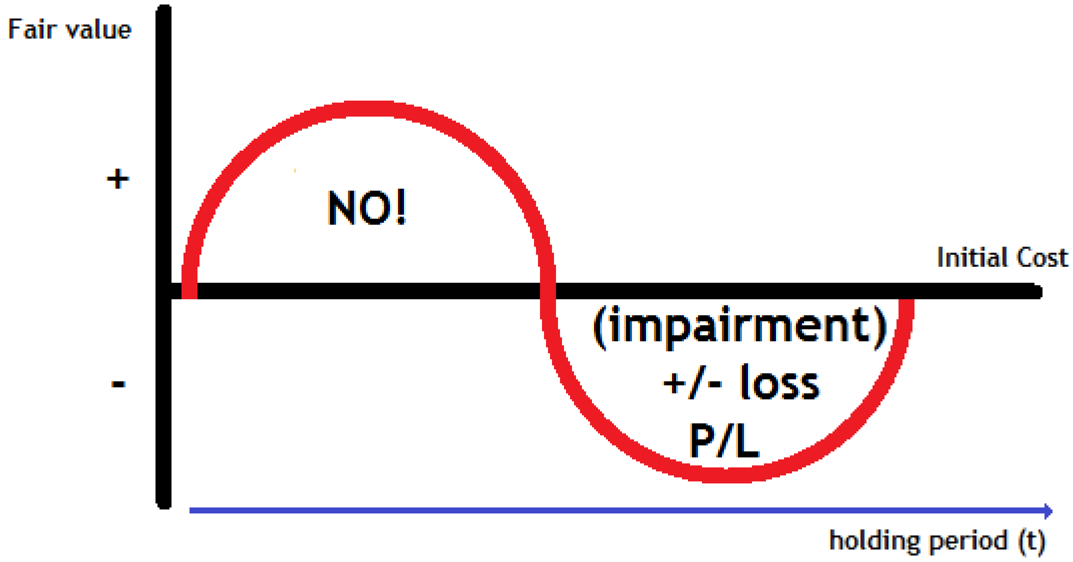
2.3.1 Historical Costs Measurement

Historical costs measurement is based on the costs associated with the acquisition of assets (with the emergence of a liability). The advantage of this approach to measurement is relatively easy feasibility, conclusiveness and to a high extent the elimination of the penetration of subjective effects in the measurement. The rate of application of those properties, however, depends on how the asset was acquired.
The disadvantage of historical costs approach is especially its relationship to the past. The original cost of purchase may be only reduced in this measurement model. Undervaluation of the original (historical) cost of

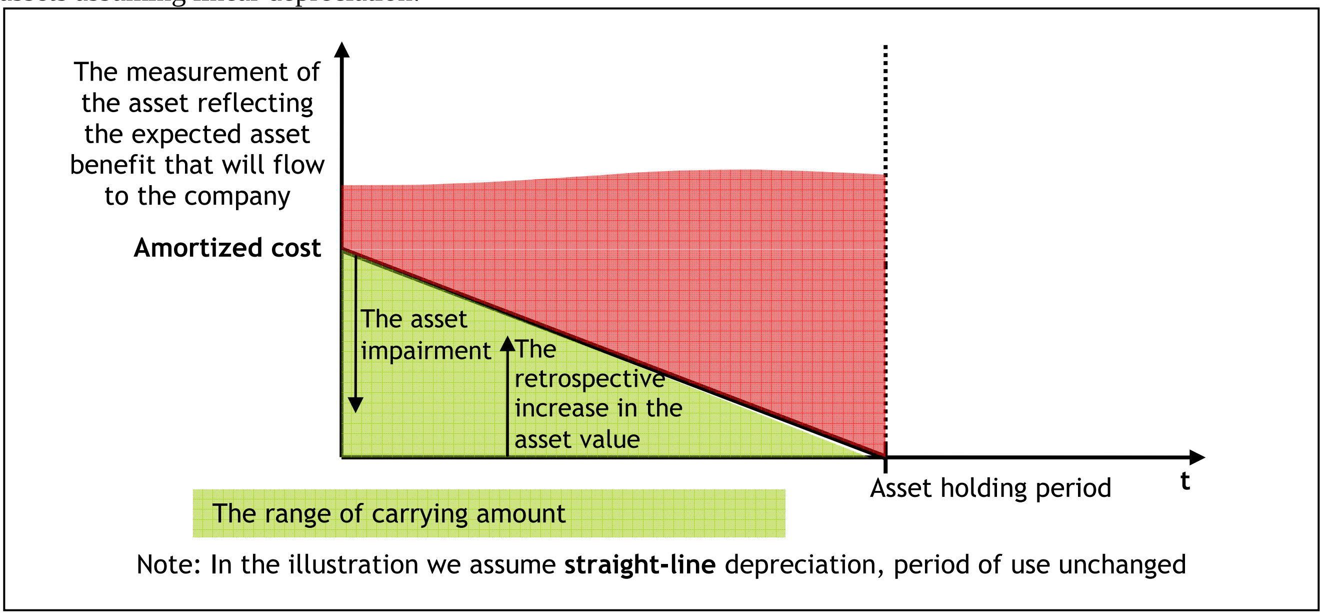
purchase compared to the current market price s caused especially by inflation. At a certain part of the assets, however, there may be also an increase in value in the course of their holdings gain from previous (correct) decision (about the acquisition of these assets), and currently is not connected, or is only loosely connected with the costs expended.
Initial costs are reduced

- as a result of depreciation of long-term assets
- if there is an impairment

Impairment of assets
The carrying amount of assets should reflect the benefits expected from the asset. If the expected benefits that will arise from the asset in the future are lower than its carrying amount, the carrying amount should be reduced in accordance with the principle of prudence and with the accrual principle. If the value in use of the asset in the next period increases again, the original impairment is revoked; the subsequent increase in value shall not exceed the original historical value, though. The retrospective increase in value may be prohibited by specific accounting rules.
The illustration of reduction and retrospective increase of the asset value within the model of historical costs of non-depreciable assets:



The reduction and the retrospective increase in the asset value within the historical cost model of depreciated assets assuming linear depreciation:



The impairment of assets or the retroactive increase always affects the economic result (profit or loss). Impairment testing is dependent on the nature of an asset and its use in the entity. Testing for impairment may be in the national (international) accounting rules modified in various ways.

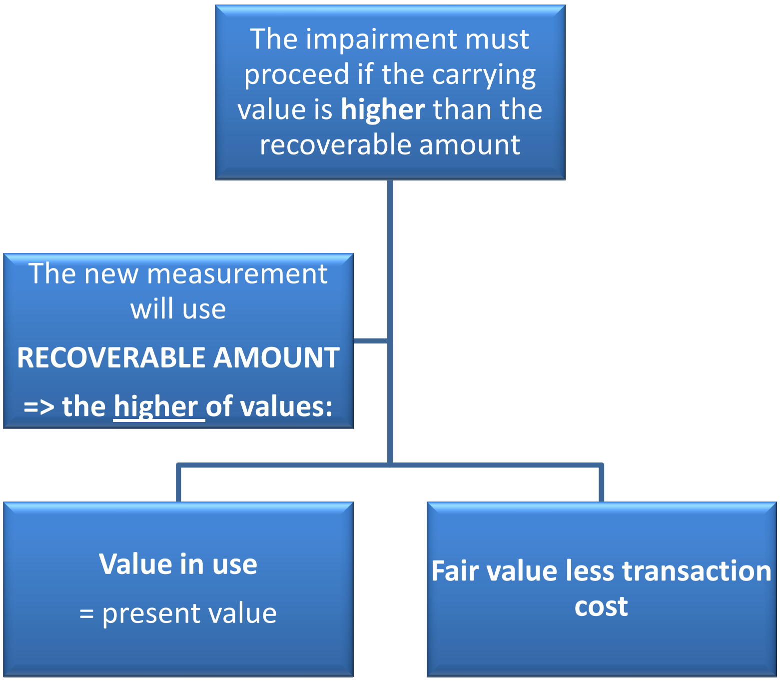
The impairment of long-term assets

Under IFRS the model based on rational behavior of the entity is used for the detection of impairment of long-term assets. Long-term assets are held for long-term use by the entity. The benefits that these assets bring may be twofold - first, benefits brought gradually throughout the use of the asset and also benefits that can be obtained by selling the asset.

The detection of impairment may be based on the determination of the maximum amount of benefit, which the asset is able to bring to the entity under circumstances given (under IFRS this value is known as recoverable amount) and from comparison of this amount with the carrying amount.

The determination of the recoverable amount is based on the assumption that the entity considers the effects that the asset can provide. This fact will be reflected in determining of the recoverable amount as a higher value of: fair value of assets less the estimated costs of sales and the present value of future benefits, which an asset could bring the entity.

The procedure of recognition of impairment may be shown transparently as follows:



To determine the selling prices of such assets IFRS requires using the price that meets the definition of fair value. It is still necessary to reduce this price by the costs that will be incurred in bringing the asset to market (transport, advertising, brokerage fee for sales, etc.).

Value in use is determined by estimating the future net cash flows (i.e., the revenue expected from the use of an asset less the costs of operating the asset), the asset is expected to bring the entity. Perhaps the biggest practical problem in determining the value in use of an asset is represented by the assets that do not generate cash flows independently.

It should be noted that not all accounting legislation approaches impairment testing in so much detail, as IFRS. For example, to detect impairment the asset's carrying amount can only be compared to its market value. It is evident that for long-term assets this approach does not correspond with the assumption of going concern.

Impairment of inventories

Inventories bring a single effect – by consumption or sale.

Selling prices of inventories may decrease during their holding due to damage, obsolescence, changes in market demand, etc. The impairment test is based on the fact that the carrying amount is often compared with

the ***„net realizable value”***. If the carrying amount exceeds the net realizable value, impairment has occurred and the carrying amount should be reduced.
Net realizable value can be defined within the national frameworks with various nuances of content. According to IAS 2 it is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Impairment of receivables
The impairment of receivables is a specifically important area. Each receivable represents a risk that it will not be paid in future and the expected benefit of the receivable – increase in cash or other assets – will not be fulfilled. The risks connected with receivables are probably considered most strictly within US GAAP, where it is not even allowed to recognize the income that arises in connection with a receivable with a long maturity by a customer at the very moment of sale. Revenue in the case of a long-term-deferred maturity of a receivable is recognized gradually on the basis of different methods. To reflect the risk associated with uncollectible receivables in the cost of claims it can be proceeded in two ways - the “individual” basis or “estimation method”, which refers to the entire portfolio of receivables.
The entity accesses the impairment of the receivable individually if the particular receivable has not been paid in the due date. In view of the fact that entities have often a great amount of receivables, internal rules are usually created for impairment and also depreciation of uncollectible receivables. The situation is often complicated by tax provisions (in the accounting systems that are linked to taxation), which significantly limit the tax applicability of the expenses incurred by the impairment of receivables. The disadvantage of the suggested “individual approach” is that the situation linked to bad debts is starting to be dealt with as late as in the period when the specific receivable remains unpaid after the maturity date, which may be in the accounting period following the emergence of the receivable and related revenue. The probability that a part of receivables will remain unpaid exists already at the time of their creation. An entity can estimate this risk and reflect in the value of receivables immediately - right in the period when the claim arose (the estimation method).
The “estimation method“ lies in the fact that the value of receivables is reduced already in the period in which the receivable arose. The receivables may not be after the maturity date and it may not even be known if the recoverability of certain specific receivables is risky. Thus the profit is reduced by the estimated amount of uncollectible receivables in the period when the related revenue and at the same time the risk of partial non-payment of these receivables is generated.

2.3.2 Fair Value Measurement
Using the fair value concept for measurement at the balance sheet date requires revaluation of individual items of assets and liabilities at the recorded fair value at the balance sheet date. The items measured in fair value reflect the current level of price at the market. This approach to the measurement enables not only impairment (as it was also when applying the concept of historical cost, while respecting the prudence principle), but also increase of the asset value. Revaluation of assets is the basis for measurement of assets at their disposal (for example at their consumption or sale) and in determining the eventual depreciations (for depreciable assets) in the following year.

Measurement at fair value on the balance sheet date is more and more used to the detriment of historical cost measurement. A key problem of this approach is a reliable determination of fair value.
The rules for the determination of fair value may differ in individual legal modifications of accounting.
Most of IFRS standards which use the revaluation at fair value deal with the issues of determining fair value in greater detail. If there is an active market price, the entities shall apply this price if there is no active market price, fair value is determined on the basis of:

- inactive market prices taking into account any changes in economic conditions
- current cost of similar assets, taking into account differences
- discounted future net cash flows

Current IFRS do not specify the hierarchy that would determine the order in which the entity should use the estimates unless the active market price of the particular item is known.
It is different for example in the US GAAP system where this hierarchy is set. SFAS 157 emphasizes market-based measurement and, in doing so, stipulates a fair value hierarchy:

- **Level 1** lies at the top of the hierarchy, where inputs are quoted prices in active markets. Level 1 inputs may be observable in markets such as the New York Stock Exchange.
- **Level 2** inputs are in the middle of the hierarchy, where data are adjusted from similar items traded in active markets, or from identical or similar items in markets that are not active. Level 2 inputs do not stem directly from quoted prices. For example, the fair value of finished goods at a retail outlet acquired in a business acquisition could be based on the price expected to be received in selling the inventory at retail, or the value at wholesale, adjusted for differences between the condition and location of the items. Conceptually, fair value should be the same whether adjustments are made to a retail price or a wholesale price, but the fair value estimate that maximizes inputs in the higher level of the hierarchy is the one that should be used to estimate the price to be received in selling the inventory.
- **Level 3** inputs are unobservable and generated by the entity itself. An asset retirement obligation for an oil well, for example, would include expected risk-adjusted cash flows, using the company's own data. Another example of a Level 3 input is a financial forecast developed using the reporting entity's own data.

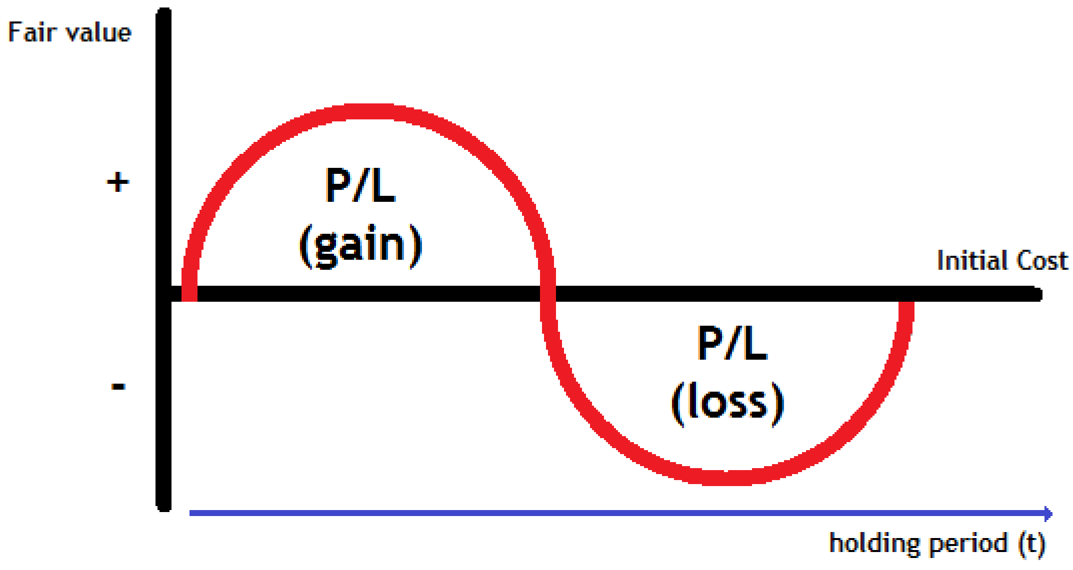
When measuring on the balance sheet date fair value is set as the exit price according to SFAS 157. The current version of IFRS does not comment on the decision whether to use exit price or entry price (see the discussion above). Taking over the hierarchy and the concept of fair value determined on the basis of exit price is also being considered within the IASB [17].
Within the particular national (international) accounting legislation it is set:

- which balance sheet items are revaluated at fair value (single model of measurement based on fair value has not been used anywhere yet.),
- what is the impact of revaluation (whether the revaluation will affect profit or other comprehensive income).

The key problem of measurement based on fair value is especially reporting of holding gains. Currently three models are being used:

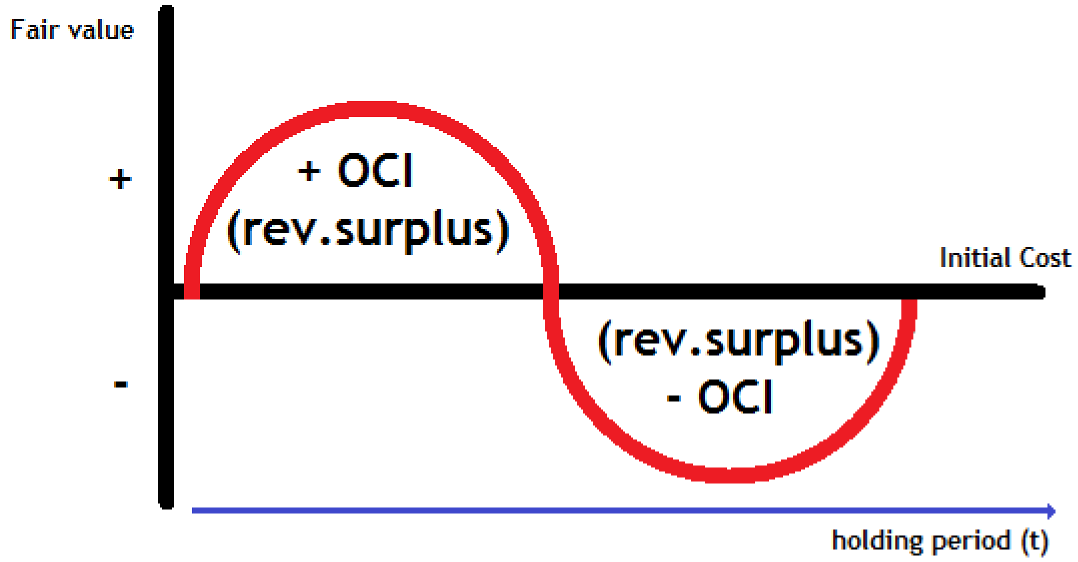
- the model when the revaluation affects the result (through profit or loss);
- the model in which the revaluation does not affect profit or loss (affecting other comprehensive income);
- the revaluation model (a combination of both the above two models).

Fair value through profit or loss
Revaluation to fair value in this model will always affect the profit, increasing the value of assets / gain / will increase the profit and a decrease in asset value will reduce the profit.



Fair value through other comprehensive income

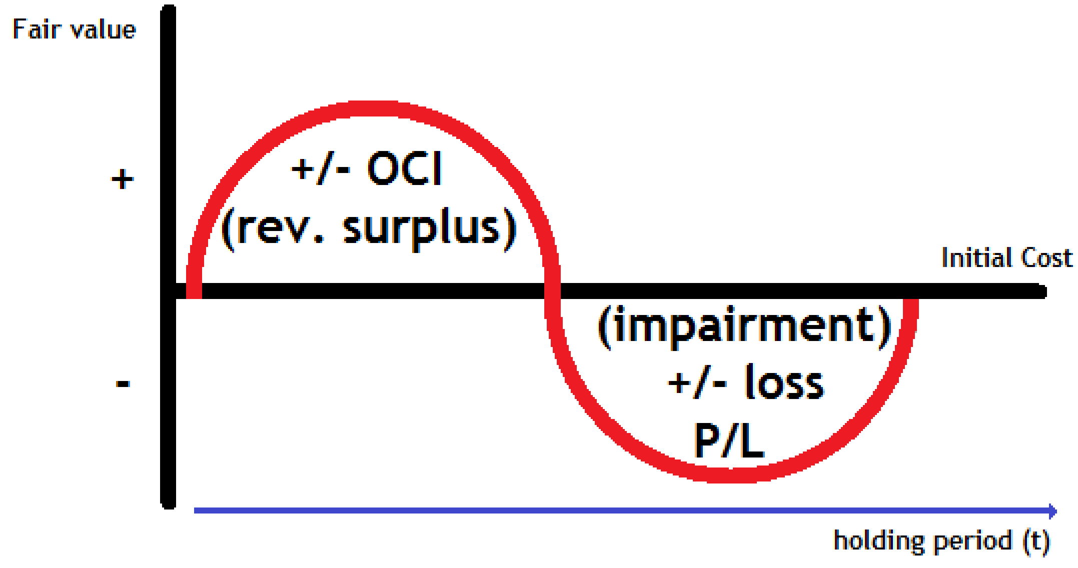
In this model the revaluation of assets does not affect the profit, but the revaluation surplus which is created for this purpose in equity.



Recording the impact of revaluation at fair value to the revaluation surplus causes the fact that the revaluation will not increase the reported profit by the possible unrealized gains and in this case shares in the profit (dividends) from the results of the revaluation cannot be paid to the owners.

Revaluation model

The revaluation model is used only under IFRS, namely for the revaluation of tangible assets for use by the entity and intangible assets as an alternative to the historical cost measurement.



Based on the new measurement of fixed assets the depreciation is newly set which the entity will record for these assets. If there is an increase in the asset value, it consequently means an increase in depreciation in subsequent years. The profit is reduced through depreciation at a level which corresponds to the value that will be necessary to restore the asset at the end of its useful life. So the revaluation of fixed assets in this case does not allow the distribution of unrealized holding gains to the owners.

2.3.3 Measurement of Assets upon Disposal

Assets are at disposal (for example, their sale, donation, destruction, etc.) measured at the carrying amount. For long term assets, which are usually individually monitored in accounting, individual prices monitored in

the accounts are used. The measurement of disposed current assets (inventories or securities) should proceed due to their number and character in such a way that it is done efficiently and systematically.
At disposal, current assets (especially inventories) may be measured similarly as long term assets on the basis of individual carrying amount. The use of this approach is suitable for the inventories which have an individual character. The problem which occurs mainly in by inventories of a homogeneous character is handled through the cost formulas.
At disposal (removal), inventories may be measured by the average price (weighted average) or the measurement techniques *"FIFO" (First In First Out)* or *"LIFO" (Last In Last Out)* can be used. The measurement by the FIFO method is based on the fact that the oldest inventories are consumed first.
On the other hand, according to the LIFO method the inventories that came last to the enterprise are consumed first.
If the inventory prices are rising, the consumed inventories are measured in case of using the LIFO method by the most current and highest price; in case of the FIFO method it is quite the opposite. The choice of the measurement technique affects expenses of the entity and the reported profit or loss. The choice of the measurement techniques also depends on the set accounting rules.

3 Harmonization of SMEs' Reporting throughout IFRSs

Companies operating in the EU member countries prepare financial statements according to the accounting system of the given country, i.e. according to national regulations which respect historical development, traditions, prevailing economic and legal environment. According to EU decree No. 1606/2002 companies listed on the European capital markets have the obligation to prepare their financial statements based on IFRS framework since 2005.
One of the pillars of the EU business environment is the single European market. The reasons of low integration of SMEs in business activities on the single market (cross-border activities), compared to big companies are mainly the following:

- differences in legal regulations of individual member countries,
- non-existence of unified accounting standards for these enterprises (until July 2009)
- non-existence of unified taxation of these enterprises,
- limited offer of capital and financial sources,
- insufficient support of SMEs business activities on the single market,
- cultural and language differences,
- lack of information.

IASB finalized in 2009 its effort on the wider spread of international accounting standardization issuing brand-new standard **IFRS for Small and Medium-Sized Entities (IFRS for SMEs)**. This standard in fact brought a lot of positive and reasonable simplification of rules from "full IFRS" for the necessities of SME businesses. However it is necessary to state that certain "full IFRS" requirements were not simplified or superseded, but only shortened. This leads to the worse understandability of this standard among SMEs. Due to this reason can be stated that IFRS for SMEs is still not required as a reporting framework within lots of countries or within European Union.
IFRS for SMEs defines ***"small and medium-sized enterprises" as entities that do not have public accountability, and publish general purpose financial statements for external users***. Every entity has some form of accountability, if only to its owners and the local tax authorities. Note that size is not the determining factor as to which entitles can use the IFRS for SMEs – the applicability is based entirely on whether the entity has public accountability or not. Therefore, entities that wish to apply the standard may vary in size from very small to substantial private entities. Hence, the standard potentially could have a large audience. The IASB estimates that 95 % of all companies meet these criteria.

There is some evidence that suggests the difficulties or the failure of the adoption process: the lack of political will, rooted in local culture and a strong national outlook prevented a truly harmonized framework, a magnitude of the differences that exist between countries and the high costs to eliminate them [21]; local traditions exercise a strong influence over the implementations of new concepts (as previously noted on true and fair view) [35]; tax and legally-based orientation hinder the harmonization process [22, 37]; diversity will not disappear as it comes from different accounting cultures and their interpretation will be partly influenced by their history and previous practice [2, 3, 16, 32, 33, 36].

Several questions arise in this context: are transition countries, while their accounting models have understandably less tradition, more at ease to implement full IFRSs and the IFRS for SMEs? Are the differences between local practices and IFRSs more easily to be reduced? Previous studies show that even if some changes towards Substance over Form and a focus on investors have been tempted, the emphasis on compiling proper accounting records and on adhering to tax regulations rather than fairly presenting financial statements has continued in the Czech Republic [34, 35], and considerable differences between the Polish regulations and IFRS were identified given the legalistic and rule-based orientation of Polish rules [37]. Also, problems associated with lack of clarity in the fiscal law, a variable level of understanding of IFRSs by the regulators and preparers, the persistence of the communist mentality among accountants who gained their knowledge and skills prior the transition, the accountants' preference for more prescriptive regulation and less choice of accounting treatments, were also documented [37].

Some could argue that the change of the accounting model is more easily achieved in transition countries just because of the reduced impact of the tradition. However, impediments to convergence are seen as more of a problem in the new EU member states [22]. Drawing on this experience in applying full IFRSs, we assert that the implementation of the IFRS for SMEs will be even more challenging, given the characteristics of these entities. The particular context of SMEs is discussed in the next section.

Following text will provide an insight on IFRS for SMEs [19], how measured balance sheet items are and which financial statements are obligatory and how to prepare them according to this standard.

3.1 Balance Sheet Items

3.1.1 Intangible Assets

As an **intangible asset** we consider non-monetary asset without any physical substance.
Upon initial recognition intangible asset is measured at **cost**. Cost comprises:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- any directly attributable cost of preparing the asset for its intended use.

Upon balance sheet day intangible asset is measured at **cost less accumulated amortization and accumulated impairment losses**.

According to [19] company shall **disclose** for the area of intangible assets:

- the useful lives or the amortization rates used;
- the amortization methods used;
- the gross carrying amount and any accumulated amortization at the beginning and end of the reporting period;
- the line item(s) in the statement of comprehensive income in which any amortization of intangible assets is included;
- a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
    - additions;
    - disposals;
    - acquisitions through business combinations;
    - amortization;
    - impairment losses;
    - other changes.

3.1.2 Property, Plant and Equipment

As an item classified as **property, plant or equipment (PPE)** we can understand tangible assets that are expected to be used during more than one period and are held for use in the production or supply goods or services, for rental to others, or for administrative purposes.
Upon initial recognition PPE is measured at **cost**. The cost comprises:

- its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management (e.g. costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality);
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Upon balance sheet day PPE is measured at **cost less accumulated depreciation and accumulated impairment losses**.

PPE shall be depreciated during its useful life. Company has to select a depreciation method that best reflects the pattern in which it expects to consume the asset's future economic benefits. As a general depreciation method shall be stated the following ones:

- ***linear method***

$$depreciation = \frac{cost - residual\ value}{useful\ life\ (in\ years)}$$

- ***double-declining balance method (DDB)***

$$\%_{DDB} = \frac{100\ \%}{useful\ life\ (in\ years)} \cdot 2$$

$$depreciation = net\ value \cdot \%_{DDB}$$

- ***sum-of-the-years'-digits method (SYD)***

$$depreciation = (cost - residual\ value) \cdot \frac{residual\ years\ of\ useful\ life}{sum\ of\ the\ years'digits}$$

$$sum\ of\ the\ years'digits = \frac{useful\ life\ (in\ years)}{2}[1 + useful\ life(in\ years)]$$

According to [19] company shall **disclose** for the area of property, plant and equipment:

- the measurement bases used for determining the gross carrying amount;
- the depreciation methods used;
- the useful lives or the depreciation rates used;
- the gross carrying amount and the accumulated depreciation;
- a reconciliation of the carrying amount at the beginning and end of the reporting period showing separately:
  - additions;
  - disposals;
  - acquisitions through business combinations;
  - transfers to investment property if a reliable measure of fair value becomes available;
  - impairment losses recognized or reversed in profit or loss;
  - depreciation;
  - other changes.

3.1.3 Investment Properties

As **investment property** we understand a property held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of business.

Upon initial recognition investment properties are measured at their *costs*. These comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs.
Investment property has to be measured upon balance sheet date at **fair value** and the changes of fair value affects directly **profit or loss** of the company. Standard IFRS for SMEs provides guidance how to measure a fair value of investment properties.

According to [19] company shall **disclose** for the area of investment properties:

- the methods and significant assumptions applied in determining the fair value of investment property;
- the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent evaluator who holds a recognized and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed;
- the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal;
- contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements;
- a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing separately:
    - additions, disclosing separately those additions resulting from acquisitions through business combinations;
    - net gains or losses from fair value adjustments;
    - transfers to property, plant and equipment when a reliable measure of fair value is no longer available without undue cost or effort;
    - transfers to and from inventories and owner-occupied property;
    - other changes.

3.1.4 Leases (lessee's point of view)

Leases could be divided onto two major groups: (i) ***finance leases***, and (ii) ***operational leases***. Obviously the financial lease is recognize when there are transferred all the risks and rewards incidental to ownership. Moreover IFRS for SMEs provides a list of situations which leads to the recognition of financial lease:

- the lease transfers ownership of the asset to the lessee by the end of the lease term;
- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- the lease term is for the major part of the economic life of the asset even if title is not transferred;
- at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
- the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

Finance lease

The object of financial lease is measured at amounts equal to its fair value or, if lower, the present value of the minimum lease payments, determined at the inception of the lease. The present value of the minimum lease payments should be calculated using the interest rate implicit in the lease.

According to [19] company shall **disclose** for the area of finance leases:

- for each class of asset, the net carrying amount at the end of the reporting period.
- the total of future minimum lease payments at the end of the reporting period, for each of the following periods:
    - not later than one year;
    - later than one year and not later than five years; and
    - later than five years.

- a general description of the lessee's significant leasing arrangements (e.g. information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements).

Operating lease

Lessees shall recognize lease payments as an ***expense on a straight-line basis*** unless either

- another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis; or
- the payments to the lessor are structured to increase in line with expected general inflation (based on published indexes or statistics) to compensate for the lessor's expected inflationary cost increases.

According to [19] company shall **disclose** for the area of operating leases:

- the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
    - not later than one year;
    - later than one year and not later than five years; and
    - later than five years.
- lease payments recognized as an expense.
- a general description of the lessee's significant leasing arrangements (e.g. information about contingent rent, renewal or purchase options and escalation clauses, subleases, and restrictions imposed by lease arrangements).

3.1.5 Financial Instruments

Financial instrument is defined as a contract giving a right to a financial asset of one entity and financial liability (or equity instruments) of another entity.

IFRS for SMEs divide financial instruments onto two groups: (i) basic financial instruments, and (ii) other financial instruments.

Among **basic financial instruments** may be stated:

- cash;
- demand and fixed-term deposits when the entity is the depositor, eg bank accounts;
- commercial paper and commercial bills held;
- accounts, notes and loans receivable and payable;
- bonds and similar debt instruments;
- investments in non-convertible preference shares and non-puttable ordinary and preference shares;
- commitments to receive a loan if the commitment cannot be net settled in cash.

These basic financial instruments shall be measured upon initial recognition at the **transaction price**.

Upon balance sheet date subsequent measurement varies according to type of the financial instrument:

- ***debt instruments***
    - at amortized cost using the effective interest rate
- ***commitments to receive a loan***
    - at cost less impairment
- ***investments in non-convertible preference shares and non-puttable ordinary or preference share***
    - if these instruments are publicly traded or their fair value can be measured reliably, at fair value through profit or loss,
    - otherwise at cost less impairment.

Other financial instruments have to be measured upon initial recognition at **fair value** (obviously the transaction price).

Upon balance sheet date the subsequent measurement is following:

- ***general approach***
    - at fair value through profit/loss
- ***exemptions***
    - equity instruments which are not publicly traded or their fair value is not reliably measured and contracts linked to such instruments

- at cost less impairment

According to [19] company shall **disclose** for the area of financial instruments:

- financial assets measured at fair value through profit or loss;
- financial assets that are debt instruments measured at amortized cost;
- financial assets that are equity instruments measured at cost less impairment;
- financial liabilities measured at fair value through profit or loss;
- financial liabilities measured at amortized cost;
- loan commitments measured at cost less impairment;
- income, expense, gains or losses, including changes in fair value, recognized on:
  - (i) financial assets measured at fair value through profit or loss;
  - (ii) financial liabilities measured at fair value through profit or loss;
  - (iii) financial assets measured at amortized cost;
  - (iv) financial liabilities measured at amortized cost;
- total interest income and total interest expense for financial assets or financial liabilities that are not measured at fair value through profit or loss;
- the amount of any impairment loss for each class of financial asset.

3.1.6 Inventories

As **inventories** we can consider assets held for sale (i.e. goods), assets in the production process for such sale (i.e. own products), and assets in the form of material or supplies to be consumed within the production process.

Upon initial recognition inventories are measured at their **costs**. As costs we can understand all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
In case we do not apply individual costs, we can use to measure the costs following formulas:

- **FIFO (First-In, First-Out);** or
- **weighted average.**

LIFO (Last-In, Last-Out) method is not permitted.

<table>
<tr><th>Allowed techniques</th><th>Not-allowed techniques</th></tr>
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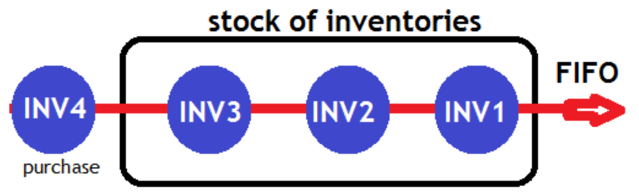

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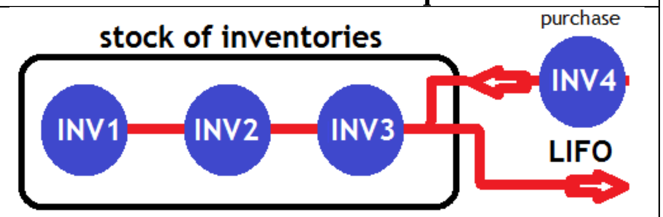

</td></tr>
<tr><td>$weighted\ average = \frac{\sum p_i q_i}{\sum q_i}$</td></tr>
<tr><td>individual costs</td></tr>
</table>

Upon balance sheet date company shall measure inventories at the **lower of cost and estimated selling price less costs to complete and sell**. In case of the second option, company shall recognize an impairment loss.

According to [19] company shall **disclose** for the area of inventories:

- the accounting policies adopted in measuring inventories, including the cost formula used;
- the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;
- the amount of inventories recognized as an expense during the period;
- impairment losses recognized or reversed in profit or loss;
- the total carrying amount of inventories pledged as security for liabilities.

3.1.7 Provisions

Company may recognize a **provision** only when:

- has an obligation at the reporting date as a result of a past event;
- it is probable that the company will be required to transfer economic benefits in settlement;
- the amount of the obligation can be estimated reliably.

Provisions are measured as the **best estimate of the amount required to settle the obligation at the reporting date**.
In case that the effect of time value is significant, provision has to be calculated at the present value of the amount expected to be required to settle the obligation. As a discount rate shall be used pre-tax rate reflecting the current market assessments of the time value of money.

According to [19] company shall **disclose** for the area of provisions:

- a reconciliation showing
  - o the carrying amount at the beginning and end of the period;
  - o additions during the period, including adjustments that result from changes in measuring the discounted amount;
  - o amounts charged against the provision during the period;
  - o unused amounts reversed during the period;
- a brief description of the nature of the obligation and the expected amount and timing of any resulting payments;
- an indication of the uncertainties about the amount or timing of those outflows;
- the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

3.1.8 Borrowing Costs

As **borrowing costs** we understand interest and other costs that an entity incurs in connection with the borrowing of funds. They include interest expense calculated using the effective interest method, finance charges in respect of finance leases, and exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
According to [19] borrowing costs are considered as an **expense in the period in which they are incurred**.

3.2 Financial Statements

The main aim of SMEs financial statements has to be providing of the information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
According to [19], a complete set of financial statements of an entity shall include all of the following:

- **a statement of financial position as at the reporting date;**
- either:
  - o **a single statement of comprehensive income** for the reporting period displaying all items of income and expense recognized during the period including those items recognized in determining profit or loss (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income, or
  - o **a separate income statement and a separate statement of comprehensive income**. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with profit or loss and then displays the items of other comprehensive income.
- **a statement of changes in equity for the reporting period**;
- **a statement of cash flows for the reporting period**;
- **notes**, comprising a summary of significant accounting policies and other explanatory information.

3.2.1 Statement of Financial Position (Balance Sheet)

IFRS for SMEs provides only minimum requirements for the items presented within the statement of financial position. It is expected to present at least the following amounts:

- cash and cash equivalents;
- trade and other receivables;
- financial assets;
- inventories;
- property, plant and equipment;
- investment property carried at fair value through profit or loss;
- intangible assets;
- biological assets carried at cost less accumulated depreciation and impairment;
- biological assets carried at fair value through profit or loss;
- investments in associates;
- investments in jointly controlled entities;
- trade and other payables;
- financial liabilities;
- liabilities and assets for current tax;
- deferred tax liabilities and deferred tax assets;
- provisions;
- non-controlling interest, presented within equity separately from the equity attributable to the owners of the parent;
- equity attributable to the owners of the parent.

The **example of this Statement** provided by IASB [20] is shown below:

Item	**Note No.**	**Currency unit**	
		20X2	**20X1**
ASSETS			
Current assets • Cash • Trade and other receivables • Inventories • ***Current assets (total)***			
Non-current assets • Investment in associate • Property, plant and equipment • Intangible assets • Deferred tax asset • ***Non-current assets (total)***			
TOTAL ASSETS			
LIABILITIES AND EQUITY			
Current liabilities • Bank overdraft • Trade payables • Interest payable • Current tax liability • Provision for warranty obligations • Current portion of employee benefit obligations • Current portion of obligations under finance leases • *Current liabilities (total)*			
Non-current liabilities • Bank loan			

• Long-term employee benefit obligations • Obligations under finance leases • *Non-current liabilities (total)*			
Total liabilities			
Equity • Share capital • Retained earnings • ***Equity (total)***			
TOTAL LIABILITIES AND EQUITY			

3.2.2 Statement of Comprehensive Income and Retained Earnings

Company has to present within its ***Statement of Comprehensive Income and Retained Earnings*** at least the following items:

- revenue.
- finance costs.
- share of the profit or loss of investments in associates and jointly controlled entities accounted for using the equity method.
- tax expense
- a single amount comprising the total of
    - the post-tax profit or loss of a discontinued operation, and
    - the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation.
- profit or loss
- each item of other comprehensive income
- share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.
- total comprehensive income
- profit or loss for the period attributable to
    - non-controlling interest.
    - owners of the parent.
- total comprehensive income for the period attributable to
    - non-controlling interest.
    - owners of the parent.
- retained earnings at the beginning of the reporting period.
- dividends declared and paid or payable during the period.
- restatements of retained earnings for corrections of prior period errors.
- restatements of retained earnings for changes in accounting policy.
- retained earnings at the end of the reporting period.

IFRS for SMEs provides an example [20] of this Statement for the classification of costs and expenses by nature as well as by function.

Classification of Expenses by Nature

Item	**Note No.**	**Currency unit**	
		20X2	**20X1**
Revenue			
Other income			
Changes in inventories of finished goods and work in progress			
Raw material and consumables used			
Employee salaries and benefits			
Depreciation and amortization expense			
Impairment of property, plant and equipment			
Other expenses			

Finance costs			
Profit before tax			
Income tax expense			
Profit for the year			
Retained earnings as start of year			
Dividends			
Retained earnings at end of year			

Classification of Expenses by Function

Item	**Note No.**	**Currency unit**	
		20X2	**20X1**
Revenue			
Cost of sales			
Gross profit			
Other income			
Distribution costs			
Administrative expenses			
Other expenses			
Finance costs			
Profit before tax			
Income tax expense			
Profit for the year			
Retained earnings as start of year			
Dividends			
Retained earnings at end of year			

3.2.3 Cash Flow Statement

It is well known myth that the SME owners believe that ~~profit~~ really ~~means money~~. However because of applying accrual basis in double-entry bookkeeping, it is a fiction. Therefore it is vital for the owners to have information about the increase/decrease of money within a separate statement.

There are two methods for preparation of cash flow statement; (i) direct method, (ii) indirect method.

Indirect method is possible to use for analysis of operating activities, all other activities (i.e. financing activities and investing activities) has to be analyzed throughout direct method.

Examples of the activities are following:

- ***operating activities***
  - cash receipts from the sale of goods and the rendering of services;
  - cash receipts from royalties, fees, commissions and other revenue;
  - cash payments to suppliers for goods and services;
  - cash payments to and on behalf of employees;
  - cash payments or refunds of income tax;
  - cash receipts and payments from investments, loans and other contracts held for dealing or trading purposes;
- ***investing activities***
  - cash payments to acquire property, plant and equipment, intangible assets and other long-term assets;
  - cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
  - cash payments to acquire equity or debt instruments of other entities and interests in joint ventures;
  - cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures;
  - cash advances and loans made to other parties;
  - cash receipts from the repayment of advances and loans made to other parties;

  - cash payments for financial derivatives, except when the contracts are held for dealing or trading, or the payments are classified as financing activities;
  - cash receipts from financial derivatives, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities;
- ***financing activities***
  - cash proceeds from issuing shares or other equity instruments;
  - cash payments to owners to acquire or redeem the entity's shares;
  - cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
  - cash repayments of amounts borrowed;
  - cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

IFRS for SMEs provides an example [20] of Cash Flow Statement, when applying the indirect method:

Item	**Note No.**	**Currency unit**	
		20X2	**20X1**
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit for the year			
Adjustments for non-cash income and expenses: • Non-cash finance costs • Non-cash income tax expense • Depreciation of property, plant and equipment • Impairment loss • Amortisation of intangibles			
Cash flow included in investing activities: • Gain on sale of equipment			
Changes in operating assets and liabilities: • Decrease (increase) in trade and other receivables • Decrease (increase) in inventories • Increase (decrease) in trade payables • Increase in current and long-term employee benefit payable			
Net cash from operating activities			
CASH FLOW FROM INVESTING ACTIVITIES			
Proceeds from sale of equipment			
Purchases of equipment			
Net cash used in investing activities			
CASH FLOWS FROM FINANCING ACTIVITIES			
Payment of finance lease liabilities			
Repayment of borrowings			
Dividends paid			
Net cash used in financing activities			
Net increase (decrease) in cash and cash equivalents			
Cash and cash equivalents at beginning of year			
Cash and cash equivalents at end of year			

3.3 Concluding Remarks

According to the results of research [29] there could be stated that SMEs, which are not obliged to prepare financial statements according to IFRS, are not interested in IFRS. It is probably due to the fact that these companies concentrate mainly on the current state, the question of their future development (in unspecified future) is not so important for them. It is also due to disadvantageous proportion between the expenses invested and the revenues obtained.

IFRS information can help SMEs involved in buying or selling goods or services across national borders to initiate new relationships with customers and suppliers. As the spread and acceptance of IFRS grows internationally, so does the importance of IFRS financial statements as a tool to cultivate a positive image. It is

not only large foreign groups that now demand financial statements from SMEs as part of the process of supplier selection and evaluation.
Many parent companies currently require their foreign subsidiaries to adjust individual financial statements to conform to the nation GAAP of one country. This can reduce financial reporting effectiveness and add costs to the group reporting process because the national peculiarities of those standards are likely to need further explanation at the subsidiary level.
Special standards would require SMEs to change their opinion on high-quality accounting in general, where instead of stressing correct accounting procedures and methods, the emphasis is placed on the presentation of results - financial statement. A stress upon the final product of accounting, statements, requires understanding of the consequences and relationships among transactions and their reflection in accounting, because no set rules will be available any more. All this requests for increased demands upon qualification of professional accountants and upon change in their accounting thinking.
Strength of SMEs (small and smaller medium enterprises in particular) consists in their higher flexibility and to a certain point also in their innovative creativity. The standard offers an opportunity for entities without public accountability to adopt a reporting framework that nay lighten their reporting burden, if permitted by local regulation. Furthermore, it could facilitate an internationally recognized common reporting language for entities that meet the definition of an SME as set out in the standard.
Apart from the accounting differences between IFRS for SMEs and full IFRS (and local GAAPs), there are many other issues that an entity must take into account before adopting IFRS for SMEs. The considerations often relate to qualitative factors, and require management's judgments to be exercised before the conclusion can be reached that IFRS for SMEs is the preferred route for the reporting entity.
Having financial information that is universally understood and comparable to other companies' information can improve relationships with customers, suppliers, investors and bankers. If these business partners have more confidence in the financial information being provided using IFRS, this can be a crucial factor in securing a new supplier, obtaining finance, reducing the cost of borrowing, and arriving at an acquisition or cooperation agreement.

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Financial Reporting in the Czech Republic

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Czech Republic. Due to the globalization of business and international harmonization of financial reporting also Czech Republic experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Czech Republic

Country
Czech Republic
(Česká republika)
Location
Central Europe
Area
78,867 km^2
Population
10,201,707 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
koruna (CZK); 25.295 CZK/EUR (as at 31.12.2010)

1 Country Introduction

Czech Republic is country situated in Central Europe and comprises three historical lands: Bohemia (western part), Moravia (South-eastern part) and Silesia (north-eastern part). It borders Germany to the west and northwest, Austria to the south, Poland to the northeast and Slovakia to the east.

The Czech state (historically "Lands of the Bohemian Crown") was formed in 9th century. The greatest territorial extent was reached by Přemyslid and Luxembourg dynasties in 13th and 14th century. As a Golden Age of Czech history is considered the 14th century, particularly the reign of Charles IV. (1342 – 1378). At that time was founded Charles University in Prague (1348) and Prague was the capital of Holy Roman Empire. After the Battle of Mohács (1526) Bohemian Kingdom became a part of Habsburg monarchy as one of its three principal parts alongside Austria and Hungary [16].

After World War I was formed Republic of Czechoslovakia in 1918. In 1948 coup d'état, Czechoslovakia became a communist-ruled country. Despite of the attempts to reform the communist regime in late 60s (Prague Spring of 1968 – ended with an invasion by the armies of the Warsaw Pact countries excluding Romania), it lasted until Velvet Revolution in November 1989. Four years later Czechoslovakia was peacefully divided into Czech Republic and Slovakia.

Czech Republic is a member of European Union since 1st May 2004 (from 2007 part of Schengen area) and member of NATO since 1999. From 1st January 2009 until 30th June 2009 Czech Republic held the Presidency of the Council of the European Union. Czech GDP growth was about 6 % until the outbreak of the financial crisis in 2008. The Czech Republic was the first former Comecon member reaching the status of developed country according to the World Bank.

The leading industries in the Czech Republic are mechanical engineering, petrochemical industry, food industry and metallurgical engineering. The most famous companies are ***Škoda Auto*** (part of VW group, one of the largest car manufacturers in Central Europe), ***Budějovický Budvar*** (state-owned brewery), ***ČEZ Group*** (energy producer) and ***Bat'a*** (shoemaker).
Despite Czech Republic is economically better positioned than other E.U. members to adopt EURO currency, according the current draft of the **EURO adoption plan omits giving any date** (historically the plans were to adopt EURO in 2010, respectively 2012).

2 Legal System

2.1 Business Law

The business law is treated by several acts, among which has been stated at least the following ones:

- Commercial Code
- Civil Code
- Financial Securities Act
- Act on Capital Markets Entrepreneurship

The types of business entities are defined within Commercial Code. They could be divided onto following two groups:

- **personnel companies**
  - partnership
  - partnership in commandite
- **capital companies**
  - limited liability company
  - joint-stock company

Partnership (veřejná obchodní společnost) is the first type of personnel business entities. It could be established by at least two persons who are fully responsible for the liabilities of this company. Statutory organ of this company is one or more partners of this company.
Certain combination between personnel and capital business companies is **Partnership in commandite (komanditní společnost)**. It could be established by at least two persons, from which at least one shall be a limited partner and at least one shall be an active partner. Limited partner (komanditista) has to pay a contribution to registered capital (at least 5,000 CZK), however the minimum range of the whole registered capital is not defined within a Commercial Code. Limited partner is responsible for the liabilities company only in range to his not-paid contribution. Active partner (komplementář) behaves as a partner in partnership, i.e. is fully responsible for the liabilities of the company. Profit of this company is linearly divided between the group of active partners and the group of limited partners.
First type of capital business companies is **Limited Liability Company (Ltd., společnost s ručením omezeným)**. It is a most typical legal form of business in the Czech Republic. It could be established by 1 up to 50 partners who are responsible for the liabilities of this company only in range to their not-paid contribution. The minimum amount of contribution is 20,000 CZK and the minimum amount of registered capital is 200,000 CZK. Before the registration of the company to Commercial Register has to be paid all non-monetary contributions, additional paid in capital and at least 30 % of each monetary contribution (the sum of paid monetary contributions has to be at least 100,000 CZK).
Between the organs of the company shall be stated: (i) *general assembly* (the highest organ), (ii) *agent(s)* (executive organ), and (iii) *supervisory board* (supervising organ).
Second type of capital business companies is **Joint-Stock Company (JSC, akciová společnost)**. It could be established by at least one legal entity, or two and more persons. The minimum amount or registered capital is 2,000,000 CZK in general or 20,000,000 CZK in case of public offer of shares. Obvious nominal value of share is 1,000 CZK. Shares could be issued as (i) registered share, or (ii) unregistered (anonymous) shares. Issuing of anonymous shares is possible only in three countries in the world.
Between the organs of the company shall be stated: (i) *general assembly* (the highest organ), (ii) *board of management* (executive organ), and (iii) *supervisory board* (supervising organ).

Another important issue is listing of securities. Opening capital markets to international investors brought significant benefits in knowledge spillovers for the financial sector, improvements in domestic accounting, prudential supervision standards and portfolio and risk management.
Since September 1, 1995, the Prague Stock Exchange in the Czech Republic has provided trading in three markets. The Main and Secondary markets have emerged from the original Listed market, and the Free market comprises the former Unlisted market. The whole process of the market segmentation was primarily motivated by the Exchange's efforts to clearly profile two basic groups of securities. Minimum capital requirements, quality of issue and commitment of the issuing company to provide regularly financial information and promptly report corporate actions are the basic criteria for assignment of an issue to a particular market.
The Czech Republic realized an extensive liberalization of capital movements by the Foreign Exchange Law of 1995 when joining the OECD. Further liberalization measures were taken in 1998 in the area of financial credits and guarantees, issuing of foreign securities on the Czech market, operations in money market instruments and derivatives and currency purchased abroad by residents.

2.2 Accounting Law

Accounting is treated by separate Act from the year 1992. Current accounting legislation in the Czech Republic is following:

- **general legislation**
    - Accounting Act (563/1991)
    - Decree of Ministry of Finance for entrepreneurs (500/2002)
    - Czech Accounting Standards for entrepreneurs
- **other legislation**
    - Decree of Ministry of Finance for financial institutions (501/2002)
    - Czech Accounting Standards for financial institutions
    - Income Tax Act (586/1992)
    - Act on Provisions (593/1992)
    - Commercial Code (513/1991)
    - interpretations of National Accounting Board (not legally binding) [15]

Accounting Act defines as an **accounting entity** following subjects:

- all legal entities based in the Czech Republic
- foreign entities carrying their business in the Czech Republic
- organization unit of state
- physical entities in case they are registered in the Business Register
- physical entities with the turnover higher than 25,000,000 CZK
- other physical entities, voluntarily leading the accounting books instead of simplified tax evidence

As an accounting period is understand calendar year or fiscal year. In case that the company will decide to change its accounting period for fiscal year, it has to inform the tax authority.
Presentation currency is **Czech crown (CZK)**. During the year companies can choose among the fixed exchange rate or they apply the spot exchange rate to convert the foreign currency onto crowns within their accounting books. Upon the balance sheet day there is an obligation to use the exchange rate of Czech National Bank.

There are applied following measurement bases in Czech accounting:

- cost (C)
- replacement cost (RC)
- own costs (OC)
- nominal value (NV)
- fair value (FV)

Following table summarizes the use of the measurement bases upon initial recognition and upon subsequent measurement [9]:

Balance Sheet Item	Initial Recognition	Subsequent Measurement
Intangibles	C, RC, OC	net value, or LCM model
Depreciated Tangibles	C, RC, OC	net value, or LCM model
Non-depreciated Tangibles	C, RC, OC	LCM model
Shares – controlling influence	C (RC)	equity method
Shares – substantial influence	C (RC)	equity method
Other securities	C, RC	FV
Purchased inventories	C, RC	LCM model
Own inventories	OC	
Receivables	NV, C	LCM model or FV (for derivatives)
Cash and equivalents	NV	
Securities held for trading	C, RC	FV
Registered capital	NV	
Issued bonds	NV	
Liabilities	NV	NV or FV (for derivatives)

The Decree of the Ministry of Finance provides an Illustrative Chart of Accounts. The accounts are divided onto following ten classes:

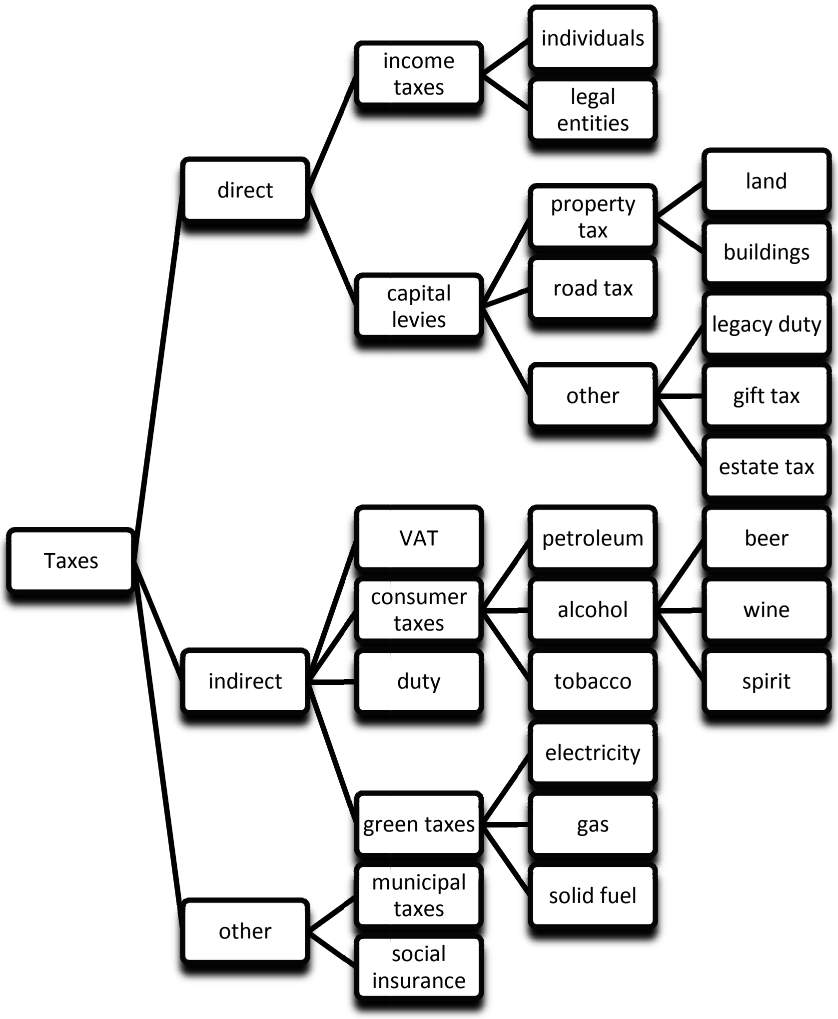
0	Fixed assets
1	Inventories
2	Short-term financial assets and short-term financial liabilities
3	Receivables and short-term liabilities
4	Equity and long-term liabilities
5	Costs and expenses
6	Revenues
7	Closing accounts, off-balance sheet accounts
8+9	Internal bookkeeping

2.3 Tax Law

According to Czech tax system, we can identify three groups of taxes there:

- direct taxes;
- indirect taxes; and
- other taxes.

Following scheme shows the full range of taxes applied in the Czech Republic:



Source: [9]

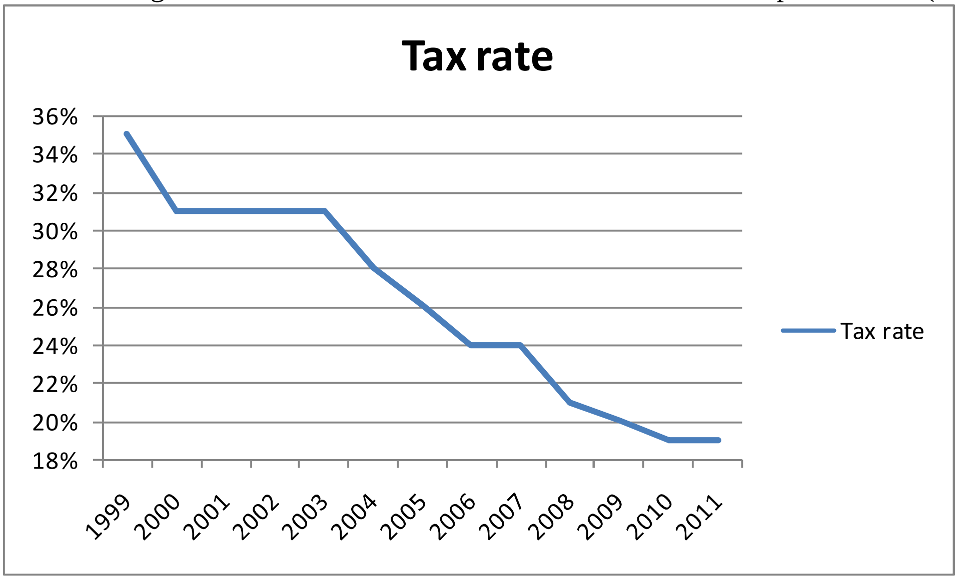
Value added tax (VAT) is treated by VAT Act, which was harmonized to the requirements of 6th E.U. Directive. Currently there are valid following rates:

- basic rate (20 %)
- reduced rate (10 %)

Due to the reform of pension system, there is expected that from **2012** on all goods and services will be applied the **basic rate**, with the exception of seven basic consumables (bread, milk, potatoes, selected vegetable, selected fishes, milk-based baby foods, dietary consumables).

All companies have to pay their income tax based on Income Tax Act. Current rate of income tax for companies is 19 %.

The following illustration shows the rate of income tax within the period 1999 (35 %) to 2011 (19 %):



Calculation of the tax is based on the accounting profit. The adjustments of accounting profit to reach the tax base are following:

	Revenues
-	Costs and expenses
=	Accounting profit before tax
+	Tax ineffective costs and expenses • travel allowances higher than the limit defined in Labour Code • representation costs • other social expenses • donations • penalties • shortage of stocks (exceeding the compensation), • calculation of provisions not based on Act on Provisions • calculation of impairment not based on Act on Provisions • positive difference between accounting and tax depreciation (amortization)
-	Tax ineffective revenues • uncollected penalties
=	Tax base I
-	Loss from previous years
=	Tax base II
-	Donations • minimum amount of 1 donation = 2,000 CZK, • maximum amount of all donations = 5 % of Tax base II
-	Other deduction based on Income Tax Act
=	Tax base
	Rounded tax base (on thousands of CZK lower)
*	***Tax rate (19 %)***
=	Income tax of the company
-	Tax allowances
=	**FINAL INCOME TAX OF THE COMPANY**

2.4 SME Issues in the Czech Republic

SME is a main destination to majority of employees (see Table 2). In the Czech Republic SMEs participate in employment with 61.52 % and in accounting value added with 54.57 %. SMEs represent 99.83 % of the total number of active business entities in the country. Table 1 provides an evidence of the SMEs evolution.

Table 1. Evolution of SMEs (1998 – 2008) [0-249 employees]

	Legal ent.	**Physical ent.**	**TOTAL**		**Book value added (mil CZK)**	**Turnover (mil CZK)**
1998	104 561	636 061	740 622		635 498	1 985 356
1999	103 679	650 128	753 807		656 378	1 996 885
2000	108 398	635 735	744 133		682 387	2 128 238
2001	111 298	634 829	746 127		720 493	2 287 962
2002	147 236	823 974	971 210		778 556	2 417 367
2003	144 311	844 386	988 697		898 360	2 654 246
2004	143 994	858 051	1 002 045		964 759	2 945 419
2005	156 583	839 118	995 701		1 027 717	3 154 579
2006	178 860	820 612	999 472		1 185 225	3 680 034
2007	195 359	839 120	1 034 479		1 278 723	3 951 875
2008	201 044	834 477	1 035 521		1 303 200	4 034 880

Source: [14]

Table 2. Number of Employees (in thousands; 1998-2008)

1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
1 948	1 870	1 830	1 848	1 947	1 910	1 904	1 924	1 983	2 033	2 061

Source: [13, 14]

3 Evolution of Accounting after 1989

Until 1918 was Czech lands part of Austrian monarchy and it was applied the Austrian accounting legislature. The requirements on preparation of balance sheet were based on *General Austrian Land Code* from 1798. *General Commercial Code* was adopted in 1862 requiring the preparation of balance sheet on yearly basis. It is an interesting fact that this Code was valid even in Czechoslovakia until 1948. In 1964 was adopted new *Commercial Code* mentioning the requirement that accounting has to follow the long-term state development planning. Seven years later was issued the *Act on Unified System of Socioeconomic Information* where was mentioned what shall be included within the information system. It was necessary to cover the information from accounting, budgeting, calculation, statistics, and operational evidence [9].
After the revolution was adopted in 1990 *Act on Enterprise* requiring from entrepreneurs leading of accounting and providing of information about income, expenditures, accounting profit, assets and liabilities. Entrepreneurs could lead at that time single- or double-entry bookkeeping.

The most important day for Czech accounting was 12.12.1991 when was adopted ***Accounting Act*** (593/1991) with validity from 1992. From that time this act was more than 20times amended [9]. The case of the Czech Republic is interesting through the choice made in 1991 referring to building the national accounting system based on the French model, even though the cultural semblance and linguistic closeness criteria did not characterize, during that period, the relationship between France and the Czech Republic [4]. The arguments for this choice are similar following:

- the intention of creating a certain frontier for the German great economic interest in the Czech economy; even though the German model caught the Czechs' attention;
- English model didn't have enough credibility because of its' dispersion and because of some scandals which were publicly presented;
- American model seemed to be complicated and difficult to implement; and
- the aim of the Czech Republic to integrate within the E.U. (majority of E.U. countries use the French model).

The evolution of Czech financial reporting may be divided just to two major stages. The pre-harmonisation period lasted from 1993 until 2001. The Czech accounting at the very beginning adopts the E.U. directives, having horizontal balance sheet and vertical income statement (expenses very divided just by nature). At that time there was a predominance of cost model as a major measurement basis and it was impossible to use fair values for revaluation purposes.
The second stage (2002 – 2004) shall be named as harmonisation period, as the Czech Republic finally joined the European Union in 2004. At that time was firstly introduced the fair value approach. This measurement basis was allowed to use for certain financial instruments (financial derivatives, financial assets held for trading or available for sale). From the year 2004 it is granted by Czech Accounting Act, that the listed companies shall present their financial statements based on IFRSs.
On the other hand reporting of non-listed companies still differs from IFRSs. It is not allowed to use present value concept as a measurement base for long-term financial securities or long-term financial instruments (i.e. receivables, liabilities). As upon IFRS companies have to apply for reporting of financial leases the substance over form rule, upon Czech accounting rules it is still the lessor who reports the object of financial lease.

3.1 Period 1992 – 2001

Within this period it was possible to apply either double-entry or single-entry accounting. The only possible accounting period was calendar year; fiscal year was not allowed as an alternative.
The law defined the following mandatory parts of the Financial Statements:

- Balance Sheet,
- Profit and Loss Statement, and
- Notes.

Notes contained information about valuation, depreciation and accounting methods and procedures applied during the accounting period and, last but not least, information necessary for the due assessment of the status of assets and liabilities, financial standing and profit/loss of the accounting entity. Mandatory audit was required for businesses that generated a net turnover exceeding 40,000,000 CZK and whose net assets exceeded 20,000,000 CZK.
As a possible measurement bases were applied: cost (purchase cost, replacement cost, own cost) and nominal value.

3.2 Period 2002 – 2004

Within this period it was possible to apply either double-entry or single-entry accounting. From 2002 was allowed to opt between the calendar and fiscal year. However it was quite difficult to apply for use of fiscal year at the tax authority. For the very first time it was mentioned within the accounting legislature that the financial statements shall follow true and fair view. True and fair are all accounting postings based on Accounting Act.
The law defined the following mandatory parts of the Financial Statements:

- Balance Sheet,
- Profit and Loss Statement, and
- Notes.

As a voluntary part of Notes were stated:

- Cash Flow Statement, and
- Statement of Changes in Equity.

Within this period has been changed the requirement on audit of financial statements. Audit was obligatory in case that:

- net assets exceeded 40,000,000 CZK,
- turnover exceeded 80,000,000 CZK, and
- number of employees exceeded 50.

PLC companies have to meet 2 criteria, JSC companies just one criterion.

In 2002 was firstly mentioned fair value as a possible measurement base. It was understood as a: (i) market value, or (ii) a value determined by a qualified evaluator in case that market value is not available.
Upon balance sheet day shall be revaluated at fair value:

- derivatives;

- selected securities;
- assets and liabilities hedged by derivatives.

3.3 Period 2004 – 2011

In 1st May 2004 Czech Republic joined European Union. From 2005 all listed companies have obligation to prepare their financial statements under International Financial Reporting Standards frameworks. However IFRS are still not considered as a tax base in the Czech Republic, and therefore listed companies have to translate the IFRS accounting profit onto Czech accounting profit, what leads to higher administrative burden. Within this period were made only particular changes in accounting rules, which could not be considered as significant ones.

To summarize the current stage of accounting legislature, there shall be stated following ***"open chapters"***:

- absolute lack of definition of basic items of financial statements
  - there does not exist any definition of assets, liabilities, equity, expenses or revenues
- application of "substance-over-form" rule when reporting the financial leases (see part 4.3)
- introduction of effective interest rate and amortized costs as a possible measurement base
- wider spread of fair value approach
  - depends on the liquidity and transparency of markets

4 Reporting Issues

Czech accounting is based on **historical costs approach** with strong application of **prudence principle**. As a major source of accounting legislature for the reporting can be considered Czech Accounting Standards. They were adopted in 2003 and currently the following ones are still in force:

CAS 001	General principles of accounting
CAS 002	Opening and closing of accounting books
CAS 003	Deferred tax
CAS 004	Provisions
CAS 005	Impairment
CAS 006	Exchange rate differences
CAS 007	Stocktaking differences
CAS 008	Financial securities
CAS 009	Financial derivatives
CAS 011	Business combinations
CAS 012	Changes in equity
CAS 013	Fixed intangible and tangible assets
CAS 014	Fixed financial assets
CAS 015	Inventories
CAS 016	Short term financial assets and short-term bank loans
CAS 017	Receivables and payables
CAS 018	Capital accounts and long-term liabilities
CAS 019	Costs, expenses and revenues
CAS 020	Consolidation
CAS 021	Bankruptcy issues
CAS 022	Inventory of assets and liabilities upon transfer of assets from state to another business unit
CAS 023	Cash Flow Statement

4.1 Intangible Assets

Accounting for intangible assets complies with CAS 013. As intangibles upon Czech accounting regulation are understood:

- incorporation expenses,
- research and development,
- software,

- valuable rights,
- goodwill,
- other intangible assets (e.g. emission rights).

Based on *Income Tax Act*, the minimum amount for recognition of the asset as intangible is *60,000 CZK*. Assets with lower cost shall be directly posted to costs.

Upon initial recognition intangible asset is measured at **cost**. Upon balance sheet day intangible asset is measured at **cost less accumulated amortization and accumulated impairment losses**.

The Income Tax Act mentions the obvious length of amortization period (it is expected to use straight-line amortization method):

incorporation expenses	5 years
research and development	3 years
software	3 years
valuable rights	6 years
goodwill	5 years

4.2 Tangible Assets

Accounting for tangibles complies with CAS 013. As tangibles upon Czech accounting regulation are understood:

- land,
- property,
- movables,
- perennial crops,
- animals,
- investment properties.

Based on *Income Tax Act*, the minimum amount for recognition of the asset as tangible is *40,000 CZK*. Assets with lower cost shall be directly posted to costs.

Upon initial recognition tangible asset is measured at **cost**. Upon balance sheet day tangible asset is measured at **cost less accumulated amortization and accumulated impairment losses**.

With the exemption of land and artworks all other tangible assets shall be depreciated. From 2009 it is possible to apply (but it is not obligatory) the **residual value** when calculating the depreciation base. From 2010 is also possible (but again not obligatory) to apply **component approach**.

Income Tax Act divides the tangibles onto six groups and states how long shall be each group depreciated:

Group 1	3 years
Group 2	5 years
Group 3	10 years
Group 4	20 years
Group 5	30 years
Group 6	50 years

For the calculation of tax depreciation it is possible to use two methods:

- ***linear***

$$depreciation = cost \times rate\ of\ depreciation \qquad (1)$$

The rates for the linear depreciation are following (in %):

Group	1st year	Other years
1	20.00	40.00
2	11.00	22.25
3	5.50	10.50
4	2.15	5.15
5	1.40	3.40
6	1.02	2.02

- ***degressive***

$$depreciation_{1st\ year} = \frac{cost}{coefficient} \qquad (2)$$

$$depreciation_{other\ years} = \frac{2 \times (cost - accumulated\ depreciation)}{coefficient - number\ of\ years, when\ was\ the\ asset\ already\ depreciated} \qquad (3)$$

The coefficients for the degressive depreciation are following (in %):

Group	1st year	Other years
1	3	4
2	5	6
3	10	11
4	20	21
5	30	31
6	50	51

The does not exist a special treatment for **investment properties**, therefore they are treated as standard tangible assets and measured at cost (upon initial recognition) and at cost less accumulated depreciation and impairment losses (upon balance sheet day).

4.3 Leases

Leases could be divided onto two major groups: (i) finance leases, and (ii) operational leases. Obviously the financial lease is recognize when there are transferred all the risks and rewards incidental to ownership. Operational leases are considered as leases of the object of the lease on short-term basis and it is expected that after the period of the lease the object will be given back to the leasing company. The accounting treatment of operational leases is very same like under IFRS for SMEs. Lessees shall recognize lease payments as an expense on a straight-line basis.

Financial leases are considered as leases of the object of the lease on long-term basis. The accounting treatment of the financial leases in the Czech Republic is totally different from international approach, where is applied “substance-over-form” rule. Lessor is the one who recognize the object of the financial lease as a tangible assets and it is allowed to depreciate it.
Lessee is just allowed to recognize lease payments as an expense on a straight-line basis. However it shall be also fulfilled following criteria:

- the length of financial lease shall be at least
  - 3 years for tangibles which are part of depreciation group 1,
  - 4.5 years for tangibles which are part of depreciation group 2,
  - 9.5 years for tangibles which are part of depreciation group 3,
  - 30 years for properties;
- the purchase price after the end of financial lease should not be higher than net price of the financial lease under straight-line depreciation;
- after the period of financial lease the object of the lease will be transferred from lessor to lessee.

When the object of the lease is transferred from lessor to lessee, lessee shall recognize this item at replacement cost.

4.4 Financial Assets

Accounting for **financial assets** complies with CAS 008, CAS 009 and CAS 014. As financial assets upon Czech accounting regulation are understood:

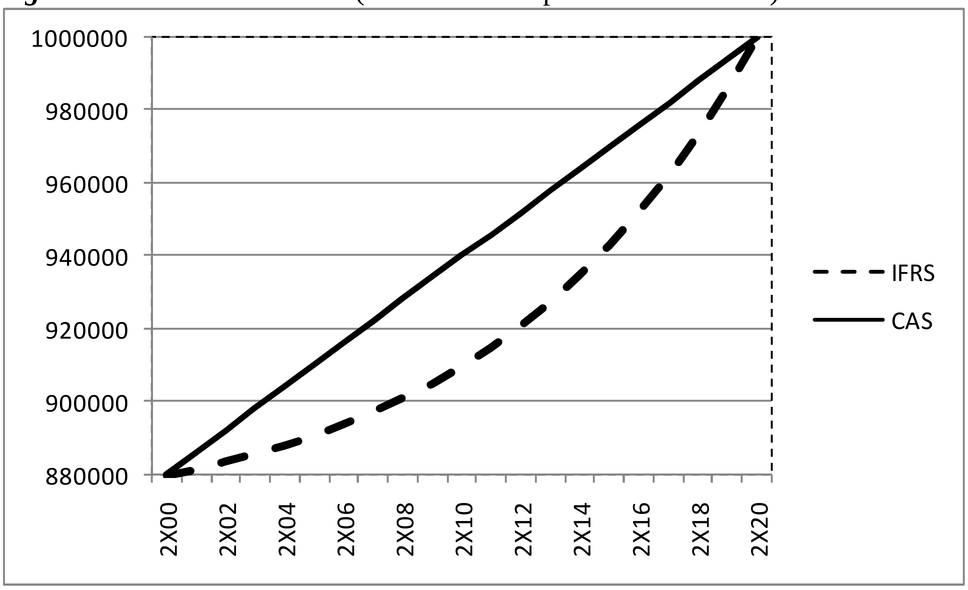
- shares,
- bonds,
- other financial securities,
- loans,
- financial derivatives.

Upon initial recognition financial asset is measured at **cost**.
Shares shall be revaluated upon balance sheet day using following principles:

- ***shares – substantial or higher influence (20 %⁺)***
    - o equity method; revaluation through revaluation fund
- ***shares – marginal influence (20 %⁻)***
    - o fair value; revaluation through revaluation fund
- ***realizable shares***
    - o fair value; revaluation through revaluation fund
    - o in case that there is an indication that the decrease of fair value is permanent, in such case the revaluation is done through P/L
- ***shares for trading***
    - o fair value; revaluation through P/L

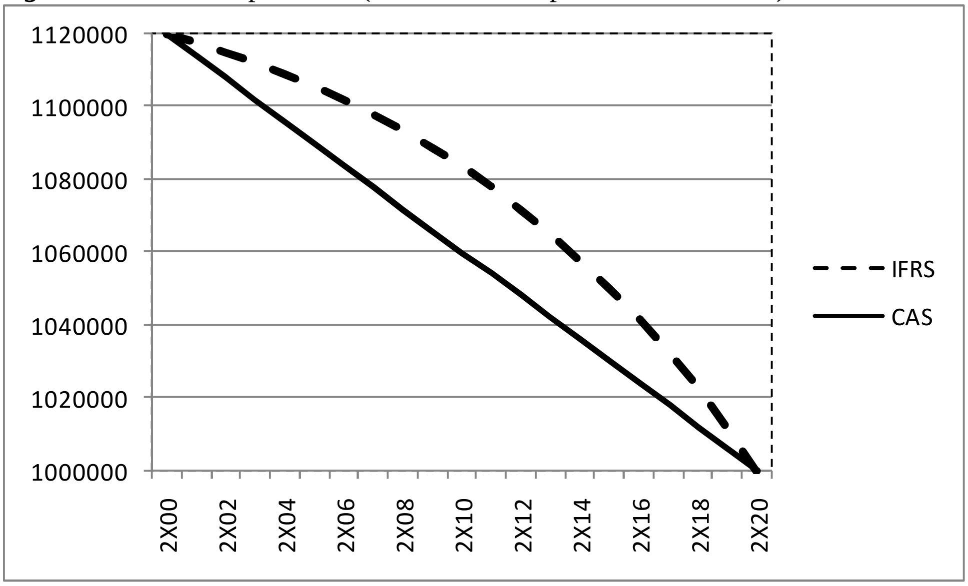
The amortization of discounts and premiums of bonds is on straight-line basis and it is not applied the effective interest rate approach [8]. The following figures (Figure 1 and Figure 2) provides an illustration of difference in measurement of bonds under Czech accounting regulations (straight-line division of the differences) and under IFRS (application of effective interest rate).

Figure 1. Bond with discount (measurement upon CAS and IFRS)



Source: own analysis

Figure 2. Bond with premium (measurement upon CAS and IFRS)



Source: own analysis

In case bonds are recognized as bonds available for sale, they are measured at fair value through revaluation fund. Bonds for trading are measured at fair value through P/L.

Financial derivatives are measured upon balance sheet day at fair value, generally through P/L. In case that the accounting unit applies hedge accounting, it is possible to revaluate financial derivatives through revaluation fund for cash-flow hedges and hedge of net foreign investments.

4.5 Receivables

Accounting for **receivables** complies with CAS 017. Receivables are measured at nominal values apart they are long- or short-term.
The impairment of accounts receivable is treated in Act on Provisions [7]. The tax solution of impairment of accounts receivable is following:

Receivable after due date	**Impairment**
6 months	20 % of nominal value
12 months	33 % of nominal value
18 months	50 % of nominal value
24 months	66 % of nominal value
30 months	80 % of nominal value
36 months	100 % of nominal value

Receivables in foreign currency shall be translated using spot rate of Czech National Bank or fixed rate of accounting unit. Upon balance sheet day all receivables shall be recalculated using Czech National Bank and all exchange rate differences shall be posted throughout P/L.

4.6 Inventories

Accounting for **inventories** complies with CAS 015. Inventories are current assets consumed by an entity during one year or within one operating cycle for generating revenues. Usually, we distinguish between inventory purchased and processed production. At the time of acquisition, the value of inventories is measured by the historical costs (acquisition price for purchased inventories), replacement price (for inventories obtained gratuitously) and production costs (for processed production). For the measurement of the value of inventory decrement, the same cost formula should be used for all inventories with similar characteristics as to their nature and use to the enterprise. For groups of inventories that have different characteristics, different cost formulas may be justified, including FIFO, the weighted average cost formula, the fixed inventory price with independent disclosure of variations or the actual acquisition price. Accounting entities are entitled to choose from the continuous inventory system (method A) and the periodic inventory system (method B) for inventory records. In the continuous inventory system, accounting entities record inventories via account groups Materials, Processed Production and Goods and allocate inventory decrement to costs (Raw Materials, Resale of Raw Materials, Consumables and Purchased Finished Goods) or to income adjustments (group Change in Inventory (Stocks)). In the periodic inventory system, accounting entities record the purchased inventories in the relevant costs accounts and during the accounting period do not even use balance-sheet entries such as Inventory of Materials and Consumables or Inventory Purchased for Resale – In Storage. Instead, as of the balance day, the accounting entity transfers the initial status of the balance-sheet entries into costs and based on the stock-taking results transfers from the costs the final status of purchased inventories into the balance sheet. Inventories must be accounted for in compliance with the prudence principle as of the balance day, meaning that the accounting entity must record the inventories with their book value or with their lower present market value.

4.7 Cash and Equivalents

Accounting for **short-term financial assets** complies with CAS 016. Short-term financial assets are included among the current assets of the company. We distinguish between cash in hand, cash at bank and short-term securities. Cash items are measured at their nominal value, while short-term securities are measured at costs. Short-term securities are upon balance sheet day measured at fair value; however it should be stated that it is quite difficult to measure the fair values of shares because of not very transparent stock exchange in the Czech Republic (Prague Stock Exchange).
Credits and financial assistance should be measured at their nominal value.

4.8 Equity

Accounting for **equity** complies with CAS 012 and CAS 018. As part of equity upon Czech accounting regulation are understood:

- ***registered capital***
    - minimum amount for PLC is 200,000 CZK
    - minimum amount for JSC is 2,000,000 CZK (without any public offer of shares), or 20,000,000 CZK (public offer of shares)
- ***capital funds***
    - share premium
    - capital fund
    - revaluation fund
- ***reserves and other funds***
    - reserve fund
        - for PLC – at least 10 % of registered capital
        - for JSC – at least 20 % of registered capital
    - statutory fund
    - other funds (e.g. social fund)
- ***profit/loss from previous years***
    - retained earnings
    - accumulated losses
- ***profit/loss of current accounting period***

All equity items are measured at **nominal values**.

4.9 Provisions

Accounting for **provisions** complies with CAS 004. Provisions are aimed to cover future expenses or liabilities, whose purpose is known and which are expected to occur, but whose timing or amount is uncertain. However, provisions may not be used to adjust the value of assets. Provisions may be used only for the purpose for which they have been originally recognized. Logically, a provision may only be used to the maximum amount in which it was created; and a provision may not have a debit balance. Accounting entities are obliged to review provisions entered in the books at the end of the accounting period. If it is discovered that the reason for which the provision has been created has lapsed, the provision should be dissolved in its full extent. If it is discovered that the provision is for a different sum than it is due, it should be adjusted. In the balance sheet, provisions should be accounted for under liabilities.

The ***Accounting Act*** defines the following types of provisions:

- provisions for risks and losses,
- provisions for income tax,
- provisions for pensions and similar obligations,
- provision for restructuring,
- technical provisions, or
- other provisions pursuant to special legal regulations (statutory provisions).

The ***Act on Provision*** stipulates three types of provisions for enterprises:

- provision for repairs of tangible assets,
- provision for cultivation of crops,
- other provisions (for the removal of mud from a pond, for the redevelopment of plots affected by mining, for the settlement of mine damage or provisions stipulated by special laws as costs required to achieve, ensure or maintain revenues).

The **provision for repairs of tangible assets** is very popular among Czech companies. This provision is calculated on straight-line basis. It is necessary to create this provision at least for two accounting periods. The maximum length of creation is given by the Act on Provisions:

Depreciation group	**Maximal length**
Group 2	3 years
Group 3	6 years
Group 4	8 years
Groups 5 and 6	10 years

However this provision is prohibited under IFRS for SMEs.

Even in case that the company applies the component depreciation; still it is possible for this accounting unit to create a provision for repair of certain component of that tangible asset [6, 11].

4.10Liabilities

Accounting for **liabilities** complies with CAS 017 and CAS 018. Liabilities are measured at nominal values apart they are long- or short-term.

Liabilities in foreign currency shall be translated using spot rate of Czech National Bank or fixed rate of accounting unit. Upon balance sheet day all liabilities shall be recalculated using Czech National Bank and all exchange rate differences shall be posted throughout P/L.

Finally we would like to stress the attention on calculation of the ***salaries***:

	Gross salary
-	Social insurance (6.5 %)
-	Health insurance (4.5 %)
-	Income tax
+	Sick benefit
=	**Net salary**

The calculation of income tax is based on “grand-gross” salary approach:

	Gross salary
+	Social insurance – to be paid by company (25 %)
+	Health insurance – to be paid by company (9 %)
=	Tax base
*	Income tax rate (15 %)
=	Income tax (before tax discounts)
-	Tax discounts
=	***Income tax***

5 Official Forms of Financial Statements

According to Czech Accounting Act there are following financial statements which are obligatory to prepare for all accounting units:

- **Balance Sheet** (form is provided within Appendix 1 of the Decree of MF)
- **P/L Statement**
    - division by costs and expenses by nature (form is provided within Appendix 2 of the Decree of MF)
    - division by costs and expenses by function (form is provided within Appendix 3 of the Decree of MF)
- **Notes**

Companies also may (but they are not obliged) prepare:

- **Cash Flow Statement** (form for indirect method is provided within Czech Accounting Standard 023 – Cash Flow Statement)
- **Statement of Changes in Equity** (official form does not exist)

It is interesting that even audited companies are not obliged to prepare cash flow statement, nor statement of changes in equity. However, it is a common practice that they prepare those statements voluntarily.

5.1 Balance Sheet

The official form of **Balance Sheet** is based on the 4th EU Directive horizontal form. There could be stressed an attention to following anomalies:

- deferred items are not a part of current assets, resp. current liabilities
- long-term receivables are part of current assets

Minimum compulsory information under Decree 500/2002 of MF CR

BALANCE SHEET
(full form)

as at __.__.201__

(in thousands CZK)

CIN

Accounting entity

Address of accounting entity

Item			ASSETS	Row	Current accounting period			Previous acc. period
					Gross	Correction	Net	Net
a			b	No.	1	2	3	4
			TOTAL OF ASSETS (r. 02 + 03 + 31 + 63)	001				
A.			Receivables from subscriptions	002				
B.			**Fixed assets (r. 04 + 13 + 23)**	003				
B.	I.		**Intangible assets (r. 05 ... 12)**	004				
B.	I.	1	Incorporation expenses	005				
		2	Research and development	006				
		3	Software	007				
		4	Valuable rights	008				
		5	Goodwill	009				
		6	Other intangible assets	010				
		7	Intangible assets under construction	011				
		8	Advance payments for intangible assets	012				
B.	II.		**Tangible assets (r. 14 ... 22)**	013				
B.	II.	1	Land	014				
		2	Property	015				
		3	Movables	016				
		4	Perennial crops	017				
		5	Animals	018				
		6	Other tangible assets	019				
		7	Tangible assets under construction	020				
		8	Advance payments for tangible assets	021				
		9	Revaluation difference to acquired assets	022				
B.	III.		**Long-term financial assets (r. 24 ... 30)**	023				
B.	III.	1	Shares in controlled and managed entities	024				
		2	Shares in accounting entities with substantial influence	025				
		3	Other financial securities	026				
		4	Loans to controlled and managed entities and to entities with substantial influence	027				
		5	Other long-term financial assets	028				
		6	Long-term financial assets acquired	029				
		7	Advance payments for long-term financial assets	030				

Item a	ASSETS b	Row c	Current accounting period Gross 1	Correction 2	Net 3	Previous acc. period Net 4
C.	**Current assets (r. 32 + 39 + 48 + 58)**	031				
C. I.	**Inventory (r. 33 ... 38)**	032				
C. I. 1	Material	033				
2	Work-in-progress and semi-products	034				
3	Own production	035				
4	Animals	036				
5	Goods	037				
6	Advance payments for inventories	038				
C. II.	**Long-term receivables (r. 40 ... 47)**	039				
C. II. 1	Trade receivables	040				
2	Receivables from controlled and managed entities	041				
3	Receivables from accounting entities with substantial influence	042				
4	Receivables from partners, cooperative members and associate members	043				
5	Long-term deposits given	044				
6	Estimated receivables	045				
7	Other receivables	046				
8	Deferred tax receivables	047				
C. III.	**Short-term receivables (r. 49 ... 57)**	048				
C. III. 1	Trade receivables	049				
2	Receivables from controlled and managed entities	050				
3	Receivables from accounting entities with substantial influence	051				
4	Receivables from partners, cooperative members and associate members	052				
5	Social and health insurance (receivables)	053				
6	Tax receivables	054				
7	Short-term deposits given	055				
8	Estimated receivables	056				
9	Other receivables	057				
C. IV.	**Short-term financial assets (r. 59 ... 62)**	058				
C. IV. 1	Cash	059				
2	Bank accounts	060				
3	Short-term securities and ownership interests	061				
4	Short-term financial assets acquired	062				
D. I.	**Accruals and deferrals (r. 64 ... 66)**	063				
D. I. 1	Deferred expenses	064				
2	Complex deferred expenses	065				
3	Deferred income	066				

Item a			EQUITY AND LIABILITIES b	Row c	Current acc. period 5	Previous acc. period 6
			TOTAL OF EQUITY AND LIABILITIES (r. 68 + 86 + 119)	067		
A.			**Equity (r. 69 + 73 + 79 + 82 + 85)**	068		
A.	I.		**Registered capital (r. 70 ... 72)**	069		
		1	Registered capital	070		
		2	Own shares and ownership's interest (-)	071		
		3	Changes in registered capital	072		
A.	II.		**Capital funds (r. 74 ... 78)**	073		
A.	II.	1	Share premium	074		
		2	Other capital funds	075		
		3	Revaluation fund	076		
		4	Revaluation fund from mergers and acquisitions	077		
		5	Differences from revaluations of mergers and acquisitions	078		
A.	III.		**Reserves and other funds (r. 80 + 81)**	079		
A.	III.	1	Reserve fund	080		
		2	Statutory and other funds	081		
A.	IV.		**Profit/loss from previous accounting periods (r. 83 + 84)**	082		
A.	IV.	1	Retained earnings from previous accounting periods	083		
		2	Accumulated losses from previous accounting periods	084		
A.	V.		**Profit/loss of current accounting period (+/-)** **(r. 01 - (+ 69 + 73 + 79 + 82 + 86 + 119))**	085		
B.			**Liabilities (r. 87 + 92 + 103 + 115)**	086		
B.	I.		**Provisions (r. 88 ... 91)**	087		
B.	I.	1	Provisions under special statutory regulations	088		
		2	Provisions for pensions and similar payables	089		
		3	Income tax provision	090		
		4	Other provisions	091		
B.	II.		**Long-term payables (r. 93 ... 102)**	092		
B.	II.	1	Trade payables	093		
		2	Payables to controlled and managed entities	094		
		3	Payables to accounting entities with substantial influence	095		
		4	Payables to partners, cooperative members and associate members	096		
		5	Long-term advances received	097		
		6	Issued bonds	098		
		7	Issued long-term bills of exchange	099		
		8	Estimated payables	100		
		9	Other payables	101		
		10	Deferred tax liabilities	102		

Item a			EQUITY AND LIABILITIES b	Row c	Current acc. period 5	Previous acc. period 6
B.	III.		**Short-term payables (r. 104 ... 114)**	103		
B.	III.	1	Trade payables	104		
		2	Payables to controlled and managed accounting entities	105		
		3	Payables to accounting entities with substantial influence	106		
		4	Payables to partners, cooperative members and associate members	107		
		5	Payroll	108		
		6	Social and health insurance	109		
		7	State - tax liabilities and government grants	110		
		8	Short-term deposits received	111		
		9	Issued bonds	112		
		10	Estimated payables	113		
		11	Other payables	114		
B.	IV.		**Bank loans and financial assistance (r. 116 ... 118)**	115		
B.	IV.	1	Long-term bank loans	116		
		2	Short-term bank loans	117		
		3	Short-term financial assistance	118		
C.	I.		**Accruals and deferrals (r. 120 + 121)**	119		
C.	I.	1	Accrued expenses	120		
		2	Deferred revenues	121		

Legal form of accounting entity:	
Core business of accounting entity:	

Date of issue	Person in charge of preparation of accounting entity's financial statements (signature)	Statutory body of accounting entity (signature)

5.2 Profit/Loss Statement

Official form of **P/L Statement** is derived from the vertical form offered by 4th EU Directive. Company may opt between the division of costs and expenses by nature or by function. In case that there is prepared P/L Statement based on functional division, company is obliged to present the division of costs and expenses by nature within notes.

There could be stressed an attention to following differences from international referential:

- change in own production and capitalization as a part of revenues, because of the application of German model for this area
- presentation of extraordinary operations

5.2.1 P/L Statement – division by nature

Minimum compulsory information under Decree 500/2002 of MF CR (division of costs+expenses by nature)

PROFIT / LOSS STATEMENT

as at __.__.201__

(in thousands CZK)

CIN

Accounting entity

Address of accounting entity

Item		TEXT	Row No.	Accounting period	
				current	previous
a		b	c	1	2
I.		Revenues from sold goods	01		
A.		Costs of the goods sold	02		
+		**Sales margin (r. 01 - 02)**	03		
II.		**Production (r. 05 + 06 + 07)**	04		
II.	1	Revenues from sold products and services	05		
	2	Change in own inventories	06		
	3	Capitalization	07		
B.		**Production consumption (r. 09 + 10)**	08		
B.	1	Consumption of material and energy	09		
B.	2	Services	10		
+		**Value added (r. 03 + 04 - 08)**	11		
C.		**Personnel expenses**	12		
C.	1	Wages and salaries	13		
C.	2	Remunerations of board members	14		
C.	3	Social and health insurance	15		
C.	4	Social expenses	16		
D.		Taxes and fees	17		
E.		Amortization and depreciation	18		
III.		**Revenues from sold fixed assets and material (r. 20 + 21)**	19		
III.	1	Revenues from sold intangible and tangible assets	20		
	2	Revenues from sold material	21		
F.		**Net value of sold fixed assets and material (r. 23 + 24)**	22		
F.	1	Net value of sold intangible and tangible assets	23		
F.	2	Sold material	24		
G.		Change in operating provisions and impairments and complex deferred expenses	25		
IV.		Other operating revenues	26		
H.		Other operating expenses	27		
V.		Transfer of operating revenues	28		
I.		Transfer of operating expenses	29		
*		**Profit/Loss from operating activities (r. 11 - 12 - 17 - 18 + 19 - 22 - 25 + 26 - 27 +(-28) - (-29))**	30		

Item		TEXT	Row	Accounting period	
			No.	current	previous
a		b	c	1	2
VI		Revenues from sold financial assets	31		
J.		Financial assets sold	32		
VII.		**Revenues from long-term financial assets (r. 34 + 35 + 36)**	33		
VII.	1	Revenues from shares in controlled and managed entities and in accounting entities with substantial influence	34		
VII.	2	Revenues from other securities and ownership interests	35		
VII.	3	Revenues from other long-term financial assets	36		
VIII.		Revenues from short-term financial assets	37		
K.		Expenses associated with financial assets	38		
IX.		Revenues from revaluation of securities and derivatives	39		
L.		Expenses associated with revaluation of securities and derivatives	40		
M.		Change in financial provisions and impairments	41		
X.		Interests received	42		
N.		Interests paid	43		
XI.		Other financial revenues	44		
O.		Other financial expenses	45		
XII.		Transfer of financial revenues	46		
P.		Transfer of financial expenses	47		
*		**Profit/Loss from financial operations (r. 31 - 32 + 33 + 37 - 38 + 39 - 40 - 41 + 42 - 43 + 44 - 45 -(-46) +(-47))**	48		
Q.		**Income tax on ordinary income (r. 50 + 51)**	49		
Q.	1	- due	50		
Q.	2	- deferred	51		
**		**Profit/Loss from ordinary activities (r. 30 + 48 - 49)**	52		
XIII.		Extraordinary revenues	53		
R.		Extraordinary expenses	54		
S.		**Income tax on extraordinary income (r. 56 + 57)**	55		
S.	1	- due	56		
S.	2	- deferred	57		
*		**Profit/Loss from extraordinary activities (r. 53 - 54 -55)**	58		
T.		Transfer of share on profit/loss to partners (+/-)	59		
***		**Profit/Loss of current accounting period (+/-) (r. 52 + 58 - 59)**	60		
****		**Earnings before taxes (+/-) (r. 30 + 48 + 53 - 54)**	61		

Legal form of accounting entity:	
Core business of accounting entity:	

Date of issue	Person in charge of preparation of accounting entity's financial statements (signature)	Statutory body of accounting entity (signature)

5.2.2 P/L Statement – functional division

Minimum compulsory information under Decree 500/2002 of MF CR (division of costs+expenses by function)

PROFIT / LOSS STATEMENT
as at __.__.201__
(in thousands CZK)

CIN

Accounting entity

Address of accounting entity

Item	TEXT	Row No.	Accounting period current	Accounting period previous
a	b	c	1	2
I.	Revenues from sold products, goods and services	01		
A.	Costs of sales	02		
*	**Gross profit or loss (r. 01 - 02)**	03		
B.	Distribution costs	04		
C.	Administrative overheads	05		
II.	Other operating revenues	06		
D.	Other operating expenses	07		
*	**Profit/Loss from operating activities (r. 03 - 04 - 05 + 06 - 07)**	08		
III.	Revenues from sold financial assets	09		
E.	Financial assets sold	10		
IV.	**Revenues from long-term financial assets (r. 12 + 13 + 14)**	11		
IV. 1	Revenues from shares in controlled and managed entities and in accounting entities with substantial influence	12		
IV. 2	Revenues from other securities and ownership interests	13		
IV. 3	Revenues from other long-term financial assets	14		
V.	Revenues from short-term financial assets	15		
F.	Expenses associated with financial assets	16		
VI.	Revenues from revaluation of securities and derivatives	17		
G.	Expenses associated with revaluation of securities and derivatives	18		
H.	Change in financial provisions and impairments	19		
VII.	Interests received	20		
I.	Interests paid	21		
VIII.	Other financial revenues	22		
J.	Other financial expenses	23		
IX.	Transfer of financial revenues	24		
K.	Transfer of financial expenses	25		
*	**Profit/Loss from financial operations (r. 09 - 10 + 11 + 15 - 16 + 17 - 18 - 19 + 20 - 21 + 22 - 23 -(-24) +(-25))**	26		
L.	**Income tax on ordinary income (r. 28 + 29)**	27		
L. 1	- due	28		
L. 2	- deferred	29		
**	**Profit/Loss from ordinary activities (r. 08 + 26 - 27)**	30		
X.	Extraordinary revenues	31		
M.	Extraordinary expenses	32		
N.	**Income tax on extraordinary income (r. 34 + 35)**	33		
N. 1	- due	34		
N. 2	- deferred	35		
*	**Profit/Loss from extraordinary activities (r. 31 - 32 -33)**	36		
O.	Transfer of share on profit/loss to partners (+/-)	37		
***	**Profit/Loss of current accounting period (+/-) (r. 30 + 36 - 37)**	38		
****	**Earnings before taxes (+/-) (r. 08 + 26 + 31 - 32)**	39		

Legal form of accounting entity:	
Core business of accounting entity:	

Date of issue	Person in charge of preparation of accounting entity's financial statements (signature)	Statutory body of accounting entity (signature)

5.3 Cash Flow Statement

Minimum compulsory information under Decree 500/2002 of MF CR and Czech Accounting Standard No. 023

CASH FLOW STATEMENT

as at __.__.201__

(in thousands CZK)

CIN

Accounting entity

Address of accounting entity

Item	TEXT	Current accounting period
P.	**Balance of cash and cash equivalents at the beginning of accounting period**	
	Cash-flow from operating activities	
Z.	Accounting profit or loss from ordinary activities before taxes	
A.1	Adjustments by noncash operations	
A.1.1	Depreciation and amortization of fixed assets (+) without net value of sold fixed assets	
A.1.2	Change in provisions and impairments (+/-)	
A.1.3	Profit/loss from sold fixed assets (-/+)	
A.1.4	Dividends received (+)	
A.1.5	Interests paid (+) and interests received (-)	
A.1.6	Adjustments by other noncash operations	
A. *	**Net cash flow from operating activities before taxation, changes of working capital and extraordinary items (Z + A.1)**	
A. 2	Change in working capital	
A. 2. 1	Change in receivables from operating activities (-/+)	
A. 2. 2	Change in short-term payables from operating activities (+/-)	
A. 2. 3	Change in inventories (-/+)	
A. 2. 4	Change in short-term financial assets not included in cash and equivalents (-/+)	
A. **	**Net cash flow from operating activities before taxation and extraordinary items (A* + A.2)**	
A. 3	Interests paid (-)	
A. 4	Interests received (+)	
A. 5	Income tax from ordinary activities paid	
A. 6	Extraordinary income	
A. 7	Dividends received (+)	
A. ***	**Net cash flow from operating activities (A** + A.3 + A.4 + A.5 + A.6 + A.7)**	
	Cash-flow from investment activities	
B. 1	Purchased fixed assets (-)	
B. 2	Income from sold fixed assets (+)	
B. 3	Loans and credits to related parties	
B. ***	**Net cash flow from investment activities**	
	Cash-flow from financing activities	
C. 1	Change in long-term payables, or short-term payables from financial activities (e.g. loans)	
C. 2	Impact of equity on cash and cash equivalents	
C. 2. 1	Increase in cash and cash equivalents as a result of increase in registered capital, share premium, or reserve funds, including deposits made for such increase (+)	
C. 2. 2	Shares in equity paid to partners (-)	
C. 2. 3	Ohter contributions of cash of partners and shareholders	
C. 2. 4	Coverage of loss by partners (+)	
C. 2. 5	Direct payments to funds (-)	
C. 2. 6	Dividends paid, including withholding tax to such claims and including financial settlements with partners in public company and general partners in commandite (-)	
C. ***	**Net cash flow from financing activities**	
F.	**Net increase or decrease in cash (A*** + B*** + C***)**	
R.	**Balance of cash and cash equivalents at the end of accounting period**	

Legal form of accounting entity:	
Core business of accounting entity:	

Date of issue	Person in charge of preparation of accounting entity's financial statements (signature)	Statutory body of accounting entity (signature)

6 Major Differences from IFRS for SMEs

Within the following text we will discuss the major differences between Czech accounting practices and the IFRS for SMEs. In general there could be stated, that there is commonly used the historical costs approach rather than fair value accounting [2, 3, 5, 10].
The absolute lack of definition of all accounting elements has to be mentioned as a crucial problem of Czech accounting.

Intangible assets
There could be stated that there are any significant differences from the measurement point of view. Like under IFRS for SMEs there are used costs upon initial recognition and costs less accumulated amortization and impairment losses upon balance sheet day. Useful life of intangibles in the Czech Republic is given by the Income Tax Act and there is expected that accounting unit will use the linear method of amortization.
However under Czech legislation there are considered as intangibles incorporation expenses and research, which are not recognized as assets under international referential.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Tangible assets
There could be stated that there are any significant differences from the measurement point of view for the category known under IFRS for SMEs as “Property, plant and equipment”. Like under IFRS for SMEs there are used costs upon initial recognition and costs less accumulated depreciation and impairment losses upon balance sheet day.
Investment properties do not form a special category under Czech accounting regulation. Therefore there are used the very same rules like for any other tangible assets. This leads to the recognition of the difference from IFRS for SMEs, where is applied the fair value approach.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Leases
There are any significant differences for reporting of operational leases.
The treatment of financial leases is totally different when applying Czech and international rules. Under Czech accounting regulation there is not applied “substance-over-form” rule and it is the lessor who recognizes the object of financial lease and depreciates it. Lessee is allowed just to post the rental payments as an expense of the period; however the rental payments have to be on straight-line basis due to the requirements of Income Tax Act.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Financial assets
Financial assets are measured upon initial recognition at cost. Upon balance sheet day there could be applied equity method or fair value approach for shares, and fair value approach for derivatives.
Czech accounting however does not apply the amortized costs (or present values) as a measurement base. The division of bonds discounts or premiums shall be therefore straight-line based and the effective interest rate is not applied.
The hedge accounting criteria are based on IAS 39 Financial instruments: recognition and measurement. The treatment of fair value hedge and cash flow hedge is very same like under “big set” of IFRS.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Receivables
Receivables are measured at nominal values and it does not matter whether they are long- or short-term based. The amortized costs (or present values) as well as the effective interest rate are not applied.
The deferred items are presented separately on balance sheet and not as a part of receivables. Long-term receivables are reporting as a part of current assets on balance sheet.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Inventories
The treatment of inventories fully complies with IFRS for SMEs and there could not be seen any significant differences.

However, the requirements on disclosed information are not specified in detail within Czech accounting legislature.

Cash and equivalents
The treatment of cash and equivalents fully complies with IFRS for SMEs and there could not be seen any significant differences.
However, the requirements on disclosed information are not specified in detail within Czech accounting legislature.

Equity
All parts of equity are measured at nominal values. The time value of money is not applied upon Czech accounting legislature. Statement of changes in equity is voluntary-based financial statement.
However, the requirements on disclosed information are not specified in detail within Czech accounting legislature.

Provisions
Provisions are measured at nominal values. The time value of money is not applied upon Czech accounting legislature.
The most popular provision in the Czech Republic, i.e. the provision on repair of tangible assets, is strictly prohibited under IFRS for SMEs.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

Liabilities
Liabilities are measured at nominal values and it does not matter whether they are long- or short-term based.
The amortized costs (or present values) as well as the effective interest rate are not applied.
The deferred items are presented separately on balance sheet and not as a part of liabilities.
The requirements on disclosed information are not specified in detail within Czech accounting legislature.

7 Sample Case

ACCOUNTANT Ltd started its business in the Czech Republic in November 2010. The core business of the company is sale of goods as well as professional consulting.
The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 20 %).
For the simplicity of postings there will be used "MU" (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

Initial Balance Sheet

Balance Sheet as at 1st November 2010			
Bank account	145,000	Registered capital	145,000
Incorporation expenses	5,000	Short-term loans	5,000
ASSETS	**150,000**	**EQUITY+LIABILITIES**	**150,000**

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses
- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study

Fixed Assets and Financial Leases
Accounting and tax amortization of incorporate expenses:

$$monthly\ amortization = \frac{5{,}000}{60} = 83.3 \equiv 84$$

Accounting depreciation of computer:

$$monthly\ depreciation = \frac{2{,}000}{36} = 55.56 \equiv 56$$

Tax depreciation of computer:

$$depreciation\ 2010 = \frac{2{,}000 \times 20}{100} = 400$$

Calculation of deferred tax

Year	Net value (accounting)	Net value (taxes)	Difference	Tax rate	Deferred tax liability
2010	1,888	1,600	288	0.19	55

Op.	Text	Amount			Account
1	Purchase of computer	2,000	Dr		Movables
		400	Dr		VAT
		2,400		Cr	Trade payables
2	Depreciation of computer (2 months)	112	Dr		E – Depreciation
		112		Cr	Movables (Ac. depreciation)
3	Calculation of deferred tax	55	Dr		E – Income Tax (deferred)
		55		Cr	Deferred Tax Liability
4	Amortization of incorporate expenses (2 months)	168	Dr		E – Depreciation (Amortization)
		168		Cr	Incorp. Expenses (Ac. amort.)
5	1st installment of financial lease	350	Dr		E – Services
		70	Dr		VAT
		420		Cr	Bank account

Inventories

Op.	pieces			Cost	MU		
	+	-	Δ		+	-	Δ
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5,700			37,500	44,850
4	3,300		9,000	9.00	29,700		74,550
5		3,600	5,400			28,050	46,500
6		2,400	3,000			19,500	27,000

$$op.3 \rightarrow issue\ \#1 = 5{,}000 \times 7.50 = 37{,}500$$
$$op.5 \rightarrow issue\ \#2 = 1{,}500 \times 7.50 + 2{,}100 \times 8.00 = 28{,}050$$
$$op.6 \rightarrow issue\ \#3 = 2{,}100 \times 8.00 + 300 \times 9.00 = 19{,}500$$

Op.	Text	Amount			Account
1	Purchase of goods (6,500 @ 7.50 MU)	48,750	Dr		Goods
		9,750	Dr		VAT
		58,500		Cr	Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600	Dr		Goods
		6,720	Dr		VAT
		40,320		Cr	Bank account
3a	Sale of goods (5,000 @ 12.00 MU)	60,000		Cr	R – Sold goods
		12,000		Cr	VAT
		72,000	Dr		Trade receivables
3b	Goods issue	37,500	Dr		E – Sold goods
		37,500		Cr	Goods
4	Purchase of goods (3,300 @ 9.00 MU)	29,700	Dr		Goods
		5,940	Dr		VAT
		35,640		Cr	Bank account
5a	Sale of goods (3,600 @ 12.00 MU)	43,200		Cr	R – Sold goods
		8,640		Cr	VAT
		51,840	Dr		Trade receivables
5b	Goods issue	28,050	Dr		E – Sold goods
		28,050		Cr	Goods
6a	Sale of goods (2,400 @ 12.00 MU)	28,800		Cr	R – Sold goods
		5,760		Cr	VAT
		34,560	Dr		Trade receivables
6b	Goods issue	19,500	Dr		E – Sold goods
		19,500		Cr	Goods
7	Calculation of impairment	4,500	Dr		E – Impairment
		4,500		Cr	Goods (impairment)

Receivables and payables

Op.	Text	Amount			Account
1	Long-term contract (12/2010)	5,000	Dr		Deferred income
		5,000		Cr	R – Sold services

Salaries

Calculation of salary

Gross salary	800
Social insurance (6.5 %)	52
Health insurance (4.5 %)	36
Income tax	78
Net salary	**634**

←

Grand-gross salary	1,072
Tax (15 %)	161
Tax allowance	83
Income tax due	***78***

Social insurance (25 %)	200
Health insurance (9 %)	72

Op.	Text	Amount			Account
Nov1	Gross salary	800	Dr		E – Salaries
		800		Cr	Payroll
Nov2	Social and health insurance (employee)	88	Dr		Payroll
		88		Cr	SHI payables
Nov3	Income tax	78	Dr		Payroll
		78		Cr	Income tax payables
Nov4	Social and health insurance (company)	272	Dr		E – Social insurance
		272		Cr	SHI payables
Nov5	Pay-off	634	Dr		Payroll
		634		Cr	Bank account
Nov6	Payment of insurance	360	Dr		SHI payables
		360		Cr	Bank account
Nov7	Payment of income tax	78	Dr		Income tax payables
		78		Cr	Bank account
Dec1	Gross salary	800	Dr		E – Salaries
		800		Cr	Payroll
Dec2	Social and health insurance (employee)	88	Dr		Payroll
		88		Cr	SHI payables
Dec3	Income tax	78	Dr		Payroll
		78		Cr	Income tax payables
Dec4	Social and health insurance (company)	272	Dr		E – Social insurance
		272		Cr	SHI payables

Other costs and expenses

Op.	Text	Amount			Account
1a	Rental payment (for November 2010)	1,200	Dr		E – Services
		240	Dr		VAT
		1,440		Cr	Bank account
1b	Rental payment (for December 2010)	1,200	Dr		E – Services
		240	Dr		VAT
		1,440		Cr	Bank account
1c	Rental payment (for January 2011)	1,200	Dr		Deferred expenses
		240	Dr		VAT
		1,440		Cr	Bank account

2a	Tax advisory (November 2010)	200 40 240	Dr Dr 	 Cr	E – Services VAT Bank account
2b	Tax advisory (December 2010)	200 40 240	Dr Dr 	 Cr	E – Services VAT Trade payables
3a	Telecommunication services (November 2010)	1,000 200 1,200	Dr Dr 	 Cr	E – Services VAT Bank account
3b	Telecommunication services (December 2010)	1,000 200 1,200	Dr Dr 	 Cr	E – Services VAT Trade payables
4	Road tax	100 100	Dr 	 Cr	E – Road tax Bank account
5	Interests received	920 920	Dr 	 Cr	Bank account R – Interests received
6	Bank charges	5,300 5,300	Dr 	 Cr	E – Financial expenses Bank account

Calculation of corporate income tax

Revenues	137,920
Expenses	102,524
Accounting profit	***35,396***
Tax inefficient expenses: • impairment	 4,500
Tax base	39,896
Corporate income tax (19 %)	**7,580**

Op.	**Text**	**Amount**			**Account**
1	Income tax (due)	7,580 7,580	Dr 	 Cr	E – Income tax (due) Income tax payables

Closing of accounts:

Profit / Loss Account as at 31st December 2010			
Sold goods	85,050	Revenues from sold services	5,000
Services	5,150	Revenues from sold goods	132,000
Salaries	1,600	Interests received	920
Social insurance	544		
Road tax	100		
Depreciation, amortization	280		
Impairment	4,500		
Financial expenses	5,300		
Income tax (due)	7,580		
Income tax (deferred)	55		
EXPENSES	***110,159***	***REVENUES***	***137,920***
Profit	**27,761**		
TOTAL	137,920	TOTAL	137,920

Balance Sheet as at 31st December 2010					
Assets	*Gross*	*Corr*	*Net*	***E+L***	*Net*
Incorporate expenses	5,000	168	4,832	Registered capital	145,000
Movables	2,000	112	1,888	Profit	27,761
Goods	27,000	4,500	22,500	Deferred tax liability	55
Trade receivables	158,400	0	158,400	Trade payables	3,840
Deferred expenses	1,200	0	1,200	Payroll	634
Deferred income	5,000	0	5,000	Soc. and health insurance payable	360
				Corporate income tax payable	7,580
				Income tax payable	78
				VAT	2,320
				Short-term loan	5,000
				Bank overdraft	1,192
TOTAL	**198,600**	**4,780**	**193,820**	**TOTAL**	**193,820**

Ratio analysis

Assets (total)	193,820
EBIT	35,396
EAT	27,761
Equity	172,761
Current assets	187,100
Current liabilities	21,004
Inventories	22,500

Profitability ratios:

$$ROA = \frac{EBIT}{\sum Assets} = \frac{35{,}396}{193{,}820} = \mathbf{18.26}\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{27{,}761}{172{,}761} = \mathbf{16.07}\ \%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{187{,}100}{21{,}004} = \mathbf{8.91}$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{187{,}100 - 22{,}500}{21{,}004} = \mathbf{7.84}$$

8 Dictionary

English	**Czech**
Accelerated Depreciation	zrychlené odpisy
Account	účet
Account Payable	závazky z obchodního styku
Account Receivable	pohledávky z obchodního styku
Accountant	účetní
Accounting	účetnictví
Accounting Change	změna v účetních pravidlech/odhadech
Accounting Policies	účetní pravidla
Accounting Profit	účetní zisk
Accrual Basis	akruální báze
Accumulated Depreciation	oprávky (kumulované odpisy)
Additional Paid in Capital	emisní ážio

Amortization	odepisování, amortizace
Annual Report	výroční zpráva
Annuity	anuita
Asset	aktivum
Auditor	auditor
Auditors’ Report	auditorská zpráva
Available-For-Sale Financial Assets	realizovatelná finanční aktiva
Balance Sheet	rozvaha
Bond	dluhopis
Book Value, Carrying Amount	účetní hodnota
Borrowing Costs	výpůjční náklady
Budget	rozpočet
Business	podnik
Business Combinations	podnikové kombinace
Business Segment	obchodní segment
Capitalized Cost	kapitalizované náklady
Capitalized Interest	kapitalizované úroky
Cash	peněžní prostředky
Cash Basis	peněžní báze
Cash Equivalents	peněžní ekvivalenty
Cash Flows	peněžní toky, cash-flow
Cash-generating Unit	penězotvorná jednotka
Closing Rate	závěrkový kurs
Consistency	konsistence
Consolidated Financial Statements	konsolidovaná účetní závěrka
Consolidation	konsolidace
Contingent Asset	podmíněné aktivum
Contingent Liability	podmíněný závazek
Contingent Rent	podmíněné nájemné
Continuing Operations	pokračující operace
Control	ovládání (kontrola)
Convertible Share	konvertibilní (vyměnitelná) akcie
Cost	pořizovací náklad
Cost Accounting	nákladové účetnictví
Cost Method	metoda pořizovacích nákladů
Costing	kalkulace
Costs of Disposal	náklady prodeje
Credit Risk	úvěrové riziko
Creditor	věřitel
Currency Risk	měnové riziko
Current Asset	oběžné aktivum, krátkodobé aktivum
Current Liability	krátkodobý závazek
Current Tax	splatná daň
Debit	strana Má dáti (Debet)
Debt	dluh
Debt Security	dlužný (dluhový) nástroj
Debtor	dlužník
Deferred Income	odložený příjem (výnos)
Deferred Income Taxes	odložená daň z příjmů
Deferred Tax Assets	odložené daňové pohledávky
Deferred Tax Liabilities	odložené daňové závazky
Depreciable Amount	odepsatelná částka
Depreciation	odpisování

Derecognition	odúčtování
Derivative	derivát
Detection Risk	zjišťovací riziko
Development	vývoj
Direct Costs	přímé náklady
Disclosure	příloha (komentář)
Discontinued Operation	ukončovaná činnost
Discount	diskont
Discount Rate	diskontní sazba
Discounted Cash Flow	diskontované peněžní toky
Dividends	dividendy
Double–Entry Bookkeeping	podvojné účetnictví
Due Date	datum splatnosti (dodací termín)
Earnings Per Share (EPS)	zisk na akcii
Economic Life	ekonomická životnost
Effective Interest Rate	efektivní úroková míra
Equity	vlastní kapitál
Equity Instrument	kapitálový nástroj
Equity Method	ekvivalenční metoda
Equity Securities	kapitálové nástroje
Estimated Tax	odhadovaná daň
Estimation Transactions	odhadované transakce
Events after the Balance Sheet Date	události po rozvahovém dni
Exchange Difference	kursový rozdíl
Exchange Rate	měnový kurs
Expenditure	výdaj
Expense	náklad
External Reporting	externí výkaznictví
Extraordinary Items	mimořádné položky
Factoring	faktoring
Fair Market Value	skutečná tržní hodnota
Fair Value	reálná (řádná) hodnota
Finance Lease	finanční leasing
Financial Asset	finanční aktivum
Financial Institution	finanční instituce
Financial Instrument	finanční nástroj
Financial Liability	finanční závazek
Financial Risk	finanční riziko
Financial Statements	účetní výkazy
Financing Activities	financování (ve výkazu cash flow)
First in, First out (FIFO)	FIFO (metoda ocenění úbytku zásob)
Fiscal Year	hospodářský rok
Fixed Asset	fixní (stálé) aktivum
Forecast	předpověď
Foreign Currency	cizí měna
Fraud	podvod, zpronevěra
Functional Currency	funkční měna
Funding	financování
Future Contract	derivátový kontrakt typu futures
Gain	výnos
General Journal	deník
General Ledger	hlavní kniha
Generally Accepted Accounting Principles	GAAP (všeobecně uznávané účetní zásady)

Going Concern	předpoklad trvání podniku
Goodwill	goodwill
Gross Income	hrubý příjem
Group	skupina
Guaranty	ručení, zástava
Hedge	zajištění
Hedge Effectiveness	účinnost zajištění
Hedged Item	zajištěná položka
Hedging Instrument	zajišťovací nástroj
Held-To-Maturity Investments	finanční investice držené do splatnosti
Highly Probable	vysoce pravděpodobný
Historical Cost	historické (např. pořizovací) náklady
Impairment Loss	ztráta ze snížení hodnoty
Impracticable	neproveditelný
Improvement	zhodnocení
Inception of the Lease	počátek leasingu
Income	příjem
Income Statement	Výkaz zisku a ztráty
Indirect Costs	nepřímé náklady
Initial Direct Costs	počáteční přímé náklady
Installment	splátka
Intangible Asset	nehmotné aktivum
Interest	úrok
Interest Cost	úrokový náklad
Interest Rate Risk	úrokové riziko
Interim Financial Report	mezitímní účetní závěrka
Interim Financial Statements	mezitímní účetní výkazy
Interim Period	mezitímní období
Internal Audit	interní audit
Internal Control	interní kontrola
Internal Rate of Return	vnitřní výnosové procento
International Accounting Standards Board	IASB (Výbor pro mezinárodní účetní standardy)
International Financial Reporting Standards (IFRSs)	Mezinárodní standardy účetního výkaznictví (IFRS)
Intradepartmental Price, Internal Transfer Price	transferová (vnitropodniková, předací) cena
Inventories	zásoby
Investing Activities	investiční činnost
Investment Property	investice do nemovitosti
Investor in a Joint Venture	investor ve společném podnikání
Joint Venture	joint venture (podnik se zahraniční účastí)
Last in, First out (LIFO)	poslední na sklad, první ven (LIFO)
Lease	leasing
Lease Term	doba leasingu
Lessee	nájemce (leasing)
Lessor	pronajimatel (leasing)
Liability	závazek, dluh, cizí kapitál
Liquid Assets	likvidní aktiva
Liquidation	likvidace
Liquidity Risk	likvidní riziko
Loans and Receivables	úvěry a jiné pohledávky
Loans Payable	úvěrové závazky
Long–Term Debt	dlouhodobý závazek (dlouhodobý dluh)
Loss	ztráta
Lower of Cost or Market	metoda nižší ze dvou hodnot (LCM)

Management Accounting	manažerské účetnictví
Margin	přirážka
Market Risk	tržní riziko
Marketable Securities	obchodovatelné finanční instrumenty
Mark–to–Market	odkaz na tržní hodnotu
Master Budget (Company Budget)	hlavní podnikový rozpočet
Materiality	významnost
Matching Principle	princip přiřazení nákladů a výnosů
Merger	fúze
Minority Interest	menšinový podíl
Monetary Assets	peněžní aktiva
Monetary Items	peněžní položky
Net Assets	čistá aktiva
Net Income	čistý výnos
Net Realizable Value	čistá realizovatelná hodnota
Non-cancellable Lease	nevypověditelný leasing
Non-current Asset	dlouhodobé aktivum
Non–for–Profit Organization	nezisková organizace
Notes	Komentář
Notional Value, Face Value	jmenovitá (nominální) hodnota
Objectivity	objektivnost
Obligations	závazky (povinnosti; často ale i dluhopisy)
Onerous Contract	nevýhodná smlouva
Operating Activities	hlavní (provozní) činnost
Operating Cycle	provozní cyklus
Operating Lease	operativní leasing
Option	opce
Other Comprehensive Income	ostatní úplný výsledek
Parent Company	mateřská společnost
Partnership	partnerství
Penalty	pokuta
Plan Costing	plánová kalkulace
Preferred Share	prioritní akcie
Present Value	současná hodnota
Presentation Currency	měna vykazování
Prior Period Errors	chyby minulých období
Probable	pravděpodobný
Profit or Loss	výsledek hospodaření
Property, Plant and Equipment	pozemky, budovy a zařízení
Prospective Application	prospektivní aplikace
Provision	rezerva
Public Offering	veřejná nabídka
Qualifying Asset	způsobilé aktivum
Ratio Analysis	analýza poměrových ukazatelů
Receivables	pohledávky
Reconciliation	sesouhlasení
Recoverable Amount	zpětně získatelná částka
Reinsurance	zajištění (v pojišťovnictví)
Related Party Transaction	operace se spřízněnými stranami
Reorganization	reorganizace
Repairs	opravy
Reporting Date	datum vykázání
Reporting Entity	vykazující jednotka

Repurchase Agreement	repo obchody
Research	výzkum
Reserve	rezervní fond
Residual Value	zbytková hodnota
Responsibility Accounting	odpovědnostní účetnictví
Restructuring	restrukturalizace
Retained Earnings	kumulované výdělky
Return on Investment (ROI)	návratnost investic
Revenue Recognition	rozpoznání (identifikace) výnosu
Revenues	výnosy
Risk Management	risk management
Securitization	sekuritizace
Security	cenný papír
Separate Financial Statements	individuální účetní závěrka
Settlement Method	metoda vypořádání
Share (Stock)	podíl, akcie
Short–Term	krátkodobý
Significant Influence	podstatný vliv
Spot Exchange Rate	okamžitý (spotový) měnový kurs
Start–up Costs	zřizovací výdaje
Statement of Cash Flows	výkaz o peněžních tocích
Statement of Comprehensive Income	Výkaz o úplném výsledku
Statement of Financial Position	Výkaz o finanční situaci
Statement of Changes in Equity	Výkaz změn vlastního kapitálu
Straight–Line Depreciation	rovnoměrné (lineární) odpisování
Subsequent Event	následná událost
Subsidiary	dceřiný podnik
Swap	swap
Tangible Asset	hmotné aktivum
Tax	daň
Tax Base	daňová základna
Tax Expense	daňový náklad
Tax Income	daňový výnos
Tax Loss	daňová ztráta
Tax Year	zdaňovací období
Taxable Income	zdanitelný příjem
Taxable Profit	zdanitelný zisk
Taxpayer Identification Number (TIN)	daňové identifikační číslo (DIČ)
Temporary Differences	přechodné rozdíly
Term Loan	termínovaný úvěr
Total Comprehensive Income	úplný výsledek celkem
Transaction Costs	transakční náklady
Unearned Income	výnos příštího období
Useful Life	doba použitelnosti
Value in Use	hodnota z užívání
Venture Capital	rizikový (spekulační) kapitál
Work in Progress	nedokončená (rozpracovaná) výroba
Working Capital	pracovní kapitál
Yield to Maturity	výnos do doby splatnosti
Zero–Coupon Bond	bezkuponový (diskontovaný) dluhopis

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Financial Reporting in Estonia

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Estonia. Due to the globalization of business and international harmonization of financial reporting also Estonia experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Estonia.

Country
Estonia
(Eesti)
Location
Baltic country (North-Eastern Europe)
Area
45,228 km^2
Population
1,291,170 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
euro (EUR) – since 1st January 2011

1 Country Introduction

Estonia is a country in the Baltic Region of Northern Europe. It is bordered to the north by the Gulf of Finland, to the west by the Baltic Sea, to the south by Latvia (343 km), and to the east by the Russian Federation (338.6 km).

During the last centuries Estonia was occupied by many powerful countries. Its first independence was internationally recognized in 1920, lost in 1940 and recovered in 1991. After the German occupation in 1941–1944, Estonia was incorporated into the Soviet Union. Over this period of time Estonian trade was affected by the planned economy. Substantial industrialization occurred: large plants were built to serve all Union needs. Even though Estonia was a part of the Soviet Union it had an autonomous position. That was the reason why Estonia became easily independent for transition in 1990.

Estonia is among the world's leaders in e-governance and features an impressively transparent system in which government decisions are almost instantly made available on the Internet.
Estonia has a modern market-based economy since the end of 1990s and one of the highest per capita income levels in Eastern Europe. Proximity to the Scandinavian markets, location between the East and West, competitive cost structure and high-skill labor force have been the major Estonian comparative advantages in the beginning of the 2000s. Tallinn as the largest city has emerged as a financial centre and the Tallinn Stock Exchange joined recently with the OMX system. The current government has pursued relatively sound fiscal policies, resulting in balanced budgets and low public debt. Nowadays the most important branches of Estonia's economy are food, construction, and electronic industries. The predecessor of Tallinn Stock Exchange was established in 1920 and liquidated in 1941. In 1995 the Tallinn Stock Exchange was established again and the first transactions started on May 31, 1996. From 2008 Tallinn Stock Exchange is a member of NASDAQ OMX.
Estonia is a member of WTO since November 13, 1999. Estonia became a NATO member state on March 29, 2004 and a European Union member state on May 1, 2004. From January 1, 2011 the currency in Estonia is **euro**.

2 Legal System

According to the classic approach, the Estonian legal system belongs to the **continental European legal** tradition, the Roman-German family, and follows the classic division into private, public, and criminal law. Significantly, however, Estonian law today is increasingly influenced by other legal systems, in common with the legal systems of other developed countries. Additionally, generally recognized principles of international law and binding international treaties form an inseparable part of Estonian law. Judicial precedent, too, serves as an important source of law in Estonia today.
The legal system is based primarily on the **German model**, especially within the field of civil law with which it has direct historical links. The Estonian legal system is subject to international law as well as the European Union law. Consequently, general principles and norms of international law and directly applicable rules of the European Union law form an integral part of the national legal system. The Judiciary is independent in Estonia, and generally free from government influence. The main source of the law is the Constitution adopted by referendum held on 28 June 1992. The Constitution of Estonia is, in a number of ways, a compilation of aspects of Estonia's previous constitutions. It has continued the democratic spirit of the 1920 Constitution, with some added mechanisms to maintain the balance of power of the state. The Constitution stipulates that Estonia is a sovereign democratic republic where the supreme power of the state is vested in the people. The Constitution also includes the principle of a state based on social justice, according to which the state must ensure basic social guarantees such as education, medical assistance, and minimum income. The independence and sovereignty of Estonia are timeless and inalienable. The key principles enshrined in the Constitution include the following: the principle of separation of powers; protection of the rights and freedoms of all people, restricted only in accordance with the Constitution; the principle of legality and equal treatment; prohibition of discrimination; the right to state protection for ensuring compliance with the rights of individuals; the right of recourse to a court of law; freedom of speech and assembly; integrity of the person; the presumption of innocence; inviolability of family life and privacy; protection of national minorities; freedom of enterprise; protection of health; protection of property; freedom of choice of occupation; and other important principles characteristic of a country governed by rule of law.

The court system is divided into three levels: courts of first instance (county and city courts and administrative courts), courts of appeal (circuit courts) and the Supreme Court which also functions as the court of constitutional review. The courts are independent; judges are appointed for life and may not hold any other elected or appointed public offices.
The Supreme Court is the court of highest instance. The Supreme Court has the authority to interpret legal rules and its opinions are taken into account when dealing with similar situations in the future. Reflection of rapid changes and shifting values in society in court judgments also conforms to the spirit of the law. However, the Estonian legal system is formally norm based, not a mixed system of precedent and statutory law. Interpretation of norms is necessary to allow the legal system to keep pace with a rapidly changing modern society. The Constitutional Review Chamber, operating within the Supreme Court and consisting of

the members of the Court, is also a body that enjoys certain independence. The Constitutional Review Chamber deals with legal issues that involve discrepancy with the Constitution.
The division of the court system into three levels is not absolute. Significantly, Estonia is a member of international organizations so that international law forms an integral part of daily legal activities. If, for example, the European Court of Human Rights rules differently on a case than the Estonian Supreme Court, this lays a basis for reopening proceedings so that a judgment earlier pronounced as final may be reviewed and a different conclusion reached.
No judicial review of legislative acts takes place in the country. Estonia being a member of the European Union, the national law in the country needs to comply with the conditions of the Community legislation. Estonia accepts compulsory ICJ jurisdiction, but with reservations.

2.1 Business Law

Estonia is traditionally bounded of codified law, as evidenced by a Commercial Code and an emphasis on legal due process. Prior to September 1, 1995 provisions of the Estonian commercial law were embraced mainly in governmental decrees. The Commercial Code (in Estonian: Äriseadustik) passed by the Riigikogu on February 15, 1995 (came into force on September 1, 1995) considerably amended those principles. The Commercial Code is a codification of business law. The Commercial Code mainly regulates the rights and duties of companies operating in the business environment. It provides for types of companies, along with principles and rules for their operation, as well as rights and duties of management bodies, and other important principles regarding companies.
The following legal forms of business organization are defined in the Estonian Commercial Code:

- ***Public limited liability company*** (in Estonian: aktsiaselts, AS);
- ***Private limited liability company*** (in Estonian: osaühing, OÜ);
- ***Limited partnership*** (in Estonian: usaldusühing);
- ***General partnership*** (in Estonian: täisühing);
- ***Commercial association*** (in Estonian: tulundusühistu);
- ***Sole proprietorship*** (in Estonian: füüsilisest isikust ettevõtja, FIE).

According to Commercial Register the number of business organizations in Estonia on January 1, 2011 was following:

Type of business organization	Total number
Public limited liability company	4,819
Private limited liability company	108,603
Limited partnership	1,505
General partnership	509
Commercial association	609
Sole proprietorship	34,797

The two most common types of companies in Estonia are the public limited company (Aktsiaselts, or AS) and the private limited company (Osaühing, or OÜ).
The main part of the Commercial Code of Estonia is generally in line with the German Commercial Code which contains all commercial affairs.
In addition to the Commercial Code, specific areas of business activity are governed by special norms provided in the Associations Act, Accounting Act, Act on Credit Banks, Insurance Act, Securities Market Act etc.

2.2 Accounting Law

Since 1995 the accounting framework and procedures in Estonian companies and institutions are legally regulated by the following items:

- Estonian Accounting Act;
- Accounting guidelines issued by the Estonian Accounting Standards Board.

Lawyers and financial analysts have had a minor influence on developing accounting rules in Estonia. As a matter of fact financial (statement) analysts as a visible and proper category are missing in Estonia. In principle preparing financial statements and auditing them are understood as separate tasks in Estonia and are expected to be carried out by separate persons or firms independent of each other.

The Accounting Act provided for establishment of the Accounting Board (in Estonian: Raamatupidamise Toimkond) who uses name Estonian Accounting Standards Board (EASB) in English. Its function is to issue accounting guidelines explaining and specifying the Accounting Act. The EASB which consists of seven members is an independent committee whose rules of procedure are approved by the Government upon proposal by the Minister of Finance. With a limited budget and no permanent staff, the EASB operates almost voluntarily. The EASB's guidelines are published in the official online publication of the Republic of Estonia The State Gazette (in Estonian: Riigi Teataja).

The EASB has already re-written most Estonian accounting guidelines and brought them closer to the requirements of IFRSs. The new national guidelines (in Estonian: Raamatupidamise Toimkonna juhendid, RTJ) became effective for accounting periods starting on or after January 1, 2003. The new guidelines are essentially a simplified summary of IFRSs, cross-referenced to corresponding paragraphs in IFRSs standards, and focusing on 18 guidelines (about 200 pages) in areas that are relevant for Estonian small- and medium-sized enterprises (SMEs). Some IFRSs accounting areas are covered only briefly or not at all. In such areas, the IFRSs treatment is recommended, but not mandatory.

2.3 Tax Law

Estonian **taxation system** is considered to be simple and liberal. A basic act for all other tax Acts is Taxation Act. It specifies Estonian tax system, requirements for tax Acts, rights, duties and liability of taxpayers, withholding agents, guarantors and tax authorities, and procedure for resolution of tax disputes and main definitions used in all tax acts. Taxation Act provides precise regulation of carrying out administrative procedures of tax authorities and creates stronger sense of reliability for taxpayers. The tax system of Estonia consists of state taxes provided for by relevant taxation acts and local taxes imposed by a rural municipality or city council in its administrative territory pursuant to law. State taxes are income tax, social tax, land tax, gambling tax, value added tax (VAT), customs duty, excise duties (levied on tobacco, alcohol, electricity, some packaging materials and motor fuel), heavy goods vehicle tax, unemployment insurance contributions and contributions to mandatory funded pension. Local taxes are sales tax, boat tax, advertisement tax, road and street closure tax, motor vehicle tax, animal tax, entertainment tax, and parking charges.

Compared to most European countries, the major difference is that income tax has only one general flat rate.

Corporate income tax is 21%, and there is a monthly unemployment insurance tax of 2.8%, which is deducted from salary by employer. An individual's income is taxable at the rate of 21% as well. The tax does not apply to accumulated undistributed profits. The tax applies to an actual distribution of profits by the company, mainly to a dividend or to gifts and benefits that have been distributed. The tax payable is at the rate of 21/79 of the actual payment (21% of the gross profit).

Estonian resident companies and permanent establishments of the foreign entities (including branches) are subject to income tax only in respect of all distributed profits (both actual and deemed), including:

- corporate profits distributed in the tax period;
- gifts, donations and representation expenses;
- expenses and payments not related to business.

The following taxes are of most importance to an employee: income tax, social insurance, unemployment insurance contributions and contributions to mandatory funded pension.

The standard rate of **VAT** is 20% (increased in 2009 from 18%). Certain supplies attract a reduced rate of 9%, including books, some periodicals, and certain medicines and medical equipment supplies. The provision of accommodation also qualifies for the reduced rate. International services, international transport services and exports are all zero-rated. VAT returns must be submitted monthly and there are severe penalties for late submission of the returns. Exemptions from VAT include insurance, postal services, financial services, health and education.

Social insurance is a financial obligation which is imposed on taxpayers to obtain revenue required for pension insurance and state health insurance. Social insurance contributions are paid by employers and self-employed persons on their business income and by the state for persons who are enumerated in the Social Insurance Act. The rate of **social insurance** in Estonia is 33% of the taxable amount. Social tax is paid by employers on all payments made to employees for salaried work performed, as well as 1.4% unemployment insurance. Social tax is not part of the salary number; it is calculated on the basis of the agreed (gross) salary. 13% of the social tax goes to the Health Insurance Fund and 20% goes to pension insurance.

Estonia has been able to maintain a liberal taxation policy. This has ensured the country's rapid development and economic success. Taxation policy is an important instrument for promoting investment and attracting foreign capital. Taxation rules and regulations in Estonia have less influence on general-purpose financial statements than in most EU Member States. This can have a two-fold impact: (a) reduced incentives to understate reported net income and (b) reduced enforcement of accounting guidelines in SMEs. First, in most EU Member States, the option to use either IFRSs or national accounting standards would require tax authorities to ensure that companies that adopt IFRSs for their legal entity financial statements receive broadly equivalent tax treatment as companies that continue to use national accounting standards. For example, tax authorities would have to ensure that financial statements prepared in accordance with either IFRSs or national accounting standards are an acceptable starting point for computing taxable profits, and ensure specific tax rules continue to allow the special relief and credits, whatever the accounting treatment. Since 2000, the payment of corporate income tax in Estonia is deferred until the moment of distributing the profits, and reinvested profits are not taxable. Therefore, companies in Estonia are less pressured to satisfy the accounting requirements of taxation authorities than in most EU Member States. Second, many EU member states currently have a strong linkage between accounting and taxation. Consequently, tax authorities have traditionally played a significant accounting enforcement role in carrying out tax audits to the point that commercial bankers have often used tax returns more than financial statements in their assessment of SMEs' creditworthiness. Estonian tax rules largely removed the need for tax audits that indirectly contribute to enforcing accounting standards. Hence, compliance with accounting standards in unregulated enterprises merely rests on two pillars (i.e., the auditing profession, if the entity is subject to a statutory audit, and corporate managers, who prepare financial statements). Therefore the weaknesses regarding corporate management and the audit profession are of particular importance to enhance the quality of financial reporting in unregulated enterprises, which account for the larger portion of GDP.

2.4 SMEs Issues in Estonia

The two most common types of companies in Estonia are the public limited company (Aktsiaselts, or AS) and the private limited company (Osaühing, or OÜ). From January 1, 2011 public limited company must have a share capital of at least 25,000 euros while a private limited company must have a company capital of at least 2,500 euros. There are fewer than 200 large enterprises in Estonia. Over half of them are in a foreign ownership, consequently global changes in economy affect their amount considerably. Though in 2008 the number of enterprises with over 250 employees grew by 14%, the year 2009 saw the decrease almost as deep. As a result of economic recession many employees were laid off, companies merged or went bankrupt. In most size groups the number of enterprises decreased by 10–12%. Only the number of micro-enterprises increased by 7%. (STATISTICAL YEARBOOK OF ESTONIA, 2010). Most of registered companies are SMEs and privately owned. Traditionally the vast majority of enterprises belong to Estonian private owners.

Table 1. SMEs in Estonia

Enterprises	Enterprises			Employment			Value added		
	Estonia		EU-27	Estonia		EU-27	Estonia		EU-27
	Number	Share	Share	Number	Share	Share	Billion	Share	Share
Micro	37 123	83.1%	91.8%	106 002	24.4%	29.7%	2	21.0%	21.0%
Small	6 205	13.9%	6.9%	122 606	28.3%	20.7%	2	25.5%	18.9%
Medium-sized	1 188	2.7%	1.1%	112 607	26.0%	17.0%	3	29.9%	18.0%
SMEs	44 516	99.6%	99.8%	341 215	78.6%	67.4%	7	76.3%	57.9%
Large	162	0.4%	0.2%	92 719	21.4%	32.6%	2	23.7%	42.1%
Total	44 678	100.0%	100.0%	433 934	100.0%	100.0%	9	100.0%	100.0%

Source: [8]

The share of SMEs in the total enterprise stock in Estonia (99.6%) roughly equals the EU average (99.8%). The SME sector in Estonia has a structure which is skewed towards larger size classes, with the percentages of medium-sized and small enterprises much higher than the European averages and the percentage of micro enterprises much lower. The share of the number of Estonian SMEs in the total number of businesses is much larger in Estonia than in the EU on average. The contribution of SMEs to employment (78.6%) in Estonia is significantly higher than the European average (67.4%). This is partly due to the particular structure of the SME sector: the relatively few Estonian micro firms contribute less to employment (24.4%) than EU micro firms do on average (29.7%) in all the Member States. In 2008, Estonian SMEs accounted for 76.3% of value

added in the non-financial business economy, far above the EU average of 57.9%. It is necessary to emphasize that the SMEs dominate the Estonian economy, but accounting and financial reporting rules have primarily issued from the viewpoint of large-scale industy. Sometimes this causes problems as most of the rules usually have to be followed by all companies irrespective of their size and branch [7].
In December 1988 the Estonian Association of Small and Medium-Sized Enterprises (in Estonian: Eesti Väike- ja Keskmiste Ettevõtjate Assotsiatsioon or EVEA) was founded. EVEA is a non-governmental, non-profit association of SMEs and self-employed performing a representative, advocacy and lobbying function for small and medium-sized businesses as a social group. The main goal of EVEA is to create a favorable entrepreneurial environment in Estonia as the basis for economic growth and social stability. EVEA is a member of the International Council for Small Business (ICSB) and an associated member of UEAPME – a pan European umbrella organization of SME associations.

3 Evolution of Accounting after 1989

The Estonian accounting regulation has only a relatively brief history compared to several other European countries. One reason was the constant changing of conquerors, all of whom exerted influence on Estonian history in every respect. The transition from command economy to market economy had a huge impact on a great number of aspects in business society, and thus also on accounting. The old bookkeeping system with detailed rules serving the primary task of controlling that the national economic plans were fulfilled was replaced by an accounting system with the primary task of preparing financial reports to the market, but also to give information to management decision making. The new accounting system in the Republic of Estonia is declared to be based on the international accounting regulations (IFRS and EU directives).

Starting the accounting reform (1990–1994). During half the century accounting in Estonia was part of the Soviet accounting system. The first step on the way to change the situation was made in 1990, while Estonia remained, albeit reluctantly, a constituent republic of the USSR. On July 6, 1990, the Regulation of Accounting was adopted by the National Government and came into force on January 1, 1991. It is of special interest because it was the first measure adopted in any of the constituent republics of the USSR to mark a departure from the path of the Soviet accounting evolution. As pointed out by [4, 5], this event marked the beginning of the spread of accounting disharmony within the territories comprising the USSR. It was really an "accounting step" on the transition from command economy to market economy. The declared purpose of the Regulation was to bring about the organization of accounting in the conditions of a market economy. Real accounting continued to be perceived as properly subject to centralized prescription and its primary purpose the meeting of the needs of the central authorities of Estonia (Statistics Bureau, Tax Department) and not, as hitherto, those of the USSR [2].
The Regulation was in force until 1995. This document introduced a number of new accounting concepts and principles, new terms and a new set of annual statements (included the balance sheet, the income statement and the statement of changes in the financial position and notes). The main characteristic of that period is that it was mixed from past (some elements of the former Soviet accounting system remained in force), present (real usage of new methods, principles and financial statements) and future (usage of many new terms of market economy which really were not represented in the Estonian economy). According to the Regulation each enterprise was required to prepare a chart of accounts. In 1991 the accounting system was based on a chart of accounts published by the Ministry of Finance of the USSR. The former Soviet standard chart of accounts was officially used in Estonia until December 31, 1992. Since January 1, 1993 there is no standard chart of accounts in Estonia. Every company can introduce its own chart of accounts [2].
Although, legally, the measure was a regulation and not statute (i.e. not approved by a legislative assembly but adopted by the executive action of the government) it was comparable to a fundamental, or basic, accounting law.

The ***first Estonian Accounting Act***. The second step started with the introduction of the first Estonian Accounting Act, which was passed by Parliament on June 8, 1994 and came into force on January 1, 1995. It was supported by introduction of the Estonian Commercial Code, which was passed by Parliament on February 15, 1995 and came into force on September 1, 1995. The Accounting Act did not contain a detailed set of rules and can best be characterized as constituting a legal framework. The legal framework was general and applied to all legal entities and physical persons registered as businesses in Estonia (referred to as accounting entities in the Act) with the exception of the Bank of Estonia [3]. It was declared to be based on internationally recognized accounting principles, which were established with the Accounting Act and good accounting practice (Estonian accounting guidelines, Estonian GAAP). The true and fair view (TFV) override was declared.

The Accounting Act was supplemented by a number of methodological recommendations (guidelines) on accounting matters issued by the EASB. These recommendations related to such accounting areas as accounting principles, preparation of financial statements, revenue recognition, business combinations and others. All together there were 16 accounting guidelines, which set up conceptual framework of generally accepted accounting principles, revenue recognition, business combination, leases, government grants, earning per share, long-term construction contracts. The only problem was these guidelines were not for obligatory use. They were only recommendations and in the case of contradictions with the Accounting Act, requirements of the Accounting Act had to be followed.

The first Accounting Act was in force during eight years (from 1995 to 2002) and was changed several times. Unfortunately, these changes were mostly cosmetic. No attempt was made to enlist the support of accounting community for changes in accounting practices. There was no publication of drafts of the Accounting Act prior to their enactment. There has been no general discussion of the purpose or the proper understanding of the required accounting changes or the manner of their implementation.

Improvement of accounting system. The third step started with the introduction of the new Estonian Accounting Act [1], which was passed by Parliament on November 20, 2002 and came into force on January 1, 2003. The new Accounting Act regulates basic accounting functions in all business entities registered in Estonia. It does not regulate accounting for taxes, which are regulated by other laws and acts. The essence of the law is framed in compliance with IFRSs.

The accounting policies and presentation formats used in accounting shall be in line with the requirements and basic principles provided for in this Act and with at least one of the following two accounting frameworks:

- Estonian GAAP;
- IFRSs.

For companies it is optional to select the Estonian GAAP or IFRSs for annual and consolidated accounts. It is the company's free choice to choose between IFRSs or Estonian Accounting Guidelines but if IFRSs selected than there is no need to prepare a second set of accounts in accordance with local accounting guidelines. Large companies are expected to choose the full IFRSs option (from 2005 the translated text of international standards is also available). Listed companies and financial institutions are required to prepare their accounts in accordance with IFRS. SMEs are likely to use the revised Estonian GAAP as their accounting framework.

An accounting entity which prepares its annual accounts in accordance with the Estonian GAAP shall use the balance sheet format set out in Annex 1 to this Act and one of the two income statement formats set out in Annex 2 to this Act. A more detailed subdivision of items in the formats of the balance sheet and income statement is permitted and new items may be added to the existing items if this makes for greater clarity.

The length of a financial year is 12 months. At the end of each financial year, an accounting entity is required to prepare an annual report that consists of the annual accounts and the management report which should provide an overview of the activities of the accounting entity, circumstances which are material to the assessment of the financial position and business activities of the accounting entity, significant events which have occurred during the financial year and the likely future developments in the following financial year. Instead of the former two basic statements (the balance sheet and the income statement) the annual accounts shall comprise the main statements (balance sheet, income statement, cash flow statement and statement of changes in owner's equity) and notes on the accounts. The auditor's report and, in the case of a company, the profit distribution proposal for the financial year should be annexed to the annual report. The written management's declaration submitted together with the annual accounts shall be signed and dated by the entire management of the accounting entity declaring their liability for the preparation of the annual accounts and confirming that:

- the accounting policies applied in the preparation of the annual accounts are in compliance with one of the accounting frameworks specified in the Accounting Act;
- the annual accounts give a true and fair view of the financial position, business performance and cash flows of the accounting entity;
- the accounting entity is carrying on its activities as a going concern.

Annual report should be filed at the Commercial Register during six months after the end of the financial year.

Unfortunately there are some shortcomings in the Estonian accounting legislation, which are worth mentioning:

- The definitions of some basic terms differ materially from definitions included in IASB Framework.
- The tfv override is not emphasized in the Accounting Act. As the Accounting Act prevails over the RTJs, the true and fair recognition of the economic results cannot be guaranteed.
- Some standpoints of the Estonian accounting guidelines are not in line with IFRSs.

4 Reporting Issues and Some Differences from IFRSs

The Estonian GAAP consists of EASB guidelines and does not include all areas of accounting or includes only in brief. In areas which are not covered by the regulations of Estonian GAAP, the IFRS treatment is recommended, but is not mandatory. Since the commencement of the Accounting Act 2003 the Estonian GAAP should be generally in line with IFRSs. In some ways the Estonian GAAP has less disclosure than the IFRSs because it is allowed for SMEs. Therefore, large companies are expected to choose the full IFRS option while other companies may use the set of Estonian accounting guidelines as their accounting framework. The guidelines are only recommendations of the EASB. The Estonian GAAP exists only in 18 guidelines from which 17 are in force.

Table 2. Guidelines issued by the Estonian Accounting Standards Board

No	**Topic**	**Respective IFRS/IAS**	**Status**
RTJ 1	General principles Objective of financial statements; true and fair view Main definitions, assumptions and principles Application of and change in accounting policies; application of and change in accounting estimates; correction of errors Events after balance sheet date Functional currency and presentation currency	IASB Framework; IAS 1, 8, 10, 21	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 2	Presentation of financial statements Balance sheet Income statement Cash flow statement Statement of changes in equity Notes Disclosure on related parties	IAS 1, 7, 24	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 3	Financial instruments Accounting for different groups of financial assets (FVTPL, AFS, financial assets at amortized cost) Accounting for financial liabilities Derivatives	IAS 39, 32	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 4	Inventories Recognition and measurement Cost calculation formulas	IAS 2	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 5	PPE and intangible assets Recognition and measurement (incl. Revaluations) Impairment Capitalization of borrowing cost Assets held for sale	IAS 16, 38, 36, 23, IFRS 5	Effective from 1.01.2003 Revised version effective from 1.01.2009

RTJ 6	Investment properties Fair value model and cost model	IAS 40	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 7	Biological assets Animals, plant and other biological assets	IAS 41	Effective from 1.01.2004 Revised version effective from 1.01.2009
RTJ 8	Provisions, contingent assets and liabilities Provisions (incl. provisions in respect of legal cases, guarantees, onerous contracts, environmental, restructuring, termination benefits, pensions etc) Deferred tax and dividend tax Contingent assets and liabilities	IAS 37, 12, 19	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 9	Lease accounting Finance and operating lease in the accounts of lessor and lessee	IAS 17	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 10	Revenue recognition Sale of goods Rendering of services, incl. long-term contracts	IAS 18, 11	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 11	Business combinations and investments in subsidiaries and associates Acquisition of subsidiaries and associates Merger of legal entities Accounting for positive and negative goodwill Equity method Consolidation, incl. Translation of foreign entities Accounting for subsidiaries and associates in parent's standalone financial statements	IFRS 3, IAS 27, 28, 21	Effective from 1.01.2003 Revised version effective from 1.01.2005 and 1.01.2008
RTJ 12	Government grants	IAS 20	Effective from 1.01.2003 Revised version effective from 1.01.2009
RTJ 13	Liquidation and closing financial statements	-	Effective from 1.01.2003
RTJ 14	Non-profit organizations	-	Effective from 1.01.2003
RTJ 15	Interim reporting	IAS 34	Effective from 1.01.2004
RTJ 16	Segment reporting	IAS 14	Effective from 1.01.2004 Not in force
RTJ 17	Public Private Partnerships	-	Effective from 1.01.2009

			Revised version effective from 1.01.2006
RTJ 18	Introduction of euro	-	Effective from 1.01.2011

Source: [6]

According to the Estonian Accounting Act the purpose of the annual accounts (annual report) is to give a true and fair view of the financial position, economic performance and cash flows of the accounting entity. This is also an obligatory part of Management declaration. At the same time the management must declare that the accounting entity is carrying on its activities as a going concern. Unfortunately the true and fair view is not defined in the Accounting Act, guidelines or anywhere else. The tfv override was declared in the old Accounting Act, which was in force during 1995–2002, but this is not emphasized in the new Accounting Act. In RTJ 1 the position that the true and fair view on presenting the financial position, performance and changes in the financial position of an enterprise can still be followed by the management, despite the controversy of the requirements of the Accounting Act and the RTJs, is emphasized. The requirements of RTJs can be omitted if these procedures are recognized and explained in public in the notes to the annual accounts. Again, the problem can arise from the fact that the Accounting Act has a prevailing character and in case of contradiction between the Accounting Act and the guidelines the law will prevail. It should be mentioned that the importance of the tfv never has been an issue in the Estonian accounting theory as well as practice.

4.1 Intangible Assets

The accounting of intangible assets is regulated by the guideline RTJ 5 “Property, Plant and Equipment and Intangible Assets”. The objective of the guideline is to prescribe rules for the recognition of intangible assets in the financial statements prepared in accordance with the accounting principles generally accepted in Estonia. The guideline RTJ 5 takes into consideration accounting policies prescribed in several IFRSs, including IAS 38 “Intangible Assets”, IAS 36 “Impairment of Assets”, IAS 23 “Borrowing Costs” and IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”.

Definition: Intangible assets are non-monetary assets without physical substance that are identifiable from other assets. Intangible fixed assets are intangible assets that the entity expects to use during more than one year. Examples of intangible assets are computer software, trademarks, patents, licenses, user rights, customer lists, quotas and other similar assets. In certain cases, an asset may contain the elements of property, plant and equipment as well as intangible assets. In such cases an asset shall be classified according to which elements are more significant. For example, computer software is treated as property, plant and equipment if it is an integral part of the related hardware. When the software is not an integral part of the related hardware, it is treated as an intangible asset.

Initial recognition. An intangible asset is initially recognized in the balance sheet only if a) an item is controlled by the entity; b) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity c) the cost of the asset can be measured reliably.

An intangible asset is initially measured at cost which comprises the purchase price and other costs directly attributable to the acquisition.

Intangible assets are not: start-up costs, costs related to research activities, training costs, advertising costs, general and administrative expenses, losses in the initial stage of production, moving costs and costs related to restructuring of entity, cost related to internally generated brands, customer lists (exception are brands and brands and customer lists acquired from outside parties or in a business combination may be capitalized). These items are expensed during the periods in which they arise.

Costs related to research activities (or research costs) are costs related to obtaining new scientific or technical knowledge or those related to research and scientific work undertaken for gathering such information. Research costs are related to creating a scientific or technical basis for the introduction of new potential products and services and they shall be recognized as an expense when they are incurred.

Development costs are costs that are used for the application of research findings to the design, construction or testing of new specific products, services, processes or systems. Development costs shall be capitalized as intangible assets if all the following criteria are satisfied: a) there exist technical and financial resources and a positive intention to implement the project; b) the entity is able to use or sell the asset to be created; c) the generation of expected future economic benefits arising from the intangible asset can be measured reliably

(incl. the existence of a market for products or services arising from the project); d) the size of development costs can be measured reliably.
Internally generated goodwill (i.e. difference between an entity's market value and the carrying amount of its net assets) shall not be recognized as an asset in the balance sheet of an entity.
Subsequent measurement. An intangible asset shall be carried in the balance sheet at its cost, less any accumulated amortization and any accumulated impairment losses. Intangible assets with indefinite useful lives shall not be amortized but an impairment test for determining their value shall be carried out at each balance sheet date. The straight-line method shall be used for amortizing depreciable intangible assets (except in cases when another method is more appropriate to allocate expected future economic benefits).
Derecognition. Items of intangible assets shall be written down to the recoverable amount if the recoverable amount is of the asset is lower than its carrying amount. In identifying whether an asset may be impaired, an impairment test shall be performed to find the recoverable amount of an asset. An impairment loss shall be recognized as an expense of the accounting period. Amortization method and rates (or useful life) of intangible assets should be disclosed in the financial statements.
Presentation. Intangible assets are presented in the balance sheet in accordance with Annex 1 of the Accounting Act. Amortization expense and impairment losses are presented as a separate item of the income statement format 1 and in the appropriate items in format 2 depending on the function of assets in the entity. Profit/loss from the disposal of intangible assets is recognised in the items "Other operating expenses"/"Other operating income".
Comparison with IFRS. The accounting policies prescribed in RTJ 5 for intangible assets are in compliance with the accounting policies prescribed in Standard IAS 38. IAS 38 allows the use of the revaluation method as an alternative accounting policy to account for intangible assets actively traded in the market, whereas RTJ 5 does not.

4.2 Tangible Assets

The accounting of tangible assets is regulated by the guideline RTJ 5 "Property, Plant and Equipment and Intangible Assets". The objective of the guideline is to prescribe rules for the recognition of property, plant and equipment in the financial statements prepared in accordance with the accounting principles generally accepted in Estonia. The guideline RTJ 5 takes into consideration accounting policies prescribed in several IFRSs, including IAS 16 "Property, Plant and Equipment", IAS 36 "Impairment of Assets", IAS 23 "Borrowing Costs" and IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".
Definition. Property, plant and equipment are tangible assets of the entity used for the production of goods, rendering of services or for administrative purposes (not those used by a business entity for attaining the goals set for it) and that are expected to be used during more than one year. The definition of property, plant and equipment includes also land and buildings (or a part of a building) and the rights associated with them (for example, the right of superficies) that the entity uses in its business activities (whether for production, provision of services or as an administrative building). The definition of property, plant and equipment does not include land and buildings that the entity holds for the generation of rental income or the increase in the market value and that are not used in its business activities.
Initial recognition. An item of property, plant and equipment is initially recognized at cost which comprises: a) its purchase price (incl. import duties and other non-refundable taxes); b) any costs directly attributable to its acquisition; and c) the present value of future estimated costs of dismantling an asset and restoring its site of location.
If the payment for property, plant and equipment is deferred beyond normal credit terms, the present value of the consideration payable shall be considered the cost of the asset. The difference between the nominal value and the present value is recognized as an interest expense over the period of credit. The capitalization of borrowing costs shall commence only when the borrowing costs are being incurred (i.e. the loan has been taken) and the production of an asset has started. The capitalization of borrowing costs shall be suspended when the asset is ready or its production has been interrupted for an extended period of time. If an asset is acquired through a non-monetary transaction (barter transaction) in exchange for another asset, the cost of the asset acquired is measured at the fair value, except when: a) the fair value of items to be exchanged cannot be determined reliably; or b) the exchange transaction lacks commercial substance. In the above-mentioned examples (a) and (b), the carrying amount of the asset given up is considered to be the cost of the asset received.

If an item of property, plant and equipment consists of separate identifiable parts with different useful lives, these parts shall be recognized initially as separate items of property, plant and equipment and separate depreciation rates shall be assigned to them depending on their useful lives.
In the balance sheet, an item of property, plant and equipment shall be carried at cost less any accumulated depreciation and any accumulated impairment losses.
Subsequent measurement. Depreciation of the items of property, plant and equipment is performed during the useful life of the item. Exceptions are items with an unlimited useful life (for example, land, works of art with sustained value, museum exhibits and books) that are not depreciated. The depreciation method selected shall systematically reflect the pattern in which the asset's future economic benefits are expected to be consumed by an entity over the asset's useful life (which may not coincide with the decrease of the value of the asset over time). Depreciation needs to express the use of an asset and not necessarily the change in its value. Hence the objective of selecting depreciation methods and rates is not to keep the carrying amount of an asset as close as possible to its market value but to reflect the asset's use as truly as possible. In practice, the straight-line method is often used for depreciating items of property, plant and equipment. The use of other methods should also be considered if they reflect more objectively the allocation of expected future economic benefits over the useful life of the asset.
If the residual value of an asset is insignificantly low, it may be assumed to be zero. If the residual value is significant only the depreciable portion of the difference between the cost and the residual value shall be depreciated into an expense over their useful lives.
The depreciation starts at the moment when the asset is available for use (i.e. when it is in the condition and location intended by management) and it is continued until the full depreciation of the depreciable amount, until it is retired from active use or reclassified into an asset held for sale. The depreciation of an asset temporarily retired shall not be stopped.
At the each balance sheet date, the appropriateness of the depreciation rates, depreciation methods and estimated residual values applied shall be assessed. If it becomes evident that the actual useful life of an asset differs significantly from the initial estimate, the depreciation term shall be changed. Also, the depreciation methods and the estimated residual value of an asset shall be changed if necessary. The effect of the change in the depreciation term, depreciation method or residual value shall be accounted for as a change in accounting estimates.
Derecognition. If there are any indications that the recoverable value of a certain item of property, plant and equipment may have fallen below its book value, an impairment test shall be carried out and the asset shall be written down.
The revaluations of items of property, plant and equipment are accepted only for items acquired in 1995 or earlier or reliable information regarding the actual cost of the item is missing.
Costs related to subsequent improvements shall be added to the cost of property, plant and equipment only if they meet the definition of property, plant and equipment and the criteria for recognizing assets in the balance sheet (incl. expected participation in the provision of future economic benefits). Costs related to ongoing maintenance and repairs shall be charged to period expenses. In case a part of an item of property, plant and equipment is replaced, the cost of the new part shall be added to the cost of the item if it meets the definition of noncurrent assets and the criteria for recognizing assets in the balance sheet. The replaceable part shall be written off the balance sheet even if it had not been accounted for as a separate part. If the initial cost (and hence the current carrying amount) of the replaceable part is not known, it may be assessed based on the current cost of this part less estimated depreciation.
Items of property, plant and equipment shall be written down to their recoverable amount if the recoverable amount of the asset is lower than its carrying amount. In identifying whether an asset may be impaired, an impairment test shall be performed to find the recoverable amount of an asset. An impairment loss shall be recognized as an expense of the accounting period.
At the each balance sheet date, an impairment test shall be performed for assets with indications of impairment. The management of an entity shall critically assess whether there are any indications that an asset may be impaired. The following factors may be such indications:

- the market value of similar assets has declined;
- the general economic environment and market situation have deteriorated, as a result of which it is probable that the future economic benefits generated by an asset will decline;
- market interest rates have increased as a result of which the discount rate used to calculate an asset's value in use has increased and the asset's value in use has decreased;

- the carrying amount of the net assets of an entity is higher than its market value;
- the physical condition of assets has sharply deteriorated;
- revenues generated by an asset or a group of assets are lower than expected;
- the entity plans to discontinue some areas of operations or close some departments.

If any of the indications described earlier occur (or any other factor indicating impairment of an asset), an impairment test shall be performed. An impairment test is performed to determine the recoverable amount of an asset, which is the higher of the two indicators – fair value of an asset (less costs to sell) and its value in use. A need for the asset's write-down exists if both the asset's fair value (less costs to sell) as well as its value in use is smaller than its carrying amount. If the amount calculated first (either the asset's fair value or its value in use) exceeds the asset's carrying amount, then it is not necessary to estimate the other amount as the asset's recoverable amount is in any case higher than its carrying amount. At each balance sheet date, an entity shall assess whether the recoverable amount of assets written down has increased since then. If this is probable, a new impairment test shall be performed. A reversal of an impairment loss for an asset shall be recognized in the income statement for the accounting period as a reduction of an impairment loss of noncurrent assets.

Items of property, plant and equipment expected to be sold within the next 12 months, shall reclassified as non-current assets held for sale and are recognized as current assets in the balance sheet. The depreciation of non-current assets classified as held for sale is terminated at the time of reclassifying an asset.

Presentation. Property, plant and equipment is presented in the balance sheet in accordance with Annex 1 of the Accounting Act. Subdivisions of balance sheet items (for example, "Land", "Buildings", "Machinery and equipment") may be disclosed in the notes instead of the balance sheet. Non-current assets held for sale shall be shown in a separate item of current assets. The depreciation expenses and impairment losses are presented in a separate item of the income statement format 1 and in the appropriate items in format 2 depending on the function of assets in the entity. Profit/loss from the disposal of property, plant and equipment and intangible assets is recognized in the items "Other operating expenses"/"Other operating income".

Comparison with IFRS. The accounting policies prescribed in the guideline RTJ 5 are in accordance with the accounting policies prescribed in IAS 16, except for the fact that according to IAS 16 the revaluation method may be used as an alternative accounting policy for all items of property, plant and equipment whereas according to RTJ 5 the revaluation is allowed only as a one-time exception for certain items of non-current assets (with the goal of correcting previous misstatements in accounting). According to IAS 16, revaluations should be performed at regular intervals if the revaluation method is used, according to RTJ 5 a revaluation shall be performed only if reliable information on the actual (inflation-adjusted) cost is missing. The EASB does not consider it necessary to allow regular application of the revaluation method, but revaluation may be necessary for finding a "new", proper cost if the current cost recorded in the balance sheet is misleading. In accordance with IAS 16, the surplus differences from the application of the revaluation method shall be recognized in the equity line "Revaluation reserve" (which in turn shall be depreciated during the remaining useful life of a revalued non-current asset into retained earnings), in accordance with RTJ 5 such differences shall be recognized in the line "Retained earnings/accumulated loss".

4.3 Leases

The accounting of leases is regulated by the RTJ 9 "Accounting for Leases". The objective of RTJ 9 is to prescribe criteria for the accounting for and recognition of lease agreements in the financial statements of both lessees as well as lessors. RTJ 9 is based on IAS 17 "Leases" and the interpretation of SIC-15.

Leases are classified as finance and operating leases.

Finance lease – lessor. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership to the lessee; otherwise a lease agreement is classified as an operating lease. The substance over form principle is used in classification process. The classification of a lease agreement into finance or an operating lease depends on the substance of the transaction rather than the legal form of the agreement. Lease classification is made at the inception of the lease.

To be classified as finance lease some criteria must be followed. The following criteria show that substantially all the risks and rewards incidental to ownership are transferred to the lessee, leading to a lease being classified as a finance lease:

- the ownership of the leased assets is transferred to the lessee by the end of the lease term;

- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the lessee uses this option;
- the lease term covers the major part (over 75%) of the economic life of the leased asset, even if the title is not transferred;
- at the inception of the lease the present value of the minimum lease payments amounts to at least substantially (over 90%) all of the fair value of the leased asset; and
- the leased asset is of such specialized nature that only the lessee can use it without major modifications as a result of which the lease agreement can be renewed so that it covers a major part of the asset's useful life.

The lessor shall recognize assets leased out under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease. When selling their products under the finance lease, manufacturer or dealer lessors recognized two types of income: a) Sales revenue to be recognized upon the entry into force of a lease agreement; and b) Financial income to be recognized over the lease term.

Finance lease – lessee. The lessee shall recognize a finance lease as an asset and a liability in its balance sheet at amounts equal to the fair value of the leased property or at the present value of the minimum lease payments, if lower. The discount rate used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease or if its calculation is not possible, then the lessee's incremental borrowing rate shall be used. Minimum lease payments are divided between the finance charge and the reduction of the outstanding liability. The lessee must also depreciate the leased asset; the depreciation rates used for depreciating assets leased under the finance lease are the same as used for similar assets at the entity.

Operating lease – lessor. Lessors shall present assets leased out under an operating lease in their balance sheet according to the nature of the asset, similarly to other assets presented in the balance sheet. Operating lease payments shall be recognized in income on a straight-line basis, unless another systematic reflects more objectively the time pattern of the user's benefits. The leased out asset shall be depreciated in accordance with regular depreciation methods used for depreciating the entity's similar assets.

Operating lease – lessee. Lease payments under an operating lease shall be recognized as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefits.

A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset to the seller. The lease payment and the sale price are usually interdependent because they are negotiated as a package.

A sale and leaseback transaction. The recognition depends on whether the leaseback is an operating or a finance lease and in the case of an operating lease, whether the transaction occurred at the market price or not. If a sale and leaseback transaction results in a finance lease, the transaction shall be recognized as a financing transaction and not as a purchase and sales transaction, i.e. the "sold" asset shall stay in the balance sheet of the seller and the finance lease liability shall be recognized in the amount of the payment received ("sale price"). The difference between the "sale price" and the minimum lease payments is recognized as an interest expense over the lease term similarly to regular finance lease agreements. If the sale-leaseback transaction is under an operating lease terms, the transaction shall be recognized as a purchase-sale transaction, whereas any profit or loss shall be recognized immediately, except in cases when: (a) the sale price is below the fair value of the asset and the low price is compensated for by low interest rates in the future; or (b) the sale price is above the fair value of the asset.

Comparison with IFRS. The accounting policies set out in the guideline RTJ 9 regarding the accounting for leases are in compliance with the accounting policies set out in IAS 17, except for sale-leaseback transactions under the finance lease agreements from the point of view of the seller-tenant leasing back the asset. Under IAS 17 the difference between the sale price and the carrying amount of the "sold" asset is amortized into the income over the lease term; under RTJ 9 the transaction is recognized as a loan with the asset used as collateral and the sale revenue shall not be recognized. The requirements of IAS 17 for the disclosures in the notes differ in their details from the requirements of RTJ 9.

4.4 Financial Assets

The accounting of **financial assets** is regulated by the RTJ 3 "Financial Instruments". The objective of RTJ 3 "Financial Instruments" is to prescribe rules for the recognition of financial instruments. The guideline RTJ 3

is based on IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement".
The guideline RTJ 3 "Financial Instruments" shall be applied to accounting for and reporting of the following financial instruments (i.e. financial assets, financial liabilities and equity instruments) in the financial statements:

- Cash;
- Trade receivables, accrued income and other short and long-term receivables to be settled in cash;
- Short and long-term investments in securities (e.g. shares, bonds, debentures, etc.), with the exception of participations in subsidiaries and associates that are measured either under the consolidation or equity method in accordance with the guideline RTJ 11 "Business Combinations and Accounting for Subsidiaries and Associates";
- Loans received, supplier payables, accrued expenses, bonds issued and other short and long-term borrowings to be settled in cash;
- Derivatives (e.g. forward, future, swap or option contracts);
- Shares and other equity instruments issued by an entity itself;
- Such contracts for the purchase or sale of non-financial assets that can be settled in cash or other financial instruments (accounted for as derivatives), except when they have been concluded for meeting regular purchase, sale or consumption needs of an entity.

Initial recognition. Financial assets and financial liabilities shall initially be recognized at cost which is the fair value of the consideration payable or receivable for the financial asset or the financial liability. A regular way purchase or sale of financial assets shall be consistently recognized using either trade date accounting or settlement date accounting.
Subsequent recognition. All financial assets shall be measured at their fair values in the balance sheet (change in value measured either in the income statement or the revaluation reserve of financial assets under equity), except for the following financial assets:

- Receivables from other parties that the entity has not acquired for resale – shall be measured at amortized cost;
- Held-to-maturity financial investments (e.g. bonds) – shall be measured at amortized cost;
- Investments in shares and other equity instruments whose fair value cannot be reliably measured and derivatives that are linked to such assets – shall be measured at cost.

An accounting method once selected for a financial instrument shall be applied consistently.
At each balance sheet date, financial instruments measured at fair value shall be revalued to fair value at that particular moment, from which the potential transaction costs related to the settlement of the financial instrument have not been deducted.
Gains/losses arising from a change in fair value shall be recognized as follows:

- Changes in the fair values of financial assets and financial liabilities and derivates acquired for the purpose of trading shall be recognized in profit or loss in the income statement of the accounting period;
- Changes in the fair value of other financial assets measured at fair value shall be recognized consistently (i.e. in the same way from the time of acquiring the asset until its disposal) either in:
    - profit or loss in the income statement of the accounting period; or
    - in the revaluation reserve of financial assets under equity.

Comparison with IFRS. The accounting policies prescribed in the guideline RTJ 3 for financial instruments are generally in compliance with the accounting policies prescribed in IAS 39, although IAS 39 provides a more thorough description of several accounting areas of financial instruments than RTJ 3 does, including:

- IAS 39 imposes strict conditions on bonds that can be measured at amortized cost. The EASB did not deem it necessary to lay down such conditions, but recommends their application by the management of an entity.
- RTJ 3 allows the application of a simplified amortized cost method (instead of applying the effective interest rate, a straight-line interest calculation or the recognition of transaction costs directly in expense), if the effect on the statements is insignificant. IAS 39 does not mention directly this simplified approach.
- IAS 39 provides special rules for measuring derivative financial instruments for the purpose of hedge accounting. The EASBoard did not deem it necessary to describe these special rules in the guideline

RTJ 3 as the number of companies applying such rules in Estonia is relatively small. RTJ 3 allows the application of special rules of hedge accounting described in IAS 39.

The policies prescribed in the guideline RTJ 3 for the classification of financial instruments into liabilities and equity are in compliance with the policies of IAS 32 and the principles of IFRIC 2. Unlike RTJ 3, IFRS does not prescribe specific rules for the presentation of financial assets and financial liabilities in different balances sheet items and the presentation of gains and losses arising from them in the income statement. IAS 32 and IAS 39 require more disclosures in notes than RTJ 3 does.

4.5 Receivables

The presentation of receivables is regulated by the RTJ 2 “Requirements for Presentation in the Financial Statements”. Accounting of receivables is regulated by the RTJ 3 “Financial Instruments”.

In the balance sheet among current assets separate item “Receivables and prepayments“ is presented. Short-term receivables and prepayments made are classified by main groups: Trade receivables; Prepaid and deferred taxes; Other short-term receivables. The long term receivables are presented among non-current assets. The notes disclose additional information on the receivables from shareholders, other group companies and ohter related parties.

All receivables (e.g. trade receivables, accrued income, loans granted and other short and long-term receivables), except for receivable acquired for the purpose of trading shall generally carried at amortized cost in the balance sheet. The amortized cost of short-term receivables generally equals their nominal value (less provisions made for impairment), therefore short-term receivables are recorded in their net realizable value in the balance sheet (which is, for example, reported in an invoice, contract or other source document).

For determining the amortized cost of long-term receivables they are initially recognized at the fair value of the consideration receivable, and subsequently measured at amortized cost using the effective interest rate method. If the effective interest rate of long-term receivable differs from the nominal interest rate (for example, in the case of an interest-free loan) specified in the contract, the receivable shall initially be recognized at its present value by discounting it using the prevailing market rate of interest for similar instruments (e.g. similar as to currency, term, credit rating, etc.)

Write-downs due to an impairment loss shall be recognised as an expense in the income statement.

An impairment of individually significant financial assets shall be assessed separately for each asset. Financial assets that are not individually significant and for which there is no evidence of their impairment can be assessed collectively for impairment. Financial assets whose impairment has been individually assessed shall not be included in a group of financial assets assessed collectively if they exhibited individual signs of impairment; they shall be included in groups of financial assets assessed collectively if they lack individual signs of impairment.

Impairment losses of receivables shall either be recognized in the appropriate contra account (for example, impairment losses of “Trade receivables” shall be included in the balance sheet item “Allowance for doubtful receivables”) or as a reduction of the carrying amount of the receivable.

If the impairment loss of a receivable was initially recognized in the account of doubtful receivables designed for it but later it becomes evident that the collection of the receivable is completely unrealistic, the receivable shall be deemed and both the receivable itself as well as its write-down in the corresponding contra account shall be taken off the balance sheet (an additional cost is not incurred at this time). A receivable is deemed irrecoverable when an entity lacks all opportunities to collect the receivable (e.g. the debtor has gone bankrupt and the assets in the bankruptcy estate are not adequate to pay the receivable). If the previously made estimate on the amount of doubtful receivables changes subsequently, it shall be recognized in the income statement in the period when the change occurred and it shall not be adjusted retrospectively. The collection of doubtful or irrecoverable receivables shall be shown as a reduction of an expense in the period when the collection occurs. Upon the collection of a doubtful receivable both the balances of the receivable itself as well as its contra account shall be reduced.

4.6 Inventories

The accounting of inventories is regulated by the RTJ 4 “Inventories”. The objective of RTJ 4 “Inventories” is to prescribe the rules for the recognition of inventories in the financial statements prepared in accordance with the Estonian GAAP. RTJ 4 is based on IAS 2 “Inventories”.

Definition. Inventories are assets: (a) held for sale in the ordinary course of business; (b) in the process of production for sale in the ordinary course of business; (c) in the form of materials or supplies to be consumed in the production process or for rendering services.
Initial recognition. Inventories shall initially be recognized at cost which comprises costs of purchase, production costs and other costs incurred in bringing the inventories to their present location and condition.
Subsequent measurement. If separate inventory items are clearly distinguishable from each other, then the identification of their costs shall be based on costs incurred specifically for the acquisition of each separate item (individual cost method). If separate inventory items are not clearly distinguishable from each other, then either the FIFO or weighted average cost formula shall be used.
Inventories shall be measured in the balance sheet at the lower of cost or net realizable value.
At the end of each accounting period the list of inventories shall be critically reviewed in order to identify inventory items whose net realizable value may have fallen below their cost. The entity's management shall consider the need for discounting inventories if:

- The physical inventory has established that inventories have either been damaged or their physical condition has deteriorated.
- The market value of similar inventory items has fallen.
- It has not been possible to sell or use certain inventory items during an extended period of time and there exists doubt whether they can be sold during a reasonable amount of time.

Presentation. Inventories are reported in the balance sheet under the items designated for them in the balance sheet format provided in Annex 1 of the Accounting Act. It is allowed to add additional sub-items or clarify the titles of sub-items as set out in the Act if this makes for greater clarity and legibility of the balance sheet. A further breakdown of balance sheet items (for example, "Finished products", "Unfinished products", etc.) may be presented in the notes instead of the balance sheet.
Comparison with IFRS. The accounting policies prescribed in the guideline RTJ 4 are in accordance with the accounting policies prescribed in Standard IAS 2. Unlike the guideline RTJ 4, IFRS does not prescribe specific rules for reporting inventories in the balance sheet and for reporting gains and loss arising from them in the income statement. The requirements of IAS 2 set for disclosures in the notes differ in details from the requirements of RTJ 4.

4.7 Cash and Equivalents

The presentation of cash and equivalents is regulated by the RTJ 2 "Requirements for Presentation in the Financial Statements". Accounting of cash and equivalents is regulated by the RTJ 3 "Financial Instruments".
Cash and cash equivalents are reported in the balance sheet under current assets. More specifically the following items are: cash on hand and at bank; deposits held at call; investments in money market funds and other highly liquid funds. Cash equivalents are short-term (generally up to 3 months), highly liquid investments that are convertible to known amounts of cash and that have no significant market value risk (for example, short-term deposits and units of money market funds).

4.8 Equity

According to Commercial Code private limited liability company (osaühing) is a company which has share capital divided into private limited company shares. A shareholder is not personally liable for the obligations of the private limited company. A private limited company is liable for performance of its obligations with all of its assets. The minimum capital of the private limited company is 2,500 EUR. According to the changed paragraph 140 of Commercial Code from January 1, 2011 it is permitted to found private limited company (with capital up to 25,000 EUR) without any payment. The minimum nominal value of a share is 1 euro. If the share capital of private limited company does not exceed 25,000 EUR or the agreement of establishing the company does not have requirement for paid in capital then the establishment of the company is without payments. Reserve capital shall be formed from annual net profit transfers and other transfers entered in the reserve capital pursuant to law or the articles of association. The amount of reserve capital shall be prescribed in the articles of association and shall not be less than one-tenth of the share capital. During each financial year, at least one-twentieth of the net profit shall be entered in the reserve capital. If the reserve capital reaches the amount prescribed in the articles of association, the increase of reserve capital from net profit shall be terminated.

A public limited company (aktsiaselts) is a company which has share capital divided into public limited company shares. A shareholder shall not be personally liable for the obligations of the public limited company. A public limited company shall be liable for performance of its obligations with all of its assets. Share capital shall be at least 25 000 EUR. The minimum nominal value of a share shall be ten cents. If the nominal value of a share is greater than ten cents, the nominal value shall be a multiple of ten cents. Shares with a nominal value of less than ten cents shall be void. The issuers shall be solidarily liable for any damage caused by the issue of such shares.

4.9 Provisions

The accounting of provisions is regulated by the RTJ 8 “Provisions, Contingent Liabilities and Contingent Assets”. The objective of RTJ 8 is to prescribe rules for the recognition of provisions, contingent liabilities and contingent assets in the financial statements prepared in accordance with the Estonian GAAP. RTJ 8 is based on IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”, IAS 19 “Employee Benefits” and IAS 12 “Income Taxes”.

Definition. A provision is a liability of uncertain timing or amount. Provisions are distinguished from other “ordinary” liabilities (e.g. supplier payables, borrowings, etc.) because there is uncertainty about the timing or amount of the future expenditures required in the settlement. The amount used for recognizing “ordinary” liabilities is generally determined in an invoice, a contract or some other document and there is no need for the application of accounting estimates. In recognizing provisions in the balance sheet, the opinion of management or other experts regarding the amount probably needed for settling provisions or the timing of provisions shall be used as the basis. Since the measurement of provisions is based on estimates that might not always be precise, it is important to recognize and report them separately from other liabilities. There is even more uncertainty regarding contingent liabilities than provisions. If the settlement of provisions is probable and the amount can be estimated relatively reliably, then the settlement of contingent liabilities is either improbable or the amount cannot be estimated reliably.

Initial recognition. An entity shall recognize a provision in its balance sheet when:

- the entity has a present legal or constructive obligation as a result of events that occurred before the balance sheet date;
- it is probable that an outflow of resources will be required to settle the obligation;
- a reliable estimate can be made of the amount of the obligation.

An entity shall recognize a provision in its balance sheet only when the so-called obligating event has occurred before the balance sheet date. For an event to be an obligating event, it is necessary that it creates either a legal or a constructive obligation for the entity, without a realistic alternative to settling the obligation.

A provision shall be recognized in the balance sheet only if the probability of its settlement is greater than 50% (i.e. settlement is more probable than non-settlement). If the probability of settlement is less than 50%, a provision will not be set up, but the expected obligation shall be disclosed as a contingent liability in the notes to the financial statements. Generally it is always possible to make a reliable estimate of the size of the necessary provision (i.e. the amount accompanying the provision). In rare cases, where no reliable estimate can be made of the amount of the provision, the provision shall not be recognized in the balance sheet, but the factors related to it shall be disclosed as a contingent liability in the notes to the financial statements. Setting up a new provision or increasing the existing provision is normally recorded as an expense for the accounting period. In case setting up the provision relates to the acquisition of a new asset, the amount of such a provision shall be added to the cost of this asset.

Subsequent measurement. The amount recognized as a provision shall be in the management’s opinion the best estimate of the expenditure required to settle the present obligation as at the balance sheet date. At each balance sheet date, the management of an entity shall assess the need for setting up new provisions and revaluing or reversing existing provisions. A provision shall be recognized in the amount which is probably necessary for the settlement of the related obligation or transferring it to a third party. The amount necessary for the settlement of an obligation relating to the provision often depends on several external factors whose development the entity cannot control but whose probability can be usually estimated. In measuring provisions, the probability of different possible scenarios should be considered. In case the provision is settled probably later than 12 months after the balance sheet date, it shall be recognized at its discounted value (i.e. in the present value of the payments related to the provision), except when the impact of discounting is immaterial. A single exception is the deferred income tax provision that shall not be discounted. In calculating the present value, the discount rate used shall be the market interest rate for similar obligations.

Provisions shall be used only for the expenditures for which the provision was originally set up. No other expenditures shall be set against a provision, as it would distort the objective nature of the financial statement set against as of an entity.
RTJ 8 includes requirements for recognition of provisions for specific areas. These provisions are warranty provisions, provisions related to the court cases, provisions related to onerous contracts, provisions for environmental damage, provisions for restructuring costs and pension provisions.
The definitions and accounting policies for provisions, contingent liabilities and contingent assets prescribed in the guideline RTJ 8 are in compliance with the accounting policies prescribed in Standard IAS 37.
Comparison with IFRS. Unlike Standard IAS 19, the guideline RTJ 8 does not provide a detailed description of pension provisions and other post-employment benefits as according to the opinion of the Accounting Standards Board, the accounting for these areas is significant only for a small number of entities in Estonia. The Accounting Standards Board recommends using the policies described in Standard IAS 19 to account for pension provisions and other postemployment benefits, when necessary. Unlike Standard IAS 12, the guideline RTJ 8 does not describe the accounting for deferred income tax provisions in detail, as since there is no income tax on profit, this accounting area has relevance for only those entities whose subsidiaries are located abroad. When necessary, the Accounting Standards Board recommends the usage of policies described in Standard IAS 12 to account for deferred income tax provisions. IAS 37, IAS 19 and IAS 12 require the disclosure of more detailed information in the notes to the financial statements than RTJ 8 does.

4.10Liabilities

The accounting for liabilities is regulated by the RTJ 1 “General Principles for Preparing the Financial Statements” and RTJ 2 “Requirements for Presentation in the Financial Statements”.
Definition. A liability is an obligation of an accounting entity,

- which has arisen from past events; and
- whose settlement is expected to result in an outflow of resources in the future.

Initial recognition. A liability is recognized in the balance sheet if as a result of it an entity is forced to act in a way that requires it to give up resources embodying potential future economic benefits. For settling an obligation, an entity may, for example, be forced to pay in cash or cash equivalents, provide a certain service or give up a certain asset. Only such liabilities are recognized in the balance sheet whose settlement amount can be measured reliably.
Assets and liabilities are divided into current and non-current assets and current and non-current liabilities on the face of the balance sheet. The following liabilities are recognized as current:

- liabilities expected to be settled during an entity’s normal operating cycle (e.g. supplier payables);
- liabilities held primarily for the purpose of trading;
- liabilities with the maturity date within 12 months after the balance sheet date (e.g. short-term loans).

All other liabilities are recognized as non-current. Assets and liabilities shall not be offset in the balance sheet unless an entity has a legal right for offsetting assets and liabilities and it is probable that it uses this right.

5 Official Forms of Financial Statements

The requirements prescribed in the guideline RTJ 2 for the components of the financial statements and their presentation are generally in accordance with the requirements prescribed in IAS 1 and IAS 7. Unlike the guideline RTJ 2, IAS 1 does not set out specific formats for the balance sheet and income statement but describes general requirements for the preparation of the balance sheet and income statement. The balance sheet and income statement formats set out in the Accounting Act of Estonia and the guideline RTJ 2 are in compliance with the general requirements of IAS 1. The requirements of IAS 1 and IAS 7 for disclosures in the notes differ from the requirements of the guideline RTJ 2. The definition of the related parties described in the guideline RTJ 2 is in compliance with IAS 24. The requirements of the guideline RTJ 2 on disclosures in the notes are similar to the requirements of IAS 24.

5.1 Balance Sheet

The official structure of Balance Sheet in Estonia is following:

Assets
Current assets
Cash
Short-term investments
Receivables and prepayments
    Trade receivables
    Prepaid and deferred taxes
    Other short-term receivables
    Prepayments for services
    Total
Inventories
    Raw materials
    Work in progress
    Finished goods
    Goods for resale
    Prepayments for inventories
    Total
Total current assets
Fixed assets
Long-term investments
    Shares in subsidiaries
    Shares in associated undertakings
    Other securities
    Long-term receivables
    Total
Investment properties
Tangible assets
    Land
    Buildings
    Machinery and equipment
    Other tangible assets
    Construction-in-progress and prepayments
    Total
Intangible fixed assets
    Goodwill
    Development costs
    Other intangible assets
    Prepayments for intangible assets
    Total
Total fixed assets
Total assets
Liabilities and owners' equity
Liabilities
Current liabilities
Loan liabilities
    Short-term loans and notes
    Current portion of long-term loan liabilities
    Convertible debt
    Total
Debts and prepayments
    Trade creditors
    Employee-related liabilities
    Taxes payable

Other payables
Prepayments received
Total
Short-term provisions
Total current liabilities
Long-term liabilities
Long-term loan liabilities
Loans, notes and finance lease payables
Convertible debts
Total
Other long-term payables
Long-term provisions
Total long-term liabilities
Total liabilities
Owner's equity
Share capital (nominal value)
Share premium
Less: Own shares
Statutory reserve
Other reserves
Retained profit/loss
Net profit/loss for financial year
Total owners' equity
Total liabilities and owners' equity

5.2 Profit/Loss Statement

In Estonia it is possible to opt between presentation of costs and expenses divided by nature or by function.

5.2.1 Expenses Divided by Nature

The official form of P/L statement is following:

Sales revenue
Other operating revenue
Changes in inventories of finished goods and work in progress
Work performed by the undertaking for its own purpose and capitalized
Goods, raw materials and services
Other operating expenses
Staff costs
Wages and salaries
Social security costs
Pension expenses
Depreciation and impairment of fixed assets
Other operating charges
Operating profit (loss)
Financial income and expenses
Financial income and expenses from shares in subsidiaries
Financial income and expenses from shares in associated undertakings
Financial income and expenses from other long-term financial investments
Interest expense
Profit (losses) on translation of foreign currencies
Other financial income and expenses
Total financial income and expenses
Profit (loss) before income tax
Income tax expense
Net profit/loss for financial year

5.2.2 Expenses Divided by Function

The official form of P/L statement is following:

Sales revenue
Cost of goods sold (COGS)
Gross profit (loss)
Marketing expenses
Administrative and general expenses
Other operating revenue
Other operating charges
Operating profit (loss)
Financial income and expenses
- Financial income and expenses from shares in subsidiaries
- Financial income and expenses from shares in associated undertakings
- Financial income and expenses from other long-term financial investments
- Interest expense
- Profit (losses) on translation of foreign currencies
- Other financial income and expenses

Total financial income and expenses
Profit (loss) before income tax
Income tax expense
Net profit/loss for financial year

5.3 Statement of Comprehensive Income

Statement of Comprehensive Income is an obligatory financial statement in Estonia too. The structure of this statement is following:

Income statement
Sales revenue
Cost of sales
Gross profit (loss)
Marketing expenses
Administrative and general expenses
Other operating revenue
Other operating charges
Operating profit (loss)
Financial income and expenses
Profit (loss) before income tax
Income tax expense
Net profit/loss for financial year
Statement of comprehensive income
Net profit/loss for financial year
Other comprehensive income/loss
Unrealized change in currency rates
Revaluation of financial assets
Other profit or loss
Other comprehensive profit or loss
Comprehensive profit or loss for the financial year

5.4 Cash Flow Statement

Structure of Cash Flow Statement, when using indirect method, is following:

Cash flows from operating activities
Operating profit
Adjustments:
Depreciation and impairment of non-current assets
Profit (loss) on the sale of non-current assets
Change in receivables and prepayments related to operating activities
Change in inventories
Change in liabilities and prepayments related to operating activities
Interest paid
Corporate income tax paid
Total cash flows from operating activities
Cash flows from investing activities
Purchases of property, plant and equipment, and intangible assets
Proceeds from sale of property, plant and equipment, and intangible assets
Investments into subsidiaries
Proceeds from the sale of subsidiaries
Investments into associates
Proceeds from the sale of associates
Purchase of other financial investments
Proceeds from the sale of other financial investments
Loans granted
Loan repayments received
Interest received
Dividends received
Total cash flows from investing activities
Cash flows from financing activities
Proceeds from borrowings
Repayments of borrowings
Finance lease principal payments
Proceeds from issue of ordinary shares
Purchase of treasury shares
Dividends paid
Total cash flow from financing activities
Total cash flow
Cash and cash equivalents at beginning of year
Net decrease/increase in cash and cash equivalents
Effects of exchange rate changes
Cash and cash equivalents at end of year

6 Sample Case

ACCOUNTANT Ltd started its business in Estonia in November 2010. The core business of the company is sale of goods as well as professional consulting.
The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 20 %).
For the simplicity of postings there will be used "MU" (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

Initial Balance Sheet

Balance Sheet as at November 1, 2010			
Bank account	145,000	Short-term loans	6,000
Paid VAT	1,000	Registered capital	145,000
Incorporation expenses	5,000		
ASSETS	**151,000**	**EQUITY+LIABILITIES**	**151,000**

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses
- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study
Fixed Assets and Financial Leases

Op.	Text	Amount			Account
1	Purchase of computer	2,000	Dr		Expenses
		400	Dr		VAT
		2,400		Cr	Trade payables
2	Leased car	16,472.88	Dr		Leased car
		3,294.58	Dr		VAT
		19,767.45		Cr	Long-term lease payable
3	1st installment of financial lease	164.73	Dr		Interest expenses
		255.27	Dr		Long-term lease payable
		420		Cr	Bank account

4	Depreciation	274.55 274.55	Dr	 Cr	Depreciation expense Accumulated depreciation
5	Leasing payable	3,234.36 3,234.36	Dr	 Cr	Long-term lease payable Short-term lease payable

Inventories

Op.	**Pieces**			**Cost**	**MU**		
	+	**–**	**Δ**		**+**	**–**	**Δ**
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5,700			37,500	44,850
4	3,300		9,000	9.00	29,700		74,550
5		3,600	5,400			28,050	46,500
6		2,400	3,000			19,500	27,000

$$op.3 \rightarrow issue\ \#1 = 5{,}000 \times 7.50 = 37{,}500$$
$$op.5 \rightarrow issue\ \#2 = 1{,}500 \times 7.50 + 2{,}100 \times 8.00 = 28{,}050$$
$$op.6 \rightarrow issue\ \#3 = 2{,}100 \times 8.00 + 300 \times 9.00 = 19{,}500$$

Op.	**Text**	**Amount**			**Account**
1	Purchase of goods (6,500 @ 7.50 MU)	48,750 9,750 58,500	Dr Dr	 Cr	Goods VAT Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600 6,720 40,320	Dr Dr	 Cr	Goods VAT Bank account
3a	Sale of goods (5,000 @ 12.00 MU)	72,000 60,000 12,000	Dr	 Cr Cr	Accounts receivables Sales revenue VAT
3b	Goods issue	37,500 37,500	Dr	 Cr	COGS Goods
4	Purchase of goods (3,300 @ 9.00 MU)	29,700 5,940 35,640	Dr Dr	 Cr	Goods VAT Bank account
5a	Sale of goods (3,600 @ 12.00 MU)	51,840 43,200 8,640	Dr	 Cr Cr	Accounts receivables Sales revenue VAT
5b	Goods issue	28,050 28,050	Dr	 Cr	COGS Goods
6a	Sale of goods (2,400 @ 12.00 MU)	34,560 28,800 5,760	Dr	 Cr Cr	Accounts receivables Sales revenue VAT
6b	Goods issue	19,500 19,500	Dr	 Cr	COGS Goods
7	Calculation of impairment	4,500 4,500	Dr	 Cr	Impairment loss Goods (impairment)

Receivables and payables

Op.	**Text**	**Amount**			**Account**
1	Long-term contract (12/2010)	6,000 5,000 1,000	Dr	 Cr Cr	Accounts Receivable (long-term) Revenue (services) VAT

Calculation of salary

Gross salary	800.00
Income tax free sum	144.00
Pension fund	8.00
Unemployment tax (2,8%)	22.40
Taxable amount	625.60
Income tax (21%)	131.38
Net salary	**638.22**

Social insurance (33 %)	264.00
Unemployment tax (1,4%)	11.20

Op.	Text	Amount			Account
Nov 30	Gross salary	800 800	Dr	 Cr	Salaries expenses Salaries payable
Nov 30	Social insurance expense (company)	264 264	Dr	 Cr	Social security expense Taxes payable
Nov 30	Unemployment tax expense (company)	11.20 11.20	Dr	 Cr	Unemployment tax expenses Taxes payable
Dec 5	Pay off	638.22 638.22	Dr	 Cr	Salaries Payable Bank account
Dec 31	Gross salary	800 800	Dr	 Cr	Salaries expenses Salaries payable
Dec 31	Social insurance (company)	264 264	Dr	 Cr	Social security expense Taxes payable
Dec 31	Unemployment tax expense (company)	11.20 11.20	Dr	 Cr	Unemployment tax expense Taxes payables

Other costs and expenses

Op.	Text	Amount			Account
1 a	Rental expenses (for November 2010)	1,200 240 1,440	Dr Dr	 Cr	Rental expenses VAT Bank account
1 b	Rental payment (for December 2010)	1,200 240 1,440	Dr Dr	 Cr	Deferred expenses VAT Bank account
1 c	Rental expenses (for December 2010)	1200 1200	Dr	 Cr	Rental expenses Deferred expenses
1c	Rental payment (for January 2011)	1,200 240 1,440	Dr Dr	 Cr	Deferred expenses VAT Bank account
2a	Tax advisory (November 2010)	200 40 240	Dr Dr	 Cr	E – Services VAT Bank account
2b	Tax advisory (December 2010)	200 40 240	Dr Dr	 Cr	E – Services VAT Trade payables
3a	Telecommunication services (November 2010)	1,000 200 1,200	Dr Dr	 Cr	E – Services VAT Bank account
3b	Telecommunication services (December 2010)	1,000 200 1,200	Dr Dr	 Cr	E – Services VAT Trade payables

4	Interest received	920 920	Dr	 Cr	Bank account R – Interest received
5	Bank charges	5,300 5,300	Dr	 Cr	E – Financial expenses Bank account

Closing of accounts:

Profit/Loss Account as at December 31, 2010			
Goods sold	85,050	Revenues from services sold	5,000
Services	4,800	Revenues from goods sold	132,000
Salaries	1,600	Interest received	920
Social insurance	550.40		
Depreciation expense	274.55		
Impairment loss	4,500		
Financial expenses	5,464.73		
Incorporation expenses	5,000		
Computer	2,000		
EXPENSES	***109,239.68***	***REVENUES***	***137,920***
Profit	**28,680.32**		
TOTAL	137,920	TOTAL	137,920

Balance Sheet as at December 31, 2010					
Assets	*Gross*	*Corr*	*Net*	***L+E***	*Net*
Accounts Receivable			158,400	Bank overdraft	3,058.22
Goods	27,000	4,500	22,500	Salaries payable	961.78
Deferred expenses			1,200		
Prepaid taxes			467.60	Accounts payable	7,553.42
Total Current Assets			182,567.60	Short-term lease payable	3,234.36
				Total CL	14,807.78
Leased car	16,472.88	274.55	16,198.33	Long-term payables	16,277.83
Long term debtors			6,000.00	Equity	
				Registered capital	145,000
Total long-term assets			22,198.33	Profit	28,680.32
				Total equity	173,680.32
TOTAL			**204,765.93**	**TOTAL**	**204,765.93**

Ratio analysis

Assets (total)	204,765.93
EBIT	33,225.05
EAT	28,680.32
Equity	173,680.32
Current assets	182,567.60
Current liabilities	14,807.78
Inventories	22,500.00

Profitability ratios:

$$ROA = \frac{EBIT}{\sum Assets} = \frac{33{,}225.05}{204{,}765.93} = \mathbf{16.23}\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{28{,}680.32}{173{,}680.32} = \mathbf{16.51}\%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{182{,}567.60}{14{,}807.78} = \mathbf{12.33}$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{182{,}567.60 - 22{,}500}{14{,}807.78} = \mathbf{10.81}$$

7 Dictionary

English	Estonian
Accelerated Depreciation	kiirdepretsiatsioon, kiiramortisatsioon
Account	konto, aruanne
Account Payable	kreditoorne võlg
Account Receivable	debitoorne võlg
Accountant	raamatupidaja
Accounting	raamatupidamine, majandusarvestus
Accounting Change	arvestusmeetodi muutmine
Accounting Policies	arvestuspoliitka
Accounting Profit	raamatupidamislik kasum
Accrual Basis	tekkepõhine
Accumulated Depreciation	akumuleeritud kulum
Additional Paid in Capital	üleväärtus
Amortization	amortisatsioon
Annual Report	aastaaruanne
Annuity	annuiteet
Asset	varaobjekt
Auditor	audiitor
Auditors' Report	audiitori järeldusotsus
Available-For-Sale Financial Assets	müügivalmis finantsvara
Balance Sheet	bilanss, raamatupidamisbilanss
Bond	võlakiri
Book Value, Carrying Amount	raamatupidamislik väärtus, jääkmaksumus
Borrowing Costs	laenuvõtu kulutused
Budget	eelarve
Business	äri
Business Combinations	äriühendus, äriühendlus
Business Segment	ärisegment
Capitalized Cost	kapitaliseeritud kulu
Capitalized Interest	kapitaliseeritud intress
Cash	raha, sularaha
Cash Basis	kassapõhine
Cash Equivalents	rahalähendid, rahaekvivalendd
Cash Flows	rahakäive
Cash-generating Unit	rahateeniv üksus
Closing Rate	sulgemiskurss
Consistency	järjepidevus
Consolidated Financial Statements	konsolideeritud finantsaruanded
Consolidation	konsolideerimine
Contingent Asset	tingimuslik varaobjekt
Contingent Liability	tingimuslik kohustis
Contingent Rent	tingimuslik rent
Continuing Operations	jätkuv tegevus
Control	valitsev mõju

Convertible Share	konverteertav aktsia
Cost	kulutus, kulu
Cost Accounting	kuluarvestus
Cost Method	soetushinna meetod, soetusmaksumuse meetod
Costing	kuluarvutlus
Costs of Disposal	võõrandamiskulud, likvideerimiskulud
Credit Risk	krediidirisk
Creditor	kreeditor
Currency Risk	valuutakursirisk
Current Asset	käibevara
Current Liability	lühikohustis, lühiajaline kohustis
Current Tax	jooksev tulumaks
Debit	deebet
Debt	võlg
Debt Security	võlaõiguslik väärtpaber
Debtor	deebitor
Deferred Income	edasilükatud tulu
Deferred Income Taxes	edasilükatud tulumaks
Deferred Tax Assets	edasilükatud tulumaksuvara
Deferred Tax Liabilities	edasilükatud tulumaksukohustis
Depreciable Amount	depretsieeritav summa, amortiseeritav summa
Depreciation	depretsiatsioon, amortisatsioon
Derecognition	mittekajastamine
Derivative	derivatiiv
Detection Risk	avastamisrisk
Development	arendamine
Direct Costs	otsekulud
Disclosure	avalikustamine
Discontinued Operation	lõpetatud tegevus
Discount	diskonto
Discount Rate	diskonteerimismäär
Discounted Cash Flow	diskonteeriteeritud rahakäive
Dividends	dividendid
Double–Entry Bookkeeping	kahekordne kirjendamine
Due Date	täitepäev
Earnings Per Share (EPS)	EPS, aktsiakasum
Economic Life	kasutusaeg
Effective Interest Rate	tegelik intressimäär, reaalintressimäär
Equity	omakapital
Equity Instrument	omakapitaliinstrument
Equity Method	kapitaliosaluse meetod
Equity Securities	omandiõiguslikud väärtpaberid
Estimated Tax	hinnanguline tulumaks
Estimation Transactions	hinnangulised tehingud
Events after the Balance Sheet Date	bilansipäevajärgsed sündmused
Exchange Difference	vahetuskursi erinevus, kursierinevus
Exchange Rate	vahetuskurss
Expenditure	kulutus, väljaminek
Expense	
External Reporting	info välistarbijale mõeldud aruandlus
Extraordinary Items	erakorralised kirjed
Factoring	faktooring
Fair Market Value	turuväärtus

Fair Value	reaalväärtus, õiglane väärtus
Finance Lease	kapitaalrentimine, kapitalirent
Financial Asset	finantsvaraobjekt
Financial Institution	finantsasutus
Financial Instrument	finantsinstrument
Financial Liability	finantskohustis
Financial Risk	finantsrisk
Financial Statements	finantsaruanded
Financing Activities	finantstegevus
First in, First out (FIFO)	FIFO-meetod, FIFO
Fiscal Year	rahandusaasta, majandusaasta
Fixed Asset	põhivaraobjekt
Forecast	prognoos
Foreign Currency	välisvaluuta
Fraud	pettus
Functional Currency	arvestusvaluuta
Funding	rahastamine, subsideerimine
Future Contract	futuurleping
Gain	tulum
General Journal	žurnaal, päevaraamat
General Ledger	pearaamat
Generally Accepted Accounting Principles	üldtunnustatud arvestuspõhimõtted
Going Concern	jätkuvus
Goodwill	*goodwill*, firmaväärtus
Gross Income	brutokasum
Group	kontsern
Guaranty	garantii
Hedge	riskiturve
Hedge Effectiveness	riskiturbe tõhusus
Hedged Item	riskiturvatud kirje
Hedging Instrument	riskiturbevahend
Held-To-Maturity Investments	lunastustähtpäevani hoitavad investeeringud
Highly Probable	suure tõenäosusega
Historical Cost	soetushind, soetusmaksumus
Impairment Loss	väärtuskadu
Impracticable	teostamatu
Improvement	parendamine, täiustamine
Inception of the Lease	rendiliigi fikseerimiskuupäev
Income	tulu, kasum
Income Statement	kasumiaruanne
Indirect Costs	kaudkulud
Initial Direct Costs	algsed otsekulud
Installment	paigaldamine
Intangible Asset	ainetu varaobjekt, immateriaalne varaobjekt
Interest	intress
Interest Cost	intressikulu
Interest Rate Risk	intressimäära risk
Interim Financial Report	vahearuanne
Interim Financial Statements	vahearuanded
Interim Period	vaheperiood
Internal Audit	siseaudit
Internal Control	sisekontroll
Internal Rate of Return	sisemine tasuvuslävi, siserentaabluse määr

International Accounting Standards Board	Rahvusvaheline Arvestusstandardite Nõukogu, Rahvusvaheline Arvestusstandardite Toimkond
International Financial Reporting Standards (IFRSs)	rahvusvahelised finantsaruandluse standardid
Intradepartmental Price, Internal Transfer Price	sisehind
Inventories	varud
Investing Activities	investeerimistegevus
Investment Property	kinnisvara
Investor in a Joint Venture	ühisettevõtte investor
Joint Venture	ühisettevõte
Last in, First out (LIFO)	LIFO
Lease	liising, rentimine
Lease Term	rendiperiood
Lessee	rentnik, rendilevõtja
Lessor	rendileandja
Liability	kohustis
Liquid Assets	likviidne vara
Liquidation	likvideerimine
Liquidity Risk	likviidsusrisk
Loans and Receivables	laenud ja deebitorid
Loans Payable	laenuvõlg
Long–Term Debt	pikaajaline võlakohustus, pikaajaline võlg
Loss	kahjum, kadum
Lower of Cost or Market	vähimväärtus
Management Accounting	juhtimisarvestus
Margin	rentaablus, rentaablusnäitaja, marginaal
Market Risk	tururisk
Marketable Securities	turustatavad väärtpaberid
Mark–to–Market	turuhinnapõhine
Master Budget (Company Budget)	koondplaan, ettevõtte koondplaan
Materiality	olulisus
Matching Principle	tulude ja kulude õige vastandamise põhimõte, tulude ja kulude seostatuse põhimõte
Merger	ühinemine
Minority Interest	vähemusosalus
Monetary Assets	rahaline vara
Monetary Items	rahalised kirjed
Net Assets	netovara
Net Income	puhaskasum, puhastulu
Net Realizable Value	neto-realiseerimisväärtus
Non-cancellable Lease	mittetühistatav rendileping
Non-current Asset	pikaajaline vara
Non–for–Profit Organization	mittetulundusühing
Notes	märkused, lisad
Notional Value, Face Value	nimiväärtus
Objectivity	objektiivsus
Obligations	kohustused
Onerous Contract	ränk leping
Operating Activities	põhitegevus
Operating Cycle	tegevustsükkel
Operating Lease	kasutusrentimine, kasutusrent
Option	optsioon
Other Comprehensive Income	muu ühendkasum
Parent Company	emaettevõte, emafirma

Partnership	partnerlus
Penalty	trahv
Plan Costing	kavapõhine kuluarvutlus
Preferred Share	eelisaktsia
Present Value	nüüdisväärtus
Presentation Currency	esitusvaluuta
Prior Period Errors	eelmiste perioodide vead
Probable	tõenäoline
Profit or Loss	kasum või kahjum
Property, Plant and Equipment	aineline põhivara, materiaalne põhivara
Prospective Application	rakendus eelseisvatele perioodidele
Provision	eraldis
Public Offering	avalik pakkumine
Qualifying Asset	kitsendustega varaobjekt
Ratio Analysis	suhtarvuanalüüs
Receivables	debitoorne võlg
Reconciliation	sobitamine, vastavusse viimine, kooskõlla viimine
Recoverable Amount	kaetav summa
Reinsurance	edasikindlustus
Related Party Transaction	seotud osapoolte vaheline tehing
Reorganization	reorganiseerimine
Repairs	remont
Reporting Date	aruandekuupäev
Reporting Entity	aruandekohustuslik üksus
Repurchase Agreement	tagasiostuleping, tagasiostulepe
Research	uuring, teaduslik uuring
Residual Value	lõppmaksumus, likvideerimismaksumus
Responsibility Accounting	vastutuspõhine arvestus
Restructuring	ümberstruktureerimine, restruktureerimine
Retained Earnings	jaotamata kasum, akumuleeritud kasum
Return on Investment (ROI)	investeerimsrentaablus, investeerngurentaablus, investeeringu kasumisiduvus
Revenue Recognition	tulu kajastamine
Revenues	tulud
Risk Management	riskijuhtimine
Securitization	väärtpaberistumine, sekuritisatsioon
Security	väärtpaber
Separate Financial Statements	eradiseisvad finantsaruanded
Settlement Method	arveldusmeetod
Share (Stock)	aktsia
Short–Term	lühiajaline
Significant Influence	oluline mõjuvõim
Spot Exchange Rate	hetke valuutavahetuskurss
Start–up Costs	asutamiskulutused
Statement of Cash Flows	rahakäibe aruanne
Statement of Comprehensive Income	ühendkasumi aruanne
Statement of Financial Position	finantsseisundi aruanne, raamatupidamisbilanss, bilanss
Statement of Changes in Equity	omakapitali muutuste aruanne
Straight–Line Depreciation	lineaarne meetod
Subsequent Event	bilansipäeva järgne sündmus
Subsidiary	tütarettevõte
Swap	swap

Tangible Asset	aineline varaobjekt, materiaalne varaobjekt
Tax	maks
Tax Base	maksubaas
Tax Expense	maksukulu
Tax Income	maksutulu
Tax Loss	maksukahjum
Tax Year	maksuaasta
Taxable Income	maksustatav tulu, maksustatav kasum
Taxable Profit	maksustatav kasum
Taxpayer Identification Number (TIN)	maksukohustuslase koodtähis
Temporary Differences	ajutised erinevused
Term Loan	tähtajaline laen
Total Comprehensive Income	kogu ühendkasum
Transaction Costs	tehingukulud
Unearned Income	tulevaste perioodide tulu, avansstulu
Useful Life	kasulik eluiga
Value in Use	kasutusväärtus
Venture Capital	riskikapital
Work in Progress	lõpetamata toodang, lõpetamata töö
Working Capital	käibekapital
Yield to Maturity	lõpptähtaeg
Zero–Coupon Bond	kupongideta võlakiri

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Financial Reporting in Latvia

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Latvia. Due to the globalization of business and international harmonization of financial reporting also Latvia experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Latvia.

Country
Latvia
(Latvija)
Location
Baltic country (North-Eastern Europe)
Area
64,589 km^2
Population
2,217,969 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
lats (LVL); 0.711 LVL/EUR (as at 31.12.2010)

1 Country Introduction

Latvia is a country in the Baltic Region of Northern Europe. Latvia lies on the eastern shores of the Baltic Sea between Estonia and Lithuania. It borders on Estonia (343 km) in the north, Lithuania (588 km) in the south, the Baltic Sea with the Gulf of Riga (coastline 531 km) in the west, Russia (276 km) in the east, and Belarus

(141 km) in the southeast. Latvia is a democratic parliamentary republic. Administratively, the country is divided into 109 counties and nine municipalities. The capital and largest city is Riga. The official language in Latvia is Latvian. Russian, German and English are widely spoken. The predominant religions are Lutheranism, Roman Catholicism, and the Russian Orthodox Church. The majority of Latvians belong to the Evangelical Lutheran Church. A sizable minority is Russian Orthodox and Eastern Latvia is predominantly Roman Catholic. Latvia is one of the least populous member states of the European Union. In July 2010 the population of Latvia was 2.217 million. Population density is 34.3 inhabitants per square km. Latvians make up 59.4% of the population and Russians 27.5%. Belarusians (3.6%), Ukrainians (2.5%), Polish (2.31) and other minority groups (4.69%) make up the bulk of the rest.
The forefathers of the Latvian people were the proto-Balts, who arrived in the first half of 2000 bc, although the territory had already been long inhabited by the ancient Finno-Ugric peoples. The region became a key trading crossroads, lying on a route stretching from Scandinavia to Russia and the Byzantine Empire. By the late 12th century traders from Western Europe used the river Daugava as a trade route to Russia. Latvias strategic geographic location meant it was prone to invasion from neighboring territories. From the 13th century onwards the country fell under German (until 1561), Polish (from 1562 to 1629), Swedish (from 1629 to 1721) and Russian (from 1721 to 1918) rule. The Russian Revolution of 1917 gave Latvia the opportunity for freedom, and the Republic of Latvia was proclaimed on November 18, 1918. The republic lasted little more than 20 years. The so-called Molotov-Ribbentrop Pact of 1939 steadily forced Latvia under Soviet influence, culminating in Latvias annexation by the Soviet Union in 1940. Nazy German army occupied the country from 1941 to 1944. The Soviet order was re-established in 1944 when Red Army forced German army out of Latvia. The fall of the USSR led to Latvia once again achieving full independence in 1991.
According to the Latvian Constitution (in Latvian: Satversme), Latvia is a parliamentary democracy where the highest power belongs to the Latvian nation (full-fledged citizens of both sexes of at least 18 years of age). The highest organ of state is a unicameral parliament (the Saeima) with 100 members who are elected by direct, popular vote to serve four-year terms. The President who holds a primarily ceremonial role as head of state, is elected by the Saeima for a four-year term. The President has rights to initiate a law, as well as in other countries, to grant a pardon. The President appoints diplomatic representatives of Latvia. He/she is the commander-in-chief of the Latvian army in peacetime. The Prime Minister is also elected by the Saeima. The Cabinet of Ministers is nominated by the Prime Minister, and must receive a confidence vote by the Saeima before it can start exercising its duties.
Latvia became a member of United Nations on September 17, 1991, a member of the WTO on February 10, 1999, NATO member state on March 29, 2004 and a European Union member state on May 1, 2004. Latvia is part of the EUs Schengen Area, meaning that there is visa free movement within Schengen of nationals of all those EU Member States belonging to the area. Citizens of EU Member States and of a number of non-EU countries (including the USA, Australia, New Zealand, Canada, Japan) do not require a visa for visits of up to 90days within a six-month period from the day of arrival. The Latvian central bank expects Latvia to adopt the Euro in 2014 at the earliest.

2 Legal System

According to the classic approach, the Latvian legal system belongs to the continental **European legal tradition**, the Roman-German family, and follows the classic division into private, public, and criminal law. The main source of the law is the Constitution. The Constitution of the Republic of Latvia was first adopted in 1922 and re-instituted by the 5th Saeima in 1993.
Exclusive judicial power in Latvia lies with the courts. The Latvian court system was established pursuant to the Constitution of Latvia dated 1920 and reinstated in 1993 as well as in accordance with the Law on Judicial Power effective since 1993. The court system of the Republic of Latvia is divided into three levels and comprises district or city courts, regional courts and the Supreme Court.
The Supreme Court is the court of highest instance. The Supreme Court consists of a Senate and two court chambers – Civil law chamber, Criminal law chamber. The Senate has the power of cassation in all cases that have been tried in regional and district (city) courts. The regional court is court of first instance for civil and criminal cases that according to the law are within its competence. The regional court is instance of appeal when criminal and civil cases have been tried in the district (city) courts. District courts are the first instance for civil and criminal cases as set by the law. Administrative cases are tried in separate district and regional courts.

With the joining of the European Union many areas of law are subordinated to the European Union/European Community requirements. In other words, there are several legal acts in Latvian legal system that include a direct reference to the corresponding EU directive transposition of which they provide.
The Constitutional Court of the Republic of Latvia functions pursuant to the law dated June 5, 1996. It has been effective since June 28, 1996. The Constitutional Court examines the compliance of legislative acts with the Constitution and with the other laws of the Republic of Latvia. The basis for a case to be heard before the Constitutional Court may be an application by the officials set out in the Law on Institutions of the Republic of Latvia. In some instances it may be an application by physical or legal entities if their interests have been involved pursuant to the court judgment by applying a legal norm that is considered to be anti-constitutional at the opinion of the applicant.

2.1 Business and Accounting Law

According to the Company Law a business organization registered with the Commercial Register could be

- **a natural person (sole proprietor);**
- **a commercial company:**
    - o general partnership;
    - o limited partnership;
    - o limited liability company (public limited liability company or private limited liability company).

A sole proprietor (in Latvian: individuālais komersants) has a duty to apply for recording in the Commercial Register if:

- his/her annual sales turnover from business activities > 200 000 LVL, or
- his/her annual sales turnover > 20 000 LVL and provides employment to > 5 employees, or
- he/she acts as a commercial agent, or
- he/she acts as a broker.

There is also an opportunity to apply in all other cases. A sole proprietor has a liability for obligations with his whole property.
General partnership (in Latvian: pilnsabiedrība) is established, when at least two members have united, utilizing a joint firm name, on the basis of a partnership agreement, without limiting their liability against creditors of the general partnership. The profits or losses of general partnership are specified at the end of every accounting year, based upon the annual accounts, which have been approved by the members of the partnership. The profits and losses are divided between members in proportion to their contribution in the partnership (the calculated profit is added to member's contribution, member's contribution is reduced by the amount of calculated loss).
Limited partnership (in Latvian: komandītsabiedrība) is established, when at least two members have united, utilizing a joint firm name, on the basis of a partnership agreement, if the liability of at least 1one limited partner in relation to the creditors of the partnership is limited to the amount of their contribution, but the liability of general partners is not limited. The limited partner has the right to request a written report (copies of the balance sheet and annual accounts) on the status of the property of the partnership and to verify its accuracy and to examine the accounting and other documents of the partnership.
Limited liability company (in Latvian: kapitālsabiedrība) is a legal person and can be established as:

- a private limited liability company (min capital 2,000 LVL) – a private company whose shares are not publicly traded;
- a public limited liability company (min capital 25,000 LVL, which should be fully paid-up not later than within one year from the date of the signing the memorandum of association of the company) – a public company whose shares (stock) may be publicly tradable.

There is an opportunity to establish a limited liability company as a company with supplemental liability, when at least one of the shareholders is liable personally with his/her whole property for the obligations of the company.
Brief summary of legal acts which regulate accounting, disclosure of information and preparation of financial reports is presented in Table 1.

Table 1. Regulation of accounting and financial reporting in Latvia

	Separate Financial Statements	**Consolidated Financial Statements**
Not-listed companies		
Large	Detailed accounting requirements within the Law on Annual Accounts and Latvian Accounting Standards	Detailed accounting requirements within the Law on Consolidated Annual Accounts and Latvian Accounting Standards
Small and medium	Same laws and standards with exemptions allowing for simplified financial reporting	
Banks	Accounting regulations set by Credit Institutions Law and regulations of the Financial and Capital Market Commission	
Insurance companies	Accounting regulations set by the Law on the Supervision of Insurance Companies and regulations of the Financial and Capital Market Commission	
Listed companies		
Main market	IFRS, as required by the Law of Financial Instruments Market	IFRS
Secondary market	Detailed accounting requirements within the Law on Annual Accounts and Latvian Accounting Standards	IFRS

2.2 Tax Law

Taxes and fees system in Latvia consists of

- state taxes, object and rate of which are set by the Parliament – Saeima;
- state fees (over 55 types) which are applicable according to Law "On Taxes and Fees", other laws and regulations of the Cabinet of Ministers;
- local government fees which are applicable according to Law "On Taxes and Fees" and binding regulations issued by the council of local government;
- directly applicable taxes and other obligatory payments set in the European Union regulatory enactments.

The Law on Personal Income Tax and the relevant Cabinet of Ministers regulations govern **personal income tax**. The law covers tax on private individuals. An individual is a resident of Latvia (and thus fully taxable) in any of the following situations:

- they permanently reside in Latvia;
- they stay in Latvia for 183 days or more in a twelve month period;
- they are Latvian citizens employed in a foreign state by the Latvian Government.

Individual (int. al., who derive his/her income from a business of which he/she is a sole proprietor, i.e. self employed person or individual entrepreneur, or a partner in a partnership) is a subject to personal income tax at a flat rate of 25%. A 10% tax applies to dividend and interest income and a 15% tax applies to capital gains. Under certain conditions, the sale of an individual's primary residence may be exempt.

Corporate income tax is governed by the Law on Corporate Income Tax and the related regulations issued by Cabinet of Ministers. The law applies to domestic and foreign businesses, private individuals and other people (non-residents) who have earned income in Latvia, as well as to permanent representative offices of non-residents. Residents are taxable on worldwide income, non-residents are taxed on income earned in Latvia. Permanent establishments of foreign companies are taxed in the same way as resident companies, but certain restrictions apply to payments made to the head office.

In general, the corporate taxation system incorporates EU Directive requirements. From a flat rate of 25% on January 1, 2002, the Latvian corporate income tax rate was progressively reduced to a flat rate of 15% as of January 1, 2004. The starting point for determination of taxable income is the final result of the annual profit and loss account of the company and making specified taxation adjustments to this figure. During the

following years of operations the company should pay every month advanced income tax payments based on its previous year's taxable income. The advanced income tax payments will be taken into account in process of determination of the actual income tax.
Depreciation for tax purposes is calculated on the basis of book value for each category of fixed assets doubled rate of depreciation prescribed in the Law on Corporate Income Tax (Table 2) is applied.

Table 2. Depreciation rates for tax purposes

Group No	Rate	Type of Fixed Assets
1	5 %	Buildings and perennial plants.
2	10 %	Railway rolling stock and technological equipment, sea and river fleet vessels, fleet and port technological equipment, power equipment.
3	35 %	Computers and related office equipment (printers, software products and data storage equipment, means of communication, copiers etc.).
4	20 %	Other fixed assets (except the fixed assets of the 5th category).
5	7.5 %	Oil exploration and extraction platforms and ships together with related equipment.

Revaluation of fixed assets is not allowed for tax purposes. The value of intangible assets for tax purposes is written off

- for concessions – within 10 years;
- for patents, licences and trademarks – within 5 years.

Research and development costs (except costs of determining the location, quantity and quality of minerals) should be written off in the year when they are incurred. Expenses directly related to the business activities are tax deductible.
Mandatory social insurance payments are governed by the Law on State Social Insurance and paid by insured persons and their employers. Social security payments cover old age pensions, social insurance in case of unemployment, and social insurance against work accidents, disability, maternity and illness. Total basic rate is 35.09% of an employee's gross salary (24.09% is paid by employer and 11% by employee). Reduced rates apply for certain categories of employees.
The Property Tax Law and the related regulations of Cabinet of Ministers govern the application of property tax, whose rate is currently from 0.1% till 1.5% of the cadastral value of real estate (land and buildings). A 3% tax is levied on agricultural land not in use. The property tax is calculated and collected by local municipalities which have the power to grant taxation reductions to specific categories of individuals.
Indirect taxes
The Law on Value Added Tax and the related regulations of Cabinet of Ministers govern the application of **value added tax (VAT)**. The standard rate of VAT is 22%. Standard rate applies to almost all entities that are subject to VAT and reach or exceed a de minimis level of LVL 10,000 (excluding import) in a 12-month period. On some occasions VAT is applied at a reduced rate of 12% (for example to medical devices, infant food, various newspapers and magazines, public transport, utilities, and some other items). For some items (for instance, export) zero-rate is applied and other are exempt from VAT (for instance, financial and insurance services).
The Law on Excise Duties and the related regulations Cabinet of Ministers govern the application of **excise duties**. Excise duty is imposed on oil products, alcoholic and non-alcoholic beverages, and tobacco products. The Latvian excise duty legislation is in line with EU rules.
Customs duty is paid by natural persons and legal entities and imposed on goods imported in Latvia from countries outside of the EU upon their release for free circulation. The duty is based on the common customs tariff applicable in all EU member states..
Other taxes
The Law on Natural Resources and the related regulations of Cabinet of Ministers govern the application of **natural resource tax** in Latvia. In Latvia natural resources tax is applied to extraction of natural resources, waste storage, air pollution and greenhouse effect gas emissions produced by stationary technological equipment not included in the emission quotas, as well as goods polluting water and environmentally harmful goods, e.g. lubricants and other goods and substances. The tax is paid by legal entities and natural persons if extracting natural resources, distributing or importing environmentally unfriendly goods or which are allowed to perform such activities. The basic rate and additional rate are prescribed by the law.

Lottery and gambling tax is paid by lottery and gambling providers. The rate depends on the kind of gambling, gambling venue location, gaming equipment and number of participants.
A **special tax regime** (indirect tax payments and social contributions) applies to the commercial activity of free ports (Riga and Ventspils) and special economic zones (Liepaja and Rezekne) in Latvia. The application of special tax regime is regulated by law.

2.3 SMEs in Latvia

Small and medium-sized enterprises (SMEs) comprise a major part of the national economy and play a significant role in GDP growth and employment in Latvia like elsewhere in Europe. Law on Control of Aid for Commercial Activity provides the definition of SMEs (according to the European Commission Regulation No. 70/2001 and amendments by the European Commission Regulation No. 364/2004, as well as pursuant to the European Commission Recommendation No. 361 of May 6, 2003):

- ***medium-sized enterprises:***
  - number of employees: 50–249;
  - annual turnover does not exceed 50 million EUR;
  - total annual balance sheet value is under 43 million EUR;
- ***small enterprises:***
  - number of employees: 10–49;
  - annual turnover does not exceed 10 million EUR;
  - total annual balance sheet value is under 10 million EUR;
- ***micro enterprises:***
  - number of employees: 1–9;
  - annual turnover does not exceed 2 million EUR;
  - total annual balance sheet value is under 2 million EUR.

Table 3. SMEs in Latvia

Enterprises	Enterprises			Employment			Value added		
	Latvia		EU-27	Latvia		EU-27	Latvia		EU-27
	Number	Share	Share	Number	Share	Share	Billion	Share	Share
Micro	59 929	83.1%	91.8%	150 488	21.7%	29.7%	2	18.6%	21.0%
Small	10 086	14.0%	6.9%	196 453	28.3%	20.7%	3	26.9%	18.9%
Medium-sized	1 877	2.6%	1.1%	182 560	26.3%	17.0%	3	28.7%	18.0%
SMEs	71 892	99.7%	99.8%	529 501	76.3%	67.4%	9	74.2%	57.9%
Large	240	0.3%	0.2%	164 144	23.7%	32.6%	3	25.8%	42.1%
Total	72 132	100.0%	100.0%	433 934	100.0%	100.0%	12	100.0%	100.0%

Source: [6]

The share of SMEs in the total enterprise stock in Latvia (99.7%) is very close to the EU average (99.8%). When looking within the SME size classes, the relative distribution is quite different in Latvia than in EU, on average the shares of medium sized and small enterprises are more or less double the European averages, whereas the percentage of micro enterprises is much lower. The contribution of Latvian SMEs to the overall economy as measured by the value added, is much higher than that of the average SME sector in the EU (76.3% vs. 57.9%). The same holds for SMEs' contribution to employment which is in Latvia considerably higher than the European average (78.6% compared to 67.4%). Within the SME sector however there are big differences as there are relatively few micro firms in Latvia, their contribution to employment (24.4%) is consequently lower than EU average (29.7%).

3 Evolution of Accounting after 1989

During half the century accounting in Latvia was part of the Soviet accounting system, which was an integral part of the centralized administrative institutional structures for the direction and control of the command system of economy. Tremendous political and economic changes took place in the national economy of Latvia after the independence was proclaimed on May 4, 1990. The transition from a centrally planned economy to market economy also required extensive changes in accounting organization and regulation.

There were several common problems and other difficulties in the early stage of the development of accounting in Latvia. Under the umbrella of the accounting reform several significant steps in transition from the so-called "Soviet bookkeeping" to international market oriented accounting were taken. In November 1990 the meeting of leading accounting academics and professionals from Estonia, Latvia and Lithuania took place in Druskininkai (Lithuania). There was suggested an interesting idea of creating a common model of accounting for all three Baltic States. The specialists recommended adherence to a single approach to accounting reform through the adoption of a national chart of accounts and uniform accounting procedures, common to all three Baltic States. Unfortunately, this idea was not fully accepted by the governmental officials and was not realized [1].

Latvia was the last of the Baltic States to embark on accounting reform. The decision was made to use Danish legislation and practice as a basis for accounting reforms. This choice was motivated by the facts that Denmark just like Latvia is a small country and Danish accounting was quite close to IASs (IFRSs). The principal legislative acts, which regulate accounting and financial reporting in Latvia after restoration of independence, namely, the Law on Accounting (in Latvian: Par grāmatvedību) and the Law on Annual Accounts of Enterprises (in Latvian: Par uzņēmumu gada pārskatiem, since November 22, 2006 the law has been renamed as Law on Annual Accounts) were prepared in cooperation with Danish company Schobel & Marholt, confirmed on October 14, 1992 and came into force on January 1, 1993. These laws were adopted four months later than the Lithuanian Law on the Principles of Accounting. Compared with the Estonian Regulation on Accounting of 1990, the Latvian Law on Accounting was shorter and simpler (comprising only 17 sections compared with 50 sections in the Estonian Regulation). In Latvia, unlike Estonia and Lithuania, no new versions of Law on Accounting and Law on Annual Accounts were adopted but instead several crucial amendments were made. The basic principles of accounting and preparation of financial statements as well as management aspects of accounting were included in the Law on Accounting. The Law on Annual Accounts included layout of balance sheet and 4 different formats for profit and loss account, valuation of assets, rules regarding the content of the annexes etc. Although the rules prescribed by the laws were very brief and superficial, these laws have had a great positive influence on the general transformation of Latvian accounting towards international rules because they were based on the 4th EC Directive.

Nevertheless, during the first years after new system was introduced, there were some problems shortcomings. One of the main reasons was that many accountants had Soviet time experience and old type of thinking and were not able to understand the fundamental concepts and principles of accounting under new conditions. The new national chart of accounts which was introduced on January 1, 1994 and was in force until 2000 assisted to solve the problems.

In 1993 wide and intensive self-education of accountants started. Many discussions concerning the legal requirement for obligatory annual audit in banks and enterprises were took place. Auditing as well as auditor's profession was something very new and unknown in Latvia. Under the supervision of the Ministry of Finance of Latvia, short courses and qualification exams for local auditors were organized. The first international audit firms (Arthur Andersen, Coopers & Lybrand and other) started their business in Latvia.

Further development of accounting continued and new fundamental improvements were introduced in laws in 1996. The main purpose of these changes was to reach a better compliance of Latvian laws with the 4th EU Directive and IASs (IFRSs). It is worth mentioning that the amendments of the Law on Annual Accounts (came into force on December 10, 1996) prescribed Latvian enterprises to prepare Statement of Cash Flows. Tremendous, but not very successful, efforts were devoted to translation of IASs (IFRSs) into Latvian. The main reason – undeveloped accounting terminology in Latvian and the specific business environment in Latvia under the transition period.

Despite the urgent need for development of national accounting standards the idea was introduced into legislation only in November 1996 by the amendment made in the Law on Accounting. The extraordinary long period between the adoption of the law in 1992 and the above-mentioned amendment in 1996 clearly show lack of interest in development of detailed national accounting regulations by governmental institutions. Since one of the main tasks was to devise a new system of taxation, fit for market economy, considerable attention was paid to the accounting treatment of taxes. Hence, this process based on such governmental institutions as the Ministry of Finance and the State Revenue Service, issuing guidelines and interpretations to fill "gaps" in tax legislation. Occasionally these documents were not published, or were in contradiction with laws/regulations. Unfortunately the amendment in the Law on Accounting did not specify the way in which drafts of national accounting standards developed by Methodology Committee of Latvian Association of

Sworn Auditors should have been embodied in the regulations of the Cabinet of Ministers. This turned out to be a severe and lasting obstacle to the standard setting.

On May 14, 1999 the Latvian Technical Committee for Standardization of Financial Accounting was established. Unsuccessful activities of Committee and failed attempts to provide the observance of Latvian Financial Accounting Standards[1] without any enforcement mechanism leaded up to major and long depression.

Significant achievement in development of regulative framework was the Law on the Consolidated Annual Accounts which came in force from January 1, 2000 (the new version of law came in force on November 22, 2006) [3, 4].

On May 15, 2003 the legislator once more amended the Law on Accounting. The Cabinet of Ministers was entrusted with a task to establish a new institution – Accounting Board. A comparison of the Board and its predecessors reveals that the new institution enjoys considerably more competence: not only passive tasks (e.g., evaluation of the drafts of accounting regulations and submission of proposals to the Minister of Finance), but also an active promotion of the standardization process, and as the most important – guidance of the process. At present setting of standards is organized in working groups or technical committees, which consist of Board members and outside experts and specialists. The Board appoints the members of the group (committee), defines the purpose and terms of planned activities. On January 1, 2011 11 Latvian accounting standards were in force.

The short overview of organizational development of Latvian national accounting after restoration of independence is given in table 4 [5].

Table 4. Organizational development of Latvian national accounting after restoration of independence

Council of Accounting Methodology (Grāmatvedības metodiskā padome) (1992–1996)
Consisted of 14 members, who represented government and state institutions, research institutions and institutions of higher education as well as private business. The main tasks of the Council were following: to work out the drafts of laws; to work out recommendations for development of accounting education; to issue licenses for activity of the sworn auditors; to appraise the accounting computer programs and to recommend them for use.
Consultative Council of Accounting Standards (Grāmatvedības standartu konsultatīvā padome) (1996–1997)
Consisted of 11 members, who represented Ministry of Finance (3), Latvian Association of Accountants (3) and Latvian Association of Sworn Auditors (5). Recommendations concerning: drafts of laws or changing laws related to accounting; drafts of regulations of the Cabinet of Ministers; drafts of accounting standards.
Latvian Association of Sworn Auditors' Committee of Methodology (Latvijas Zvērinātu revidentu asociācijas Metodolo□ijas komiteja) (1997–1998)
The main tasks: to prepare drafts of Latvian accounting standards; to prepare of Latvian standards of auditing; to cooperate with international organizations of accounting standardization.
Establishment of Working group on development of Latvian accounting standards conception (1998–1999)

[1] As of the end of 2000, Committee had adopted the following standards: "Objectives and Procedures of Preparing Financial Statements", No 1 "Presentation of Financial Statements", No 2 "Inventories", No 7 "Cash flow statements" No 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies".

Latvian Technical Committee for Standardization of Financial Accounting (Latvijas Finanšu grāmatvedības standartizācijas tehniskā komiteja) (1999–2003)
The main tasks: to revise Latvian Financial Accounting Standards (hereinafter – LFASs); to formulate proposals for legislative amendments; to unify terminology of financial accounting; to ensure finance of preparation and publication of LFASs.
Accounting Board (Grāmatvedības padome) since May 15, 2003
Established by the Cabinet of Ministers to promote the improvement of the quality of financial statements and corresponding the Latvian standards and regulations of financial reporting to IFRSs. Members are approved by the Cabinet of Ministers upon proposal by the Minister of Finance. The Board is administered by the chairperson (a representative of the Ministry of Finance) and the deputy chairperson (elected by the Board members). The board meetings must be held at least once a month. The main tasks: to manage the development of drafts and amendments of Latvian accounting standards; to issue and update Latvian accounting standards; to issue intepretations of Latvian accounting standards, to provide the minister of finance with proposals for the improvement of the accounting legislation.

Less detailed classification stages of development of accounting in the Baltic States was suggested by other authors. For example, [2] suggested 3 stage classification:

- beginning of accounting reforms;
- beginning of the system-building by implementation of internationally recognized accounting principles (i. e., IAS and IFRS);
- improvement of accounting system.

4 Reporting Issues

In Latvia accounting, financial reporting and audit are regulated by numerous legal acts, which could be classified into three groups:

- **Laws:**
  - Law on Accounting (in Latvian: likums Par grāmatvedību)
  - Law on Annual Accounts (in Latvian: Gada pārskatu likums)
  - Law on Consolidated Annual Accounts (“Konsolidēto gada pārskatu likums)
  - Commercial Law (in Latvian: “Komerclikums)
  - Law of Financial Instruments Market (in Latvian: Finanšu instrumentu tirgus likums)
  - Credit Institutions Law (in Latvian: “Kredītiestāžu likums”)
  - Law on Supervision of Insurance Companies (in Latvian: Apdrošināšanas sabiedrību un to uzraudzības likums)
  - Law on Sworn Auditors (in Latvian: likums Par zvērinātiem revidentiem).

Law on Accounting came into force January 1, 1993 and has undergone several amendments. It prescribes that the accounting registers should be maintained using a double entry book-keeping. The single entry bookkeeping is applicable to:

- natural persons who perform business activities;
- sole proprietors, farms and fishing undertakings, if the turnover from business transactions during the previous accounting year did not exceed 200,000 LVL;
- religious organizations, if the turnover from business transactions during the previous accounting year did not exceed 25,000 LVL.

Law on Annual Accounts came into force January 1, 1993 and has undergone 13 amendments. It applies to the commercial companies and cooperative societies registered in Latvia, European economic interest groups, European cooperative societies and European commercial companies registered in Latvia. The law does not

apply to banks, savings and loan societies, insurance commercial companies and mutual insurance cooperative societies, private pension funds, investment broker companies and investment management companies.
Law on Consolidated Annual Accounts came into force on November 22, 2006 and applies to commercial companies and cooperative societies if they are parent companies. The law does not apply to banks, commercial insurance companies (in the form of public limited liability companies), mutual insurance co-operative societies, private pension funds, investment broker companies and investment management companies, institutions financed from the State budget or local government budgets. According to the law a parent company may prepare consolidated annual accounts in accordance with IFRSs.

- **Regulations and instructions**
  - issued by Cabinet of Ministers;
  - issued by Financial and Capital Market Commission;
  - issued by Bank of Latvia;
  - issued by Riga Stock Exchange (NASDAQ OMX Riga).
- **Accounting standards:**
  - Latvian Accounting Standards (Latvijas grāmatvedības standarti)
  - IAS and IFRS.

The Cabinet of Ministers determines mandatory Latvian accounting standards to be applied and range of subjects who have to apply such standards. At present just LAS No 1 – LAS No 9 (Table 4) are obligatory applicable according to the Regulation of the Cabinet of Ministers “On obligatory applicable Latvian Accounting Standards” (Noteikumi par obligāti piemērojamiem Latvijas grāmatvedības standartiem, 27.03.2007).

Table 5. List of Latvian Accounting Standards

No	Latvian Accounting Standards	Adoption	Applicable from	Respective IAS/IFRS
1	Framework for Preparation of Financial Statements (Finanšu pārskatu sagatavošanas pamatnostādnes)	05.02.2004	2004	IASB Framework, IAS 1
2	Cash Flow Statement (Naudas plūsmas pārskats)	05.02.2004	2004	IAS 7
3	Events After the Reporting Period (Notikumi pēc bilances datuma)	08.12.2004	2005	IAS 10
4	Accounting Policies, Changes in Accounting Estimates and Errors (Grāmatvedības politikas maiņa, grāmatvedības aplēšu izmaiņas un iepriekšējo periodu kļūdas)	09.02.2005	2006	IAS 8
5	Long term Contracts (Ilgtermiņa līgumi)	12.07.2005	2006	IAS 11
6	Revenue (Ieņēmumi)	07.12.2005	2006	IAS 18
7	Property, Plant and Equipment (Pamatlīdzekļi)	21.12.2005	2006	IAS 16
8	Provisions, Contingent Liabilities and Contingent Assets (Uzkrājumi, iespējamās saistības un iespējamie aktīvi)	21.12.2005	2006	IAS 37
9	Investment Property (Ieguldījuma īpašumi)	20.06.2007	2008	IAS 40
10	Leases (Noma)	29.04.2009	2010	IAS 17
11	Inventories (Krājumi)	08.09.2010	2011	IAS 2

4.1 Intangible Assets

According to the Law on Annual Accounts intangible assets should be disclosed and classified under long term investments into 5 sub-groups:

- Development costs.
- Concessions, patents, licenses, trademarks and similar rights.
- Other intangible investments.
- Goodwill.
- Payments on account for intangible investments.

Only rights acquired in exchange for valuable consideration may be set out in the item “Concessions, patents, licenses, trademarks and similar rights”. Research costs and startup expenses may not be capitalized. Development costs may be capitalized only if all of the following conditions are met:

- the company intends to finish an asset object in order to utilize it for the own needs of the company or to sell it;
- it is possible for the company to finish such asset object and it has access to the required technical, financial and other resources in order that such asset object may be finished and utilized for the own needs of the company or to sell it;
- the company is able to transparently show what kind of economic benefits from the utilization or sale of such asset object will be received in the future; and
- the company is able to believably value the amount of costs of the such asset object.

Expenses related to the creation of the investments in intangible assets shall be systematically written off over the time of useful life. If time of useful life is impossible to specify, item shall be valued as the acquisition costs from which are deducted the accumulated losses from the reduction in value.

4.2 Tangible Assets

The reporting and accounting issues for tangibles are regulated by LAS 7 “Property, plant and equipment”. *Property, plant and equipment* are tangible assets of the entity used for the production of goods, rendering of services or for administrative purposes and that are expected to be used during more than one year. Examples of group of assets are land, buildings, equipment etc.

An item of property, plant and equipment that meets the criteria for recognition as an asset in the balance sheet, shall initially be recognized at cost which comprises:

- its purchase price (incl. import duties and other non-refundable taxes);
- any directly attributable costs.

If an asset is acquired through a non-monetary transaction (barter transaction) in exchange for another asset, the cost of the asset acquired is measured at the fair value. If the fair value is not used, the book value of asset exchanged is used.

If an item of property, plant and equipment consists of separate identifiable parts with different useful lives, these parts shall be recognized initially as separate items of property, plant and equipment and separate depreciation rates shall be assigned to them depending on their useful lives.

In the balance sheet, an item of property, plant and equipment shall be carried at cost less any accumulated depreciation and any accumulated impairment losses.

Depreciation of the items of property, plant and equipment is performed during the useful life of the item. Exceptions are items with an unlimited useful life (for example, land, works of art with sustained value, museum exhibits and books) that are not depreciated. The depreciation method selected shall systematically reflect the pattern in which the asset’s future economic benefits are expected to be consumed by an entity over the asset’s useful life. Depreciation needs to express the use of an asset and not necessarily the change in its value. Therefore the objective of selecting depreciation methods and rates is to reflect the asset’s use as truly as possible. Straight-line method, declining balance method and units-of-production method are acceptable.

If the residual value of an asset is insignificantly low, it may be assumed to be zero. If the residual value is significant only the depreciable portion of the difference between the cost and the residual value shall be depreciated into an expense over their useful lives.

The depreciation starts at the moment when the asset is available for use and it is continued until the full depreciation of the depreciable amount, until it is retired from active use. The depreciation of an asset temporarily retired shall not be stopped.

At the each balance sheet date, the appropriateness of the depreciation rates, depreciation methods and estimated residual values applied shall be assessed. If it becomes evident that the actual useful life of an asset differs significantly from the initial estimate, the depreciation term shall be changed. Also, the depreciation methods and the estimated residual value of an asset shall be changed if necessary. If there are any indications that the recoverable value of a certain item of property, plant and equipment may have fallen below its book value, an impairment test shall be carried out and the asset shall be written down.

Costs related to subsequent improvements shall be added to the cost of property, plant and equipment only if they meet the definition of property, plant and equipment and the criteria for recognizing assets in the balance sheet (incl. expected participation in the provision of future economic benefits). Costs related to ongoing maintenance and repairs shall be charged to period expenses. In case a part of an item of property, plant and equipment is replaced, the cost of the new part shall be added to the cost of the item if it meets the definition of noncurrent assets and the criteria for recognizing assets in the balance sheet. The replaceable part shall be written off the balance sheet. If the initial cost (and hence the current carrying amount) of the replaceable part is not known, it may be assessed using replacement costs.

Items of property, plant and equipment shall be written down to their recoverable amount if the recoverable amount of the asset is lower than its carrying amount. In identifying whether an asset may be impaired, an impairment test shall be performed to find the recoverable amount of an asset. An impairment loss shall be recognized as an expense of the accounting period.

Items of property, plant and equipment expected to be sold within the next 12 months, shall reclassified as non-current assets held for sale and are recognized as current assets in the balance sheet. The depreciation of non-current assets classified as held for sale is terminated at the time of reclassifying an asset.

It is obligatory to provide information about long term investments on the balance sheet or in the annex regarding:

- acquisition (or production) cost in accordance with the balance sheet of the preceding period;
- increases (including improvements) during the current period;
- liquidation value at the beginning of the current period;
- any transfers from one item to another during the current period;
- revaluation during the current period and total amount of revaluation before the balance sheet date;
- depreciation and write-offs of value during the current period;
- adjustments for depreciation and write-offs of value for previous years, including adjustments in depreciation and write-offs of value of liquidated assets and assets withdrawn from use;
- total depreciation and write-offs of value before the balance sheet date.

4.3 Leases

The accounting of leases is regulated by LAS 10 “Leases”. The objective of LAS 10 is to prescribe criteria for the accounting and recognition of lease agreements in the financial statements of both lessees as well as lessors.

Leases are classified as finance and operating leases.

Finance lease – lessor. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership to the lessee; otherwise a lease agreement is classified as an operating lease. The substance over form principle is used in classification process. The classification of a lease agreement into finance or an operating lease depends on the substance of the transaction rather than the legal form of the agreement. Lease classification is made at the inception of the lease.

To be classified as finance lease some criteria must be followed. The following criteria show that substantially all the risks and rewards incidental to ownership are transferred to the lessee, leading to a lease being classified as a finance lease:

- the ownership of the leased assets is transferred to the lessee by the end of the lease term;
- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the lessee uses this option;
- the lease term covers the major part of the economic life of the leased asset, even if the title is not transferred;
- at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;

- the leased asset is of such specialized nature that only the lessee can use it without major modifications.

The lessor shall recognize assets leased out under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease. When selling their products under the finance lease, manufacturer or dealer lessors recognized two types of income:

- sales revenue to be recognized upon the entry into force of a lease agreement;
- financial income to be recognized over the lease term.

Finance lease – lessee. The lessee shall recognize a finance lease as an asset and a liability in its balance sheet at amounts equal to the fair value of the leased property or at the present value of the minimum lease payments, if lower. The discount rate used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease or if its calculation is not possible, then the lessee's incremental borrowing rate shall be used. Minimum lease payments are divided between the finance charge and the reduction of the outstanding liability. The lessee must also depreciate the leased asset; the depreciation rates used for depreciating assets leased under the finance lease are the same as used for similar assets at the entity.

Operating lease – lessor. Lessors shall present assets leased out under an operating lease in their balance sheet according to the nature of the asset, similarly to other assets presented in the balance sheet. Operating lease payments shall be recognized in income on a straight-line basis, unless another systematic reflects more objectively the time pattern of the user's benefits. The leased out asset shall be depreciated in accordance with regular depreciation methods used for depreciating the entity's similar assets.

Operating lease – lessee. Lease payments under an operating lease shall be recognized as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefits.

A sale and leaseback transaction. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset to the seller. The lease payment and the selling price are usually interdependent because they are negotiated as a package. The recognition depends on whether the leaseback is an operating or a finance lease and in the case of an operating lease, whether the transaction occurred at the market price or not. If a sale and leaseback transaction results in a finance lease, the transaction shall be recognized as a financing transaction and not as a purchase and sales transaction, i.e. the "sold" asset shall stay in the balance sheet of the seller and the finance lease liability shall be recognized in the amount of the payment received ("selling price"). The difference between the "selling price" and the minimum lease payments is recognized as an interest expense over the lease term similarly to regular finance lease agreements. If the sale-leaseback transaction is under an operating lease terms, the transaction shall be recognized as a purchase-sale transaction, whereas any profit or loss shall be recognized immediately, except in cases when (IAS 17.61): (a) the selling price is below the fair value of the asset and the low price is compensated for by low interest rates in the future (see paragraph 43); or (b) the selling price is above the fair value of the asset (see paragraph 44).

4.4 Financial Assets

The Law on Annual Accounts provides an option to value financial instruments and derivative financial instruments either in cost of their acquisition or in fair value. Fair value is also applicable to any financial asset or financial obligation item, which is qualified as a risk insured item, or also a specified part of such item if such is necessary in accordance with the accepted risk limitation accounting system of the company. Law on Annual Accounts Law defines derivative financial instruments as contracts for which the basic assets are goods and in accordance with which both parties have the right to settle in cash or with some other financial instrument, except in the case where all of the following conditions are in effect:

- the contract is entered into in accordance with the planned purchase of goods, raw materials, basic materials and ancillaries, sale or use needs of the company and they still apply;
- the contract already initially was intended for the needs referred to in previous paragraph;
- the contract obligations are intended to be completed with the supply of the goods.

Valuation of the fair value shall be applied only to those financial obligations, which are an integral part of the trade portfolio or which have been created from derivative financial instruments. The following financial assets are not the subject to valuation of fair value:

- investments held to the end of term, which are not derivative financial instruments;
- loans and debtor debts, which are not held for trade; and

- participation in the group subsidiary companies, associated companies and managed-in-common company capital and company emitted capital securities, as well as other financial instruments, which, taking into account IFRS, which have been adopted in accordance with Regulation (EC) No 1606/2002, shall not be subject to valued fair value.

There is an opportunity to derogate from regulation provided by the Law on Annual Accounts and to value financial instruments in accordance with IFRS, which have been adopted in accordance with Regulation (EC) No 1606/2002 with later amendments.

The valuation of the fair value of financial instruments in the above mentioned cases must be believable (if it is not believable the valuation in cost of acquisition should be applied). A valuation is believable if the fair value of the financial instrument is specified utilizing one of the following methods:

- financial instruments for which published prices are quoted in asset public securities market – on the basis of the market price. If the financial instrument does not have the referred to market price, but such price is for a separate component thereof or similar financial instruments, such instrument market price may be established taking into account the market price of the component thereof or similar financial instrument; or
- financial instruments for which it is not possible to specify a market price – on the basis of the value, which is calculated utilizing generally known and applicable valuation models and methods if the calculated value appropriately reflects the possible market price of such instruments.

Changes to the fair value of a financial instrument should be included in the profit or loss account, except in the following cases when the changes in the fair value should be shown under the balance sheet item “Financial instrument revaluation reserve”:

- the financial instrument is qualified as a risk limitation instrument and in accordance with the risk limitation accounting system accepted by the company it is intended that some (or all) of the changes to the value of such instrument not be reflected in the profit or loss account; and
- the changes in the value of the financial instrument is dependent upon the changes in the exchange rate associated with the long term cash investment of the company in the equity capital of an existing company under foreign jurisdiction.

Changes in the fair value of financial assets available for sale if such assets are not derivative financial instruments, should be shown in the balance sheet item “Financial instrument revaluation reserve”. It shall be included in a profit or loss account for the same period in which the relevant financial instrument is sold, extinguished or alienated in some other way or also in which the value of the financial asset is reduced.

4.5 Receivables

The Latvian accounting standard regarding disclosure and accounting of current assets is still in progress, therefore just core requirements could be found in the Law on Annual Accounts. It is prescribed that in balance sheet receivables should be classified and disclosed as:

- Purchasers and commissioning party debts;
- Related undertaking debts;
- Associated undertaking debts;
- Other debtors;
- Shares not paid into company capital;
- Short term loans to co-owners of undertakings and management;
- Prepaid expenses;
- Accrued income.

Expenses, incurred before the balance sheet date, but relating to future years, should be set out as prepaid expenses. Amounts receivable within one year, and amounts receivable later than within one year, after the balance sheet date, shall be set out separately for each item of receivables in the balance sheet.

For receivables, repayment of which is dubious, bad debt reserves shall be set up in the amount of the doubtful amounts. The debtor debt balances should be set out in the balance sheet at their net value, which shall be calculated by subtracting the balances of the established bad debt reserves, from the accounting value of the debts according to the accounting data. Justification for the amount of the established bad debt reserves shall be provided in the annex of the annual accounts. If a debt is considered unrecoverable (lost without hope of recovery), it shall be respectively written off from reserves established for bad debts or shall be included in losses.

4.6 Inventories

The inventories are a significant part of current assets. The Law on Annual Accounts prescribes that the actual cost of acquisition of current assets shall be calculated by adding expenses related to purchase to the purchase price. The actual cost of production shall be calculated by adding up the usage of raw materials, basic materials and consumables, in accordance with the costs of acquisition and additional costs directly related to production of the product being valued. There may be added to production costs, the cost of relevant parts not directly related with the production of the product, if these costs are applicable to the same period. Sales costs shall not be included in the actual cost of production.
Inventories are reported in the balance sheet under the items designated for them in the balance sheet format provided by the Law on Annual Accounts:

- Raw materials, basic materials and consumables;
- Work in progress;
- Finished products and goods for sale;
- Unfinished orders;
- Advance payments for goods;
- Draft animals and productive animals.

It is allowed to add additional sub-items with the aim to ensure greater clarity and legibility of the balance sheet.
Weighted average and FIFO methods are used in the accounting of inventories. If the value established by using these methods differs significantly from the market price on the balance sheet date, the difference for each inventory item shall be explained in the annex. Inventory balances shall be valued in accordance with actual cost, i. e. either the acquisition or production cost price, or the lowest market price on the balance sheet date depending upon which of these indicators is the lowest. In special cases – if the inventory units are damaged, partially or fully obsolete or the production termination or sale costs have significantly increased thereof – the relevant inventory units shall be valued in conformity with the net realizable value.

4.7 Cash and Equivalents

Cash and cash equivalents are reported in the balance sheet under current assets. LAS 2 “Cash Flow Statement” defines cash as cash on hand and deposits at call, but cash equivalents as short term, highly liquid investments that are convertible to known amounts of cash and that have no significant market value risk.

4.8 Equity

According to the Law on Annual Accounts the equity should be disclosed as:

- Stock or share capital (equity capital)
- Stock (share) emission premium
- Long term investment revaluation reserve
- Financial instrument revaluation reserve
- Reserves:
    - reserves specified by law
    - reserves for own stocks or shares
    - reserves specified by the company’s articles of incorporation
    - other reserves
- Retained profits:
    - retained profits brought forward from the previous year
    - retained profits of the accounting year

If stocks or shares of new emission have been sold for a larger amount than the nominal value, the difference shall be set out under item “Stock (share) emission premium”. If they have been sold for an amount below the nominal value, the difference shall be set out under the same item as a negative number.
If the equity capital consists of several types of stock or shares, the number and nominal value of each type of stock or shares shall be set out in the annex to accounts. Stock companies shall always set out the number of stock and their nominal value. The following information shall be provided regarding the company’s aggregate own stock or shares:

- the number of stocks or shares and the total amount of their nominal value, and the ratio of this total amount in the capital of the undertaking;
- the number of stocks or shares repurchased or sold during the accounting year, their nominal value, their percentage ratio in the equity capital, and the total repurchasing or selling price;
- the reason for acquiring own stock or shares of the undertaking in the accounting year.

The information mentioned above should be set out separately for those stocks or shares which have been acquired as property and those which have been acquired by way of pledge.

Long term investment objects, the value of which is significantly higher than the cost of their acquisition or production cost price or their valuation on the balance sheet of the previous year, may be re-valued in accordance with their higher value, if it may be assumed that the value increase will be long term. The increase in value resulting from such revaluation shall be recorded under the item “Long term investment revaluation reserve”. This item shall not be allocated to dividends, used to cover losses, transferred to capital or other reserves, or used in for social purposes, for charity or for other purposes. It shall be reduced if the re-valued object has been liquidated or is no longer utilized, or if the increase in value is no longer justified.

Under the item “Retained profits of the accounting year”, the amount shall be set out which corresponds to the amount set out under the profit or loss item “Profit or loss of the accounting year”. The profit distribution or coverage of losses of a company shall be set out in the accounts for the following year, correspondingly decreasing the amount set out at the beginning of the accounting year under the item “Retained profits for the previous year”.

4.9 Provisions

The objective of LAS 8 “Provisions, Contingent Liabilities and Contingent Assets” is to prescribe rules for the recognition of provisions, contingent liabilities and contingent assets in the financial statements.

Nature of Provisions. A provision is a liability of uncertain timing or amount. Provisions are distinguished from other “ordinary” liabilities (e.g. supplier payables, borrowings, etc.) because there is uncertainty about the timing or amount of the future expenditures required in the settlement. The amount used for recognizing “ordinary” liabilities is generally determined in an invoice, a contract or some other document and there is no need for the application of accounting estimates. In recognizing provisions in the balance sheet, the opinion of management or other experts regarding the amount probably needed for settling provisions or the timing of provisions shall be used as the basis. Since the measurement of provisions is based on estimates that might not always be precise, it is important to recognize and report them separately from other liabilities. There is even more uncertainty regarding contingent liabilities than provisions. If the settlement of provisions is probable and the amount can be estimated relatively reliably, then the settlement of contingent liabilities is either improbable or the amount cannot be estimated reliably.

An entity shall recognize a provision in its balance sheet when:

- the entity has a present legal or constructive obligation as a result of events that occurred before the balance sheet date;
- it is probable that an outflow of resources will be required to settle the obligation;
- a reliable estimate can be made of the amount of the obligation.

An entity shall recognize a provision in its balance sheet only when the so-called obligating event has occurred before the balance sheet date. For an event to be an obligating event, it is necessary that it creates either a legal or a constructive obligation for the entity, without a realistic alternative to settling the obligation.

A provision shall be recognized in the balance sheet only if the probability of its settlement is more probable than non-settlement. If the probability of settlement is less probable than non-settlement, a provision will not be set up, but the expected obligation shall be disclosed as a contingent liability in the notes to the financial statements.

Generally it is always possible to make a reliable estimate of the size of the necessary provision (i.e. the amount accompanying the provision). In rare cases, where no reliable estimate can be made of the amount of the provision, the provision shall not be recognized in the balance sheet, but the factors related to it shall be disclosed as a contingent liability in the notes to the financial statements.

Measurement of Provisions. The amount recognized as a provision shall be in the management’s opinion the best estimate of the expenditure required to settle the present obligation as at the balance sheet date.

At each balance sheet date, the management of an entity shall assess the need for setting up new provisions and revaluing or reversing existing provisions. A provision shall be recognized in the amount which is

probably necessary for the settlement of the related obligation or transferring it to a third party. The amount necessary for the settlement of an obligation relating to the provision often depends on several external factors whose development the entity cannot control but whose probability can be usually estimated. In measuring provisions, the probability of different possible scenarios should be considered.
In case the provision is settled not in the nearest future after the balance sheet date, it shall be recognized at its discounted value (i.e. in the present value of the payments related to the provision), except when the impact of discounting is immaterial. A single exception is the deferred income tax provision that shall not be discounted. In calculating the present value, the discount rate used shall be the market interest rate for similar obligations.
Use of Provisions. Provisions shall be used only for the expenditures for which the provision was originally set up.
Warranty Provisions. In case an entity provides warranties on the goods it sells, a provision shall be set up in the balance sheet of the entity in the amount necessary for settling the warranty obligations for the products sold by the balance sheet date. The obligating event is the sale of goods. Past experience is used as the basis for the measurement of provisions.
Provisions for Restructuring Costs. Restructuring is a thorough reorganization of an entity's operations based on a specific activity plan carried out by the management of an entity as a result of which either the scope of business undertaken by the entity or the manner in which that business is conducted will materially change. Examples of restructuring are the sale or liquidation of a line of business; the closure or relocation of certain major production units; material changes in the management structure leading to a lay-off of some management members.
A constructive obligation has arisen in conjunction with the restructuring program and the entity shall recognize a provision in its balance sheet only if the management has before the balance sheet date:

- compiled a detailed official restructuring program which describes parts of the business to be restructured, planned changes in the number of employees, the expenditures that will be undertaken and their planned schedule; as well as
- has either disclosed the main points of the restructuring program or has started to implement the restructuring program, raising valid expectations in other concerned parties regarding the implementation of the restructuring program.

4.10 Liabilities

According to the Law on Annual Accounts and LAS 1 "Framework for Preparation Financial Statements" long term liabilities include those amounts of obligations the payment of which is due more than a year after the end of the respective accounting year, and which are created in order to finance long term investments and business assets or in order to cover obligations, and which are not included in short term liabilities. Short term liabilities include amounts that are payable in nearest 12 months time after the end of the accounting year and other obligations, which occur in the normal cycle of activity of the undertaking. Assets and liabilities shall not be offset in the balance sheet unless an entity has a legal right for offsetting assets and liabilities and it is probable that it uses this right.
Some information regarding liabilities is prescribed to be discovered in the annex. Each liability item in the balance sheet should provide information about the part payable more than 5 years after the balance sheet date. If the assets of a company have been pledged or encumbered by some other loan security, such shall be set out together with the information regarding the terms of the pledge and any other conditions by way of guarantee to secure repayment of the loan, and the balance sheet value of the pledged property. The total creditor debt amounts, which are covered by the security, which has been provided to related companies, shall be set out separately indicating the type and form of security. The total amount of old-age pensions, warranty and guarantee obligations, discounted bills of exchange and other financial liabilities not reflected in the balance sheet shall be set out. If a company has entered into lease or rent agreements, which are significant for its operations, the obligations provided for under these agreements shall be specially indicated. Obligations to existing and former employees in relation to pensions and obligations to related companies shall be set out separately. The amounts of tax and fee obligations, the late charges calculated, penalty payments and other amounts payable or overpaid to the State budget or local government budgets, included in accounts payable or accounts receivable, appropriately reconciling such amounts with the tax administration, shall be set out in detail according to types of taxes and fees.

5 Official Forms of Financial Statements

The annual accounts (gada pārskats) consist of:

- a financial report (finanšu pārskats)
- balance sheet (bilance),
- profit or loss account (peļņas vai zaudējumu aprēķins),
- cash flow statement (naudas plūsmas pārskats),
- statement of changes in equity (pārskats par izmaiņām pašu kapitālā),
- annex (pielikums).
- management report (vadības ziņojums).

The annual accounts must provide a true and fair view (patiess un skaidrs priekšstats) of the assets and liabilities, financial position, profit or loss and cash flows of the company.

The Law on Annual Accounts prescribes special form of the balance sheet and four optional forms (vertical and account form classified by nature and function) of the profit or loss account. Cash flow statement and statement of changes in equity shall be prepared in accordance with the Latvian accounting standards: LAS No 1 Framework for Preparation of Financial Statements (Finanšu pārskatu sagatavošanas pamatnostādnes) and LAS No 2 Cash Flow Statement (Naudas plūsmas pārskats).

SMEs are generally entitled to prepare of shorter and simplified version of financial statements.

Special requirements for audit of annual accounts

The audit by sworn auditor (according to the Law on Sworn Auditors) is required, if:

- a limited liability company, cooperative society, European cooperative society or European commercial company registered in Latvia exceeds two of the three criteria (balance sheet total – 250,000 LVL, net sales turnover 500,000 LVL, average number of employees in the accounting year 25) or transferable securities of a company are admitted to trading on the regulated market of EU.
- a parent company prepares the consolidated annual accounts.

Submission of Annual Accounts

Companies have to submit a copy of the annual accounts (in paper or electronic form) and the sworn auditor’s report (if such exists) to the State Revenue Service (Valsts Ieņēmumu dienests) according to the place of establishment of the company. Within five working days the State Revenue Service shall submit the documents electronically or the electronic copies of these documents to the Enterprise Register, which shall ensure the public access to the documents received.

5.1 Balance Sheet

The official form of Balance Sheet in Latvia is following:

Assets	Liabilities and owners’ equity
Non current assets I. Intangible assets: 1. Research and development costs 2. Concessions, patents, licenses, trademarks and similar rights 3. Other intangible assets 4. Goodwill 5. Payments on account II. Tangible assets 1. Land and buildings 2. Leased assets 3. Equipment and machinery 4. Other fixed assets 5. Instalment costs of fixed assets and buildings under construction 6. Payments on account	Equity: 1. Share capital 2. Additional paid-in capital 3. Revaluation reserve for noncurrent assets 4. Revaluation reserve for financial instruments 5. Reserves: a) reserves specified by law b) reserves for own shares c) reserves provided for the articles of association d) other reserves 6. Retained profits: a) retained profits from the previous years b) retained profit for the accounting year Provisions: 1. Provisions for pensions and similar obligations 2. Provisions for taxation 3. Other provisions

III. Investment properties IV. Biological assets V. Long term financial assets 1. Participating interests in subsidiaries 2. Loans to subsidiaries 3. Participating interests in associated undertakings 4. Loans to associated undertakings 5. Other securities and investments 6. Other loans and long term debtors 7. Own shares 8. Loans to shareholders and management Current Assets I. Inventories: 1. Raw materials and consumables 2. Work in progress 3. Finished goods and goods for resale 4. Unfinished orders 5. Payments for account 6. Livestock II. Noncurrent assets held for sale III. Debtors 1. Trade debtors 2. Amounts owed by subsidiaries 3. Amounts owed by associated undertakings 4. Other debtors 5. Subscriptions receivable 6. Short term loans to owners and management 7. Prepaid expenses 8. Accrued income IV. Short term financial investments 1. Participating interests in subsidiaries 2. Own shares 3. Other securities and participating interests 4. Derivatives V. Cash	Long term creditors: 1. Debenture loans 2. Convertible loans 3. Loans from credit institutions 4. Other loans 5. Payments on account 6. Trade accounts payable 7. Notes payable 8. Amounts owed to subsidiaries 9. Amounts owed to associated undertakings 10. Taxes and social security 11. Other creditors 12. Prepaid income 13. [deleted by 19.10.2006 law] 14. Unpaid dividends Short term creditors: 1. Debenture loans 2. Convertible loans 3. Loans from credit institutions 4. Other loans 5. Payments on account 6. Accounts payable to suppliers and contractors 7. Notes payable 8. Amounts owed to subsidiaries 9. Amounts owed to associated undertakings 10. Taxes and social security 11. Other creditors 12. Prepaid income 13. [deleted by 19.10.2006 law] 14. Unpaid dividends 15. Accrued liabilities 16. Derivatives

5.2 Profit/Loss Statement

Profit/Loss Statement in Latvia is possible to prepare under the division of expenses by nature or by function. The official structures are provided within parts 5.2.1 and 5.2.2.

5.2.1 Expenses Divided by Nature

The official form is following:

1. Net sales turnover
2. Changes in inventories of finished goods and work in progress
3. Work performed by the undertaking for its own purpose and capitalized
4. Other operating income
5. Cost of supplies
   a) cost of raw materials and consumables
   b) other external charges
6. Labor costs:
a) wages and salaries
b) pensions from company funds
c) State social security costs
d) other social security costs
7. Depreciation and impairment of assets:
a) depreciation and impairment of tangible and intangible noncurrent assets
b) impairment of current assets
8. Other operating charges
9. Income from investments in subsidiaries and associated undertakings
10. Income from investments in long term securities and loans
11. Interest income and other similar income
12. Impairment of long term and short term financial investments
13. Interest expenses and similar expenses
14. Profit or loss before extraordinary items and taxes
15. Extraordinary income
16. Extraordinary expenses
17. Profit or loss before taxes
18. Corporate income tax for the accounting year
19. Other taxes
20. Profit or loss for the accounting year

5.2.2 Expenses Divided by Function

The official form is following:

1. Net sales turnover
2. Cost of goods sold
3. Gross profit (loss)
4. Selling expenses
5. Administrative expenses
6. Other business income
7. Other business expenses
8. Income from investments in subsidiaries and associated undertakings
9. Income from investments in long term securities and loans
10. Interest income and other similar income
11. Impairment of long term and short term financial investments
12. Interest expenses and other similar expenses
13. Profit or loss before extraordinary items and taxes
14. Extraordinary income
15. Extraordinary expenses
16. Profit or loss before taxes
17. Corporate income tax for the accounting year
18. Other taxes
19. Profit or loss for the accounting year

5.3 Cash Flow Statement

The structure of Cash Flow Statement for preparation under direct and indirect methods is following:

Indirect method

I. Cash flows from operating activities
Profit (loss) before extraordinary items
Adjustments:
Depreciation of tangible fixed assets
Amortization and impairment of intangible assets
Accruals (except for bad debts)
Foreign exchange adjustment
Income from subsidiaries and associated undertakings
Income from long term securities and loans
Other interest income and similar income
Impairment charges of long term financial investments and short term securities
Interest expenses and similar expenses
Profit (loss) before changes in current assets and short term liabilities
Adjustments:
Changes in receivables
Changes in inventories
Changes in payables
Gross cash flows from operating activities
Interest payments
Corporate income tax payments
Cash flow before extraordinary items
Cash flow from extraordinary items
Net cash flows from operating activities
II. Cash flows from investing activities
Purchase of shares of subsidiaries and associated undertakings
Proceeds from disposal of shares of subsidiaries and associated undertakings
Purchase of tangible and intangible assets
Proceeds from disposal of tangible and intangible assets.
Loans made
Principle collections from loans
Interest received
Dividends received
Net cash flow from investing activities
III. Cash flows from financing activities
Proceeds from issuing shares and debts
Proceeds from borrowings
Proceeds from subsidies, grants, donations received
Repayment of borrowings
Purchase of leased property
Dividends paid
Net cash flow from financing activities
IV. Foreign exchange adjustment
V. Total net cash flow
VI. Cash and cash equivalents at the beginning of year
VII. Cash and cash equivalents at the end of year

Direct method

I. Cash flows from operating activities
1. Cash inflow from sales of products and services
2. Cash paid to suppliers and employees
3. Other cash inflows and outflows
4. Gross cash flows from operating activities
5. Interest paid
6. Corporate income tax paid
7. Net cash flow before extraordinary items
8. Cash flows from extraordinary items
9. Net cash flow from operating activities
II. Cash flows from investing activities
1. Purchase of shares of subsidiaries and associated undertakings
2. Proceeds from disposal of shares of subsidiaries and associated undertakings
3. Purchase of tangible and intangible fixed assets
4. Proceeds from disposal of tangible and intangible assets.
5. Loans made
6. Principle collections from loans
7. Interest received
8. Dividends received
9. Net cash flow from investing activities
III. Cash flows from financing activities
1. Proceeds from issuing shares and debts
2. Proceeds from borrowings
3. Proceeds from subsidies, grants and donations
4. Repayment of borrowings
5. Purchase of leased property
6. Dividends paid
7. Net cash flow from financing activities
IV. Foreign exchange adjustment
V. Total net cash flow
VI. Cash and cash equivalents at the beginning of year
VII. Cash and cash equivalents at the end of year

6 Major Differences from IFRS

The measurement and recognition principles in Latvian accounting standards are based on IFRSs and are their simplified summary. Therefore LAS generally are written in simpler language, require less disclosure than IFRSs and sometimes provide simplified methods as they are primarily designed for application by small and medium sized entities. Some areas LAS don't covered at all. Unlike other Baltic States, namely, Estonia and Lithuania, where almost the entire list of national standards came into force some years ago, there have been adopted just 11 Latvian national accounting standards. It means that the most important loadstone isn't a difference between national regulation and IFRSs, but the lack of detailed national regulation. The normative regulation (laws and regulations issued by the Cabinet of Ministers) are too general and superficial. In practice in areas which are not covered by LAS and national accounting laws, the IFRS treatment is voluntary applied.

LAS 1 "Framework for Preparation of Financial Statements" is very similar to the IASB Framework for the preparation and presentation of financial statements. However, it does not define main users of financial reporting. The important difference between IAS 1 "Presentation of Financial Statements" and Law on Annual Accounts is that the former does not prescribe the format of a balance sheet and the order in which balance sheet items need to be presented. According to the Law on Annual Accounts, it is compulsory that assets and liabilities are grouped into long term investments and current assets, long term liabilities and short term liabilities. Whereas according to IAS 1, there is also a possibility to apply exception when the presentation of items in a balance sheet is based on liquidity providing information that is reliable and more relevant. It is not foreseen in the law to use other name such as Statement of Financial Position or other for the Balance sheet.

IAS 1 requires presenting Statement on Comprehensive Income, but the Law on Annual Accounts – Profit or Loss Account.
LAS 2 “Cash Flow Statement” defines model forms of Cash Flow Statements for direct and indirect treatment. The model forms include separate lines for cash flows from extraordinary activities. The main difference between LAS 2 and IAS 7 “Statement of Cash Flows” is that under LAS 2 completion of the cash flow form under indirect treatment should be started from the profit (loss) before extraordinary items, not from the profit before taxation.
Unlike Standard IAS 19, the LAS 8 “Provisions, Contingent Liabilities and Contingent Assets” does not provide a detailed description of pension provisions and other post-employment benefits as the accounting for these areas is significant only for a small number of entities in Latvia. IAS 19 requires the disclosure of more detailed information in the notes to the financial statements than LAS 8 does.
The accounting policies set out in the guideline LAS 10 “Leases” regarding the accounting for leases are in compliance with the accounting policies set out in IAS 17, except for the requirements for the disclosures in notes. The requirements of IAS 17 for the disclosures in the notes are more detailed in comparison with LAS 10.
The accounting policies prescribed in the LAS 11 “Inventories” are in accordance with the accounting policies prescribed in IAS 2. The requirements of IAS 2 set for disclosures in the notes differ in details from the requirements of LAS 11.
The accounting policies prescribed by the Law on Annual Accounts for financial instruments are generally in compliance with the accounting policies prescribed in IAS 39, although IAS 39 provides a more thorough description of several accounting areas of financial instruments. IAS 32 and IAS 39 require more disclosures in notes than Latvian national accounting regulation does. The Law on Annual Accounts defines neither financial assets and financial liabilities, nor available-for-sale financial assets and held-to-maturity investments. Instead it contains a cross-reference to terms used in IFRSs.

7 Sample Case

ACCOUNTANT Ltd started its business in Latvia in November 2010. The core business of the company is sale of goods as well as professional consulting.
The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 21 %).
For the simplicity of postings there will be used “MU” (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

Initial Balance Sheet

Balance Sheet as at November 1, 2010			
Bank account	145,000	Registered capital	145,000
Incorporation expenses	5,000	Short term loans	6,050
VAT paid	1,050		
ASSETS	151,050	EQUITY+LIABILITIES	151,050

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses
- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study

Fixed Assets and Finance Leases
Accounting depreciation of computer:

$$monthly\ depreciation = \frac{2000}{36} = 55.56 \equiv 56\ MU$$

Accounting depreciation of car

$$monthly\ deprecation = \frac{16473}{60} = 274.55 \equiv 275\ MU$$

Tax depreciation of computer:
2010 December
35% × 2 = 70%
2,000 × 70%/12 = 116,67 = 117 MU

Calculation of deferred tax

Year	Asset	Net value (accounting)	Net value (taxes)	Difference	Tax rate	
2010	Computer	1,888	1,883	5	15%	Deferred tax liability 0.75
2010	Car	16,198	16,473	275	15%	Deferred tax asset 41.25
Total						Deferred tax asset 41

Op.	Text	Amount			Account
1	Purchase of computer	2,000 420 2,420	Dr Dr	 Cr	Movables VAT Trade payables

2	Depreciation of computer (2 months)	112 112	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)
3	Depreciation of car (1 month)	275 275	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)
4	Calculation of deferred tax	41 41	Dr	 Cr	Deferred Tax Asset R – Income Tax (deferred)
5	Finance lease	16,473 3,459 19,932	Dr Dr	 Cr	Movables VAT Lease payable
6	1st payment of finance lease	257 257	Dr	 Cr	Lease payables Bank account
7	1st financial charge of finance lease	136 136	Dr	 Cr	E – Financial expenses Bank account

Inventories

Op.	**Pieces**			**Cost**	**MU**		
	+	-	Δ		+	-	Δ
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5,700			37,500	44,850
4	3,300		9,000	9.00	29,700		74,550
5		3,600	5,400			28,050	46,500
6		2,400	3,000			19,500	27,000

Op.	Text	Amount			Account
1	Purchase of goods (6,500 @ 7.50 MU)	48,750 10,238 58,988	Dr Dr	 Cr	Goods VAT Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600 7,056 40,656	Dr Dr	 Cr	Goods VAT Bank account
3a	Sale of goods (5,000 @ 12.00 MU)	72,600 60,000 12,600	Dr	 Cr Cr	Trade receivables R – Goods sold VAT
3b	Goods issue	37,500 37,500	Dr	 Cr	E – Goods sold Goods
4	Purchase of goods (3,300 @ 9.00 MU)	29,700 6,237 35,937	Dr Dr	 Cr	Goods VAT Bank account
5a	Sale of goods (3,600 @ 12.00 MU)	52,272 43,200 9,072	Dr	 Cr Cr	Trade receivables R – Goods sold VAT
5b	Goods issue	28,050 28,050	Dr	 Cr	E – Goods sold Goods
6a	Sale of goods (2,400 @ 12.00 MU)	34,848 28,800 6,048	Dr	 Cr Cr	Trade receivables R – Goods sold VAT
6b	Goods issue	19,500 19,500	Dr	 Cr	E – Goods sold Goods
7	Calculation of impairment	4,500 4,500	Dr	 Cr	E – Impairment Goods (impairment)

Receivables and payables

Op.	Text	Amount			Account
1	Long term contract (12/2010)	6,050 5,000 1,050	Dr	 Cr Cr	Long term receivables R – Services sold VAT

Salaries

Calculation of salary

Gross salary	800
Social insurance (9%)	72
Income tax	180
Net salary	548

← Income tax due = 26%×(800 – social insurance 72 – tax allowance 35)

Social security (24.09 %)	193

Op.	Text	Amount			Account
Nov 1	Gross salary	800 800	Dr	 Cr	E – Salaries Payroll
Nov 2	Social security (employee)	72 72	Dr	 Cr	Payroll Social security payable
Nov 3	Income tax	180 180	Dr	 Cr	Payroll Income tax payable
Nov 4	Social insurance (company)	193 193	Dr	 Cr	E – Social security Social security payable
Nov 5	Pay-off	548 548	Dr	 Cr	Payroll Bank account
Nov 6	Payment of insurance	265 265	Dr	 Cr	Social security payable Bank account
Nov 7	Payment of income tax	180 180	Dr	 Cr	Income tax payable Bank account
Dec 1	Gross salary	800 800	Dr	 Cr	E – Salaries Payroll
Dec 2	Social security (employee)	72 72	Dr	 Cr	Payroll Social security payable
Dec 3	Income tax	180 180	Dr	 Cr	Payroll Income tax payables
Dec 4	Social security (company)	193 193	Dr	 Cr	E – Social security Social security payable

Other costs and expenses

Op.	Text	Amount			Account
1a	Rental payment (for November 2010)	1,200 252 1,452	Dr Dr	 Cr	E – Services VAT Bank account
1b	Rental payment (for December 2010)	1,200 252 1,452	Dr Dr	 Cr	E – Services VAT Bank account
1c	Rental payment (for January 2011)	1,200 252 1,452	Dr Dr	 Cr	Deferred expenses VAT Bank account
2a	Tax advisory (November 2010)	200 42 242	Dr Dr	 Cr	E – Services VAT Bank account

2b	Tax advisory (December 2010)	200 42 242	Dr Dr	 Cr	E – Services VAT Trade payables
3a	Telecommunication services (November 2010)	1,000 210 1,210	Dr Dr	 Cr	E – Services VAT Bank account
3b	Telecommunication services (December 2010)	1,000 210 1,210	Dr Dr	 Cr	E – Services VAT Trade payables
4	Road tax	100 100	Dr	 Cr	E – Road tax Bank account
5	Interest received	920 920	Dr	 Cr	Bank account R – Interest received
6	Bank charges	5,300 5,300	Dr	 Cr	E – Financial expenses Bank account

Calculation of corporate income tax

Revenues	137,920
Expenses	107,259
Accounting profit	30,661
Corrections: + accounting depreciation - tax depreciation	 387 117
Tax base	30,931
Corporate income tax (15 %)	4,640

Op.	Text	Amount			Account
1	Income tax (due)	4,640 4,640	Dr	 Cr	E – Income tax (due) Income tax payable

Closing of accounts:

Profit and Loss Account as at December 31, 2010			
Goods sold	85,050	Revenues from services sold	5,000
Services	4,800	Revenues from goods sold	132,000
Salaries	1,600	Interest revenue	920
Social security	386	Income tax (deferred)	41
Road tax	100		
Depreciation and amortization	387		
Impairment	4,500		
Financial expenses	5,436		
Income tax (due)	4,640		
Incorporation expenses	5,000		
EXPENSES	**111,899**	**REVENUES**	**137,961**
Profit	*26,062*		
TOTAL	**137,961**	**TOTAL**	**137,961**

Balance Sheet as at December 31, 2010					
Assets	*Gross*	*Corr*	*Net*	**Equity + Liabilities**	*Net*
Movables	18,473	(387)	18,086	Registered capital	145,000
Long term receivables	6,050		6,050	Profit	26,062
Inventories	27,000	(4,500)	22,500	Long term payables (lease)	16,414
Trade receivables	159,720	0	159,720	Trade payables	3,872
Deferred expenses	1,200	0	1,200	Payroll	548
Deferred tax assets	41	0	41	Social security tax payable	265
VAT	950		950	Corporate income tax payable	4,640
				Income tax payable	180
				Short term payables (lease)	3,261
				Short term loans	6,050
				Bank overdraft	2,255
TOTAL	**213,434**	**(4,887)**	**208,547**	**TOTAL**	**208,547**

Ratio analysis

Assets (total)	208,547
EBIT	35,177
EAT	26,062
Equity	171,062
Current assets	184,411
Current liabilities	21,071
Inventories	22,500

Profitability ratios:

$$ROA = \frac{EBIT}{\sum Assets} = \frac{35177}{208547} = \mathbf{16.89}\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{26062}{171062} = \mathbf{15.24}\ \%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{184411}{21071} = \mathbf{8.75}$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{184411 - 22500}{21071} = \mathbf{7.68}$$

8 Dictionary

English	**Latvian**
Accelerated Depreciation	paātrinātais nolietojums
Account	konts
Account Payable	kreditoru parāds
Account Receivable	debitoru parāds
Accountant	grāmatvedis
Accounting	grāmatvedība
Accounting Change	grāmatvedības izmaiņas
Accounting Policies	grāmatvedības politika
Accounting Profit	grāmatvedības peļņa
Accrual Basis	uzkrāšanas princips
Accumulated Depreciation	uzkrātais nolietojums
Additional Paid in Capital	akciju (daļu) emisijas uzcenojums

Amortization	amortizācija
Annual Report	gada pārskats
Annuity	anuitāte
Asset	aktīvs
Auditor	revidents
Auditors' Report	revidenta ziņojums
Available-For-Sale Financial Assets	pārdošanai pieejamie finanšu aktīvi
Balance Sheet	bilance
Bond	obligācija
Book Value, Carrying Amount	uzskaites vērtība
Borrowing Costs	aizņēmuma izmaksas
Budget	budžets
Business	bizness
Business Combinations	komercdarbības apvienošana
Business Segment	biznesa segments
Capitalized Cost	kapitalizētās izmaksas
Capitalized Interest	kapitalizētie procentu maksājumi
Cash	nauda
Cash Basis	kases princips
Cash Equivalents	naudas ekvivalenti
Cash Flows	naudas plūsmas
Cash-generating Unit	naudas plūsmu ģenerējošā vienība
Closing Rate	beigu kurss
Consistency	konsekvence
Consolidated Financial Statements	konsolidētie finanšu pārskati
Consolidation	konsolidācija
Contingent Asset	nosacītie aktīvi
Contingent Liability	nosacītās saistības
Contingent Rent	nosacītā noma
Continuing Operations	turpinājušās operācijas
Control	kontrole
Convertible Share	konvertējamās akcijas
Cost	izmaksas
Cost Accounting	izmaksu uzskaite
Cost Method	izmaksu metode
Costing	izmaksu aprēķināšana
Costs of Disposal	aplēstās pārdošanas izmaksas
Credit Risk	kredītrisks
Creditor	kreditors
Currency Risk	valūtas kurss
Current Asset	apgrozāmais līdzeklis
Current Liability	īstermiņa saistība
Current Tax	nodoklis taksācijas periodā
Debit	debets
Debt	parāds
Debt Security	parāda vērtspapīrs
Debtor	debitors
Deferred Income	atliktais ienākums
Deferred Income Taxes	atliktais ienākuma nodoklis
Deferred Tax Assets	atliktie nodokļu aktīvi
Deferred Tax Liabilities	atliktās nodokļu saistības
Depreciable Amount	nolietojamā vērtība
Depreciation	nolietojums

Derecognition	atzīšanas pārtraukšana
Derivative	atvasinātais instruments
Detection Risk	atklāšanas risks
Development	attīstība
Direct Costs	tiešās izmaksas
Disclosure	informācijas atklāšana
Discontinued Operation	pārtrauktās operācijas
Discount	diskonts
Discount Rate	diskonta likme
Discounted Cash Flow	diskontētā naudas plūsma
Dividends	dividendes
Double–Entry Bookkeeping	divkāršā ieraksta grāmatvedība
Due Date	samaksas vai izpildes termiņš
Earnings Per Share (EPS)	peļņa uz akciju
Economic Life	saimnieciskās izmantošanas laiks
Effective Interest Rate	faktiskā procentu likme
Equity	pašu kapitāls
Equity Instrument	pašu kapitāla instruments
Equity Method	pašu kapitāla metode
Equity Securities	kapitāla vērtspapīrs
Estimated Tax	nodokļa avansa maksājums
Estimation Transactions	uz aplēsēm balstīts darījums
Events after the Balance Sheet Date	notikumi pēc bilances datuma
Exchange Difference	valūtas kursa starpība
Exchange Rate	valūtas maiņas kurss
Expenditure	izlietojums
External Reporting	ārējie pārskati
Extraordinary Items	ārkārtas posteņi
Factoring	faktorings
Fair Market Value	patiesā tirgus vērtība
Fair Value	patiesā vērtība
Finance Lease	finanšu līzings
Financial Asset	finanšu aktīvs
Financial Institution	finanšu institūcija
Financial Instrument	finanšu instruments
Financial Liability	finanšu saistība
Financial Risk	finanšu risks
Financial Statements	finanšu pārskati
Financing Activities	finansēšanas darbība
First in, First out (FIFO)	pirmais iekšā, pirmais ārā
Fiscal Year	taksācijas gads
Fixed Asset	pamatlīdzeklis
Forecast	prognoze
Foreign Currency	ārvalstu valūta
Fraud	krāpšana
Functional Currency	funkcionālā valūta
Funding	ieguldījumu veikšana
Future Contract	nākotnes līgums
Gain	guvums
General Ledger	virsgrāmata
Generally Accepted Accounting Principles	vispāratzītie grāmatvedības principi
Going Concern	darbības turpināšana
Goodwill	nemateriālā vērtība

Gross Income	bruto peļņa
Group	grupa
Guaranty	garantija, galvojums
Hedge	riska ierobežošana
Hedge Effectiveness	riska ierobežošanas efektivitāte
Hedged Item	pret risku nodrošinātais postenis
Hedging Instrument	riska ierobežošanas instruments
Held-To-Maturity Investments	līdz termiņa beigām turēti ieguldījumi
Highly Probable	ticami prognozēts
Historical Cost	iegādes vērtība
Impairment Loss	zaudējums no vērtības samazināšanas
Impracticable	neiespējams
Improvement	uzlabojums
Inception of the Lease	nomas uzsākšanas datums
Income	peļņa
Income Statement	peļņas vai zaudējumu aprēķins
Indirect Costs	netiešās izmaksas
Initial Direct Costs	sākotnējās tiešās izmaksas
Installment	maksājums pa daļām
Intangible Asset	nemateriālais aktīvs
Interest	procents
Interest Cost	procentu izmaksas
Interest Rate Risk	procentu likmes risks
Interim Financial Report	starpperioda finanšu pārskats
Interim Financial Statements	starpperioda finanšu pārskati
Interim Period	starpperiods
Internal Audit	iekšējais audits
Internal Control	iekšējā kontrole
Internal Rate of Return	iekšējās atdeves koeficients
International Accounting Standards Board	Starptautisko grāmatvedības standartu padome
International Financial Reporting Standards (IFRSs)	starptautiskie finanšu pārskatu standarti
Intradepartmental Price, Internal Transfer Price	iekšējā transferta cena
Inventories	krājumi
Investing Activities	ieguldīšanas darbība
Investment Property	ieguldījuma īpašumi
Investor in a Joint Venture	ieguldītājs kopīpašumā
Joint Venture	kopuzņēmums
Journal	reģistrs, uzskaites grāmata
Last in, First out (LIFO)	pēdējais iekšā - pirmais ārā
Lease	līzings
Lease Term	nomas termiņš
Lessee	nomnieks
Lessor	iznomātājs
Liability	saistības
Liquid Assets	likvīdie aktīvi
Liquidation	likvidācija
Liquidity Risk	likviditātes risks
Loans and Receivables	aizdevumi un debitoru parādi
Loans Payable	maksājamie aizdevumi
Long–Term Debt	ilgtermiņa parāds
Loss	zaudējums
Lower of Cost or Market	zemākais no tirgus cenas vai pašizmaksas
Management Accounting	vadības grāmatvedība

Margin	uzcenojums
Market Risk	tirgus risks
Marketable Securities	tirgojami vērtspapīri
Mark–to–Market	tirgus vērtība
Master Budget (Company Budget)	kompānijas budžets
Materiality	būtiskums
Matching Principle	saskaņošanas princips
Merger	apvienošana
Minority Interest	mazākuma līdzdalība
Monetary Assets	monetārie aktīvi
Monetary Items	monetārie posteņi
Net Assets	aktīvu pārsniegums pār saistībām
Net Income	tīrā peļņa
Net Realizable Value	neto pārdošanas vērtība
Non-cancellable Lease	neatceļamā noma
Non-current Asset	ilgtermiņa aktīvi
Non–for–Profit Organization	bezpeļņas organizācija
Notes	pielikums
Notional Value, Face Value	nominālā vērtība
Objectivity	objektivitāte
Obligations	saistības
Onerous Contract	apgrūtinošs līgums
Operating Activities	pamatdarbība
Operating Cycle	pamatdarbības cikls
Operating Lease	operatīvā noma
Option	iespējas līgums
Other Comprehensive Income	pārējais vispārējs ienākums
Parent Company	mātes uzņēmums
Partnership	kompānija, līgumsabiedrība, biedrība
Penalty	naudas sods, līgumsods
Plan Costing	plānoto izmaksu aprēķināšana
Preferred Share	priviliģētā akcija
Present Value	pašreizējā vērtība
Presentation Currency	pārskata valūta
Prior Period Errors	iepriekšējo periodu kļūdas
Probable	varbūtējs
Profit or Loss	peļņa vai zaudējumi
Property, Plant and Equipment	pamatlīdzekļi
Prospective Application	turpmākā piemērošana
Provision	uzkrājums
Public Offering	publiskais piedāvājums
Qualifying Asset	kritērijiem atbilstošs aktīvs
Ratio Analysis	koeficientu analīze
Receivables	debitoru parādi
Reconciliation	saskaņošana
Recoverable Amount	atgūstamā summa
Reinsurance	pārapdrošināšana
Related Party Transaction	saistīto pušu darījumi
Reorganization	reorganizācija
Repairs	remonts
Reporting Date	pārskata datums
Reporting Entity	ziņojošā iestāde; uzņēmums, kas sagatavo pārskatu
Repurchase Agreement	pārdošanas ar atpirkšanu līgums

Research	pētniecība
Residual Value	atlikusī vērtība
Responsibility Accounting	atbildīgā grāmatvedība
Restructuring	pārstrukturizēšana
Retained Earnings	nesadalītā peļņa
Return on Investment (ROI)	peļņa no investīcijām; investīciju atdeve
Revenue Recognition	ieņēmumu atzīšana
Revenues	ieņēmumi
Risk Management	riska vadība
Securitization	pārvēršana vērtspapīros
Security	vērtspapīrs
Separate Financial Statements	atsevišķais finanšu pārskats
Settlement Method	norēķina metode
Share (Stock)	akcija
Short–Term	īstermiņa
Significant Influence	būtiska ietekme
Spot Exchange Rate	tūlītējas apmaiņas kurss
Start–up Costs	uzsākšanas izmaksas
Statement of Cash Flows	naudas plūsmas pārskats
Statement of Comprehensive Income	vispārējā ienākuma pārskats
Statement of Financial Position	pārskats par finanšu stāvokli
Statement of Changes in Equity	pašu kapitāla izmaiņu pārskats
Straight–Line Depreciation	lineārā nolietojuma aprēķina metode
Subsequent Event	notikums pēc bilances datuma
Subsidiary	meitas uzņēmums
Swap	maiņas darījums
Tangible Asset	materiālais aktīvs
Tax	nodoklis
Tax Base	nodokļa bāze
Tax Expense	nodokļa izdevumi
Tax Income	nodokļa ienākumi
Tax Loss	nodokļa zaudējumi
Tax Year	taksācijas gads
Taxable Income	apliekamais ienākums
Taxable Profit	ar nodokli apliekamā peļņa
Taxpayer Identification Number (TIN)	nodokļu maksātāja reģistrācijas numurs
Temporary Differences	pagaidu starpības
Term Loan	terminēts aizdevums
Total Comprehensive Income	kopējs vispārējs ienākums
Transaction Costs	darījuma izmaksas
Unearned Income	negūtie ienākumi
Useful Life	lietderīgās lietošanas laiks
Value in Use	lietošanas vērtība
Venture Capital	riska kapitāls
Work in Progress	nepabeigtā ražošana
Working Capital	apgrozāmais kapitāls
Yield to Maturity	līdz termiņa beigām gūtie ienākumi
Zero–Coupon Bond	bezkupona obligācija

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Financial Reporting in Lithuania

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Lithuania. Due to the globalization of business and international harmonization of financial reporting also Lithuania experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Lithuania.

Country
Lithuania
(Lietuva)
Location
Baltic country (North-Eastern Europe)
Area
65,300 km^2
Population
3,545,319 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
litas (LTL); 3.451 LTL/EUR (as at 31.12.2010)

1 Country Introduction

Lithuania (Lietuvos Respublika) is a country in Northern Europe, the southernmost of the three Baltic states. Situated along the southeastern shore of the Baltic Sea, it shares borders with Latvia to the north, Belarus to the southeast, Poland and the Russian exclave of Kaliningrad to the southwest. Its capital and largest city is Vilnius. The population of Lithuania stands at 3,349,900, of whom 83.1% are ethnic Lithuanians who speak Lithuanian, which is the official language of the country. Several sizable minorities exist such as Poles (6.0%), Russians (4.8%), Belarusians (1.1%) and Ukrainians (0.6%).

For the first time the name Lithuania was mentioned in 1009 AD in a medieval Prussian manuscript, the Quedlinburg Chronicle. In the 13th century AD, the Grand Duchy of Lithuania was created by Mindaugas who united the lands inhabited by the Lithuanians, Samogitians, Jotvingians and Couronians. In the middle ages (1392–1430), the Grand Duchy of Lithuania became the largest state in Europe. Its borders stretched from the Baltic to the Black Sea and almost to Moscow. For the next four centuries, Lithuania gradually became dominated by Poland, until 1795 when the Russian-Prussian-Hapsburg alliance made the third and final partition of Poland and Lithuania became a province of Russia. Lithuania achieved its independence only in February 1918, and between 1920 and 1923 the Republic of Lithuania had been recognized by the major countries. It remained independent until 23 August 1939, when Germany and the USSR signed the so-called Molotov-Ribbentrop Pact, in which Lithuania was the first in the sphere of influence of Germany and then, following the Soviet Agreement of 28 September 1939, fell under the rule of the USSR [1]. After the occupation by Nazi Germany, the Soviet order was re-established in Lithuania in 1944 when the Red Army forced Nazi German out of Lithuania. On 11 March 1990, Lithuania was the first of the Soviet Republics to declare its independence; it regained statehood and joined the community of nations. In October 2002, Lithuania was invited to join the European Union (EU), and in May 2004 it became a member of the EU.

In 2003, before joining the European Union, Lithuania had the highest economic growth rate amongst all the candidate and member countries. Most of the trade of Lithuania is within the European Union. By the UN classification, Lithuania is a country with a high average income. The country boasts a well developed modern infrastructure of railways, airports and four-lane highways. As of October 2008, the unemployment rate is 4.7%. According to officially published figures, EU membership fueled a booming economy, increased outsourcing into the country, and boosted the tourism sector. Litas, the national currency, has been pegged to the euro since 2 February 2002 at the rate of EUR 1.00 = LTL 3.4528 and Lithuania is expecting to switch to the euro on 1 January 2014. Lithuania is part the EU single market.

Structurally, there is a gradual but consistent shift towards a knowledge-based economy with special emphasis on biotechnology (industrial and diagnostic) as well as laser equipment. Major biotechnology producers in the Baltic countries are concentrated in Lithuania. Also, mechatronics and information technology (IT) are seen as prospective knowledge-based economy directions in Lithuania. In 2009, "Barclays" bank IT centre appeared in Lithuania, and in 2010 IBM Company with the Lithuanian government decided to set up a research center there. Also, the first solar cell plant has been opened in Lithuania, and "Western Union" decided to establish a money transfer centre there in 2010. The Lithuanian government strategy is as follows: Lithuanian economy is the production of high added value products and services.

Lithuania has a flat tax rate rather than a progressive scheme. Lithuanian income levels are lower than in the older EU Member States. According to Eurostat data, Lithuanian PPS GDP per capita stood at 61 per cent of the EU average in 2008. Lower wages have been a factor that in 2004 fueled emigration to wealthier EU countries, something that has been made legally possible as a result of accession to the European Union.

Prior to the global financial crisis of 2007–2010, Lithuania had one of the fastest growing economies in the European Union. Lithuania is a member of NATO, the Council of Europe, and Lithuania became a full member of the Schengen Agreement on 21 December 2007. In 2009, Vilnius was the European Capital of Culture and Lithuania celebrated the millennium of its name.

2 Legal System

Since 1990, the legal system of Lithuania has been reformed to meet the demands of the vast social and economic changes brought about by a return to democracy and a free market economic system.

The Republic of Lithuania is an independent democratic state and its legal system is based on the legal traditions of **continental Europe**. The foundation of the social system is enforced by the Constitution of the Republic of Lithuania, which was adopted in 1992 by referendum. The Constitution establishes the rights, freedoms and duties of citizens. Also, under the Constitution of the Republic of Lithuania, the sovereign state power of Lithuania is exercised by the Seimas (Parliament), the President of the Republic, the Government and the Courts. The chief of the Republic of Lithuania is the president who is directly elected by the people and serves a five-year term. The head of the government is the premier, who is formally appointed by the president (subject to approval by the parliament).

Since Lithuania has declared its independence, there has been a large scale of complicated changes faced by the national economy in the process of changeover from a state ownership to a private one. Many new entities, especially medium and small-sized, were established and Lithuania has been continuing the growth into an economically strong country. The Republic of Lithuania Law on Small and Medium-sized Business Development defines four types of entities in Lithuania: large, medium, small and micro [3] (see Table 1).

Table 1. Classification of Enterprises by Size Based on the Republic of Lithuanian Law on Small and Medium-Sized Business

Type	**Recognition criteria**				
	Lithuanian legislation			**Recommendations of the European Commission**	
	Number of employees, people	**Annual income, LTL million**	**Balance sheet value of assets, LTL million**	**Number of employees, people**	**Annual turnover and/or balance sheet amount, EUR million**
Large	≥ 250	≥ 138	≥ 93	> 250	Turnover > 50, balance > 43
Medium	< 250	< 138	< 93	< 250	Turnover < 50, balance < 43
Small	< 50	< 24	< 17	< 50	< 10
Micro	< 10	< 7	< 5	< 10	< 2

Source: [3]

According to the Department of Statistics of the Republic of Lithuania, the number of Small and Medium-sized Enterprises (SMEs) is constantly growing. By 1 January 2008, there were 63,187 active SMEs in Lithuania. This number increased by 7,362, or 13.2 percent, as compared to the number of SMEs in 2004. Also, the significance and contribution by small and medium enterprises to the national economy increase each year. In Lithuania, small and medium sized enterprises account for more than 99 percent of the total number of active enterprises. They produce about 60 percent of the gross value added, generated by all Lithuania's enterprises, and provide jobs for more than 70 percent of all the employed [4].

Taking into account the contribution of SMEs to the national economy of Lithuania, the Government of the Republic of Lithuania has tried to create not only the best possible conditions for the establishment of new SMEs but also to encourage a further development and vitality of the already operating ones, e.g. on 19 October 2005, the Government of the Republic of Lithuania approved the Strategic Guidelines for Small and Medium-sized Business Development (Resolution No 1104). According to the Resolution, the following medium-term development trends of Small and Medium-sized Business (SMB) were defined in the Strategic Guidelines for SMB Development:

- to improve the legal and economic environment for SMB;
- to improve financial assistance for SMB;
- to encourage entrepreneurship in regions;
- to promote competitiveness of SMB entities [5].

Also, on 5 February 2010 the European Investment Fund (EIF) and Swedbank Lithuania signed an agreement under which Swedbank will provide loans worth EUR 104 million (over LTL 359 million) to small and medium sized enterprises in Lithuania. The agreement will accelerate lending to Lithuanian SMEs during the current economic recession for the benefit of local businesses and contribute to higher investment activities of those companies [6, 13].

However, there are some challenges that this business sector faces. In 2001, the biggest business constraints for SMEs were low purchasing power, high taxes and the lack of working capital. In 2005, the businessmen of the sector pointed out that the major obstacles for the development of SMEs are high taxes and severe competition; and in 2007 one of the main problems mentioned was the lack of high-skilled specialists [7].

2.1 Business Law

The procedure for the incorporation of limited civil liability companies is governed by the Law on Companies of the Republic of Lithuania (No VIII-1835). The Law regulates the incorporation, management, activities,

reorganization, transformation, split-off and liquidation of the companies having the legal form of a public or private limited liability company, the rights and duties of the shareholders, as well as establishment of branches of foreign companies and termination of their activities. When the provisions of this Law apply to a limited liability company, both public and private, the term "company" shall be used. The provisions of the Law are brought in line with the legal acts of the European Union specified in the Annex to the Law.
The authorized capital of a public company shall be not less than LTL 150,000. Its shares may be offered or traded publicly in accordance with legal acts governing the securities market.
The authorized capital of a private company shall be not less than LTL 10,000, and a company shall have not more than 250 shareholders. Shares of a private company shall not be offered or traded publicly unless the laws provide differently.

2.2 Accounting Law

Pursuant to the Law on Accounting, accounting of an entity shall be handled by the following:

- an accounting service of an economic entity
- a company rendering accounting services under a contract
- the head of an individual enterprise. (This provision shall apply to unlimited civil liability legal persons with a sole owner, notaries, lawyers and natural persons holding patents.)
- farmer and farmer's partners

The chief accountant (accountant) and the accounting company shall be responsible for accuracy of accounting entries for the timely submission of financial reports. The responsibility of the chief accountant (accountant) shall be defined by legal acts of the Republic of Lithuania. The responsibility of the accounting company shall be defined in a written agreement concluded with the customer.

The accounting department shall be run by the chief accountant. All instructions of the chief accountant with regards to the management of accounts shall be binding upon all staff of the entity and of the accounting department in particular. The chief accountant, in concert with highly experienced accounting staff, shall

- develop the organizational chart of the accounting department and the program of accounting works
- define the flows of accounting information and their users, and also the system of the turnover of documents
- take care of installation and dislocation of the workstations for the accounting staff
- create good microclimate and favorable working conditions

Particular attention is devoted to the accounting documents and registers. Pursuant to the Law on Accounting, the head of an economic entity shall approve a list of persons who are authorized to issue and sign or only to sign accounting documents, and the sample signatures of these persons. Accounting documents shall be signed personally or under the procedure established by the Law on Electronic Signature. Timely and accurate issue of accounting documents, authenticity of data thereof and legitimacy of economic transactions shall be the responsibility of persons who have issued and signed the accounting documents. The form, contents and number of the accounting registers shall be set by an economic entity according to its needs. Accounting documents and registers shall, until the approval of financial statements, be stored under the procedure established by the head of an economic entity, ensuring safety of the documents. After the approval of a financial statement, accounting documents and registers shall be stored under the procedure established by the head of an economic entity, observing the time limits of documents storage set by the Government. When accounting documents or accounting registers disappear or are partially or wholly damaged the person who lost or damaged them shall write an explanation to the head of an economic entity. The head of an economic entity shall make a decision on the restoration of the documents under the procedure established by the Government.

As mentioned before, the chief accountant (accountant) and the accounting company shall be responsible for accuracy of accounting entries for the timely submission of financial statements. It should be noted that the responsibility for the general organization of accounting and storage of the accounting documents shall rest upon the head of the entity.

Lithuania's chart of accounts is of two levels: specimen and individual. Pursuant to the Accounting Law, the specimen chart of accounts is developed, approved and published in "Valstybes Zinios" (Official Gazette) by the Audit and Accounting Authority. Each entity shall develop its own chart of accounts. The chart of accounts shall be approved by the head of that entity. Entities may prepare their individual chart of accounts according to their information needs, e.g. to reduce it, or supplement it introducing new more analytical accounts. Each entity, when preparing its individual chart of accounts, shall observe the general principles for the preparation of charts of accounts, i.e. the information received should satisfy the needs of both, external and internal users of information. Abridged Chart of Accounts is presented in Appendix IV.

Accounting policy shall comprise accounting principles, accounting methods and rules for handling an entity's accounting, as well as compiling and presenting financial statements. The head of an entity must choose and implement an accounting policy taking into consideration specific business conditions, type of business, and invoking the Business Accounting Standards. Business Accounting Standards are based on principles and they are not influenced by taxation rules. All limited civil liability profit-seeking entities, which are registered in the Republic of Lithuania in accordance with the Law on Financial Statements of Entities, shall draw up annual financial reports at the end of their financial year. For taxation purposes, entities need to prepare tax declaration in accordance with the taxation rules.

2.3 Tax Law

After regaining the independence by Lithuania free market relations started coming into existence in the national economy, and the number of enterprises increased to a material extent. This naturally caused a necessity to accordingly modify the national tax administration system. Starting from 1990, significant efforts have been devoted to the development of a tax administration system that could meet the needs of the national economy. For quite an extended period of time the authorities could not reach a decision concerning which law should set the fundamentals of the taxation system and principal provisions of tax policy and the liability of tax payers. After long discussions the Law on Tax Administration was passed by the Seimas of the Republic of Lithuania on 28 June 1995.

Law of the Republic of Lithuania on Tax Administration shall establish the basic concepts and regulations, which must be observed in implementing the tax laws of the Republic of Lithuania, the basic principles of legal regulation of taxation, the list of taxes applied in the Republic of Lithuania, the functions, rights and obligations of the tax administrator, the rights and obligations of the taxpayer, the calculation and payment of taxes, the procedure of enforced recovery of taxes and related amounts as well as the procedure for the settlement of tax disputes. This Law also ensures the implementation of the EU legal acts regulating taxation. Article 13 of the Law on Tax Adminsitration defines the following taxes that shall be administered under this Law:

- value added tax;
- excise duty;
- personal income tax;
- immovable property tax;
- land tax;
- state natural resources tax;
- petroleum and gas resources tax;
- tax on environmental pollution;
- consular fees;
- stamp duty;
- inheritance tax;
- compulsory health insurance contributions;
- contributions to the Guarantee Fund;
- state-imposed fees and charges;
- lottery and gaming tax;
- fees for the registration of industrial property objects;
- corporate income tax;
- state social insurance contributions;
- excess quota tax on white sugar;

- quota sugar production tax;
- additional sugar production tax;
- customs duties;
- deductions from income under the Law of the Republic of Lithuania on
- Forestry;
- tax on the use of state property by the right of trust.

All of above mentioned taxes are regulated by a separate Law or other legal acts.
Starting from 2009, standard **VAT tax rate** has been 21%. The reduced VAT rate of 9% is applied to books and non-periodic information publications. Personal income of individuals (except dividends and other profit distributions) is subject to personal income tax at the standard rate of 15%. Dividends and other profit distributions are taxed at the personal income tax rate of 20%. Income received by an owner of an unlimited civil liability entity from the entity's taxable profits is taxed at 15%.

3 Evolution of Accounting after 1989

Since the restoration of independence in 1990, Lithuania has been rapidly moving to the worldwide market. Its accounting system has changed considerably. In the evolution of the Lithuanian accounting after 1990 the following stages can be recognized [2]:

- Accounting reorganisation necessities (1990–1991)
- Adoption of regulatory acts (1992–1995)
- Implementation and improvement of regulatory acts (1996–2001)
- Integration in the European system of accounting (2002–2007)
- Further development and improvement (2007–present)

The main challenges of the first stage were to determine how the Lithuanian accounting system should look like and what its key principles and characteristics should be in the new business environment. During this stage, the following events have taken place:

- On 7 September 1990, the Lithuanian Association of Accountants and Auditors was set up and its first congress was held on 30 November 1990. The congress adopted the appeal to the national government requesting to begin drafting the regulatory acts for the management of accounting.
- In November 1990, the seminar-conference of the leading accounting specialists of the Baltic States was organised to develop the concept of accounting common for the Baltic States.

During the second stage, the Government of the Republic of Lithuania has adopted and approved a number of important documents on accounting. On 18 June 1992, it approved the Republic of Lithuania Law on the Principles of Accounting [8], which came into effect from 1 January 1993. According to this Law, the Government of the Republic of Lithuania is responsible for the general methodical management of accounting. The Republic of Lithuania Law on the Principles of Accounting was devoted only to the principles of accounting and it did not consider the accounting framework as a whole.
On 27 January 1993, the Government adopted the Resolution No 804 on Accounting and Annual Financial Statements of Legal Persons with Limited Liabilities. The Resolution approved a new procedure for the preparation of the financial statements and for the recognition of income and costs. Based on this Resolution, the Ministry of Finance of the Republic of Lithuania approved a new standard Chart of Accounts and drafted the forms of financial statements and explanations for the explanatory notes and the Chart of Accounts.
The third stage can be designated as a stage of new actions and expectations. The Order issued by the Ministry of Finance on 29 June 1995 on the Establishment of the Institute of Audit and Accounting might be considered as a start of this stage. On 21 December 1998, the Institute was renamed to the Institute of Audit, Accounting and Property Valuation of the Republic of Lithuania (Ministry of Finance Order No 297), and subsequently to the Institute of Accounting. On the initiative of this Institute and the Accounting Department of Vilnius University in 1997, a campaign was launched aimed at reorganization of the accounting system of Lithuania and development of the concept of its further improvement. The following works have been proposed:

- drafting a new accounting law
- improving the existing Chart of Accounts
- preparing the professional accountants training programme
- updating the applicable forms of financial reporting

- developing the national accounting standards etc.

In 1997, when the International Accounting Standards (IAS) were translated into Lithuanian by the Institute of Accounting of the Republic of Lithuania, an active campaign regarding the preparation of national accounting standards based on the international ones was launched. On 6 November 2001, the Seimas (Parliament) of the Republic of Lithuania passed three Laws regulating the accounting system: the Republic of Lithuania Accounting Law, the Republic of Lithuania Law on Financial Statements of Entities and the Republic of Lithuania Law on Consolidated Financial Statements [9, 10, 11]. These Laws have been harmonized with the Fourth (78/660) and Seventh (83/349) EEC Council Directives.

The fourth stage started from year 2002. The year 2002 is considered as the start of the integration in the European system of accounting when the Institute of Accounting of the Republic of Lithuania commenced intensive and consistent development of the Lithuanian Business Accounting Standards (BAS). On 18 December 2002, the Board of the Institute of Accounting of the Republic of Lithuania approved the first 17 Business Accounting Standards. Overall, since 2002 thirty seven Business Accounting standards have been developed; twenty nine of them are based on IFRS. From September 2008, the Accounting Institute was renamed to the Audit and Accounting Authority.

Table 2. List of Business Accounting Standards

BAS 1	Financial Statements
BAS 2	Balance Sheet
BAS 3	Income Statement
BAS 4	Statement of Changes in Equity
BAS 5	Cash Flow Statement
BAS 6	Explanatory Notes
BAS 7	Changes in Accounting Policies, Accounting Estimates and Correction of Errors
BAS 8	Equity
BAS 9	Inventories
BAS 10	Income
BAS 11	Expenses
BAS 12	Non-Current Tangible Assets
BAS 13	Intangible Assets
BAS 14	Business Combinations
BAS 15	Investments in Associates
BAS 16	Consolidated Financial Statements and Investments in Subsidiaries
BAS 17	Biological Assets
BAS 18	Financial Assets and Financial Liabilities
BAS 19	Provisions, Contingent Liabilities and Contingent Assets, and Events after the Balance Sheet Date
BAS 20	Operating Lease, Finance Lease and Loan-for-Use
BAS 21	Grants and Subsidies
BAS 22	Changes in Foreign Exchange Rates
BAS 23	Impairment of Assets
BAS 24	Income Tax
BAS 25	Construction and Other Long-Term Contracts
BAS 26	Derivative Financial Instruments
BAS 27	Concession Arrangements
BAS 28	Liquidation of Entities
BAS 29	Interim Financial Statements
BAS 30	Related Parties
BAS 31	Employee’s Benefit
BAS 33	Financial Statements of Financial Brokerage Firms and Management Companies
BAS 34	Segment Reporting
BAS 35	Transformation of Entities
BAS 36	Record Keeping and Financial Reporting of Unlimited Civil Liability Legal Persons
BAS 37	Investments in Joint Ventures

BAS 41	Splitting Up of Entities

According to the Republic of Lithuania Accounting Law (Article 4), from 1 January 2004, limited liability profit-seeking entities are required to comply with the BAS . On 7 June 2007, the Parliament of Lithuania passed amendments to the Law on Financial Statements of Entities (No X-1179), the Accounting Law (No X-1178) and the Law on Consolidated Accounts of Entities (No X-1180). According to these amended laws, limited civil liability profit-seeking entities, whose securities are not traded on regulated markets, are allowed to choose either the BAS or IFRS for keeping accounts and preparing financial statements for the financial year starting 1 July 2007 and later. The structure of these laws is presented in Table 3.

Table 3. The structure of the laws

The Republic of Lithuania Accounting Law	***The Republic of Lithuania Law on Financial Statements of Entities***	***The Republic of Lithuania Law on Consolidated Accounts of Groups of Undertakings***
Chapter I. General provisions	Chapter I. General provisions	Chapter I. General provisions
Chapter II. Organizations of accounting	Chapter II. Generally accepted accounting principles	Chapter II. Drawing up of consolidated accounts
Chapter III. Accounting documents and registers. Correction of errors	Chapter III. Requirements for the drawing up financial statements	Chapter III. Consolidated Annual Report
Chapter IV. Storage of accounting documents and registers	Chapter IV. Components of financial statements and description of reports	Chapter IV. Audit of consolidated financial reports, signature, approval and publishing of them and the consolidated annual report
Chapter V. Responsibility for arrangement of accounting, preservation of accounting documents. Commercial secrets	Chapter V. Valuation rules	Chapter V. Storage of consolidated financial reports and the consolidated annual report, responsibility for their drawing up and submission to the legal entities register
Chapter VI. Final provisions	Chapter VI. Storage of financial statements	
	Chapter VII. Liability for the drawing up of financial statements	
	Chapter VIII. Final provisions	

The adoption of the International Financial Reporting Standards in the European Union has considerably influenced Lithuanian accounting legislation and practice. The Republic of Lithuania Accounting Law prescribes that entities, whose securities are traded on an EU regulated market from 1 January 2005, have to prepare their financial statements in accordance with IAS/IFRS (Republic of Lithuania Accounting Law, Article 3).

4 Reporting Issues

The BAS are in the first instance being developed in observance of the provisions of the Fourth (78/660/EEC) and Seventh (83/349/EEC) Council Directives. If certain aspects of accounting are not described in these Directives, or there are no restrictions for the application of other provisions, the provisions of the IFRS shall apply for the purpose of the BAS.

According to BAS 1 (Article 16), the elements of financial statements can be measured by using a number of different measurement bases:

- Historical cost
- Fair value
- Net realizable value
- Net realization value
- Present value
- Value in use
- Amortized cost

In financial statements, the majority of elements are carried by entities at historical costs, unless the BAS establish otherwise. The entities are free to select the measurement bases of the elements of financial statements on their own discretion if such methods are not established by the BAS.
Fair value in most cases is applied for the measurement of financial assets.
There are two possible methods to establish the fair value of a financial asset or financial liability:

- according to the price quoted on the active securities market
- by using fair value establishing methods referring to the active market information

The most reliable information for establishing the fair value is the price quoted on the active market. The proper market price of an asset or a liability held is normally the price offered by buyers, and that of an asset or a liability intended to be acquired – the price quoted by sellers. In the event there is no price offered by buyers or asked by sellers, the price of the most recent transaction may be perceived as the basis for determining the asset's fair value provided the economic conditions in the period from the transaction to the balance sheet date have not changed significantly. Where an enterprise does not have any comparable assets or liabilities, for the purpose of establishing fair values it may refer to average market prices.
Where there is no market for a financial asset, although there is one for a comparable financial market, the fair value shall be established on the basis of the price of the comparable asset.
Where the market for a financial asset or financial liabilities is not active, in order to establish a reliable fair value the quoted prices may need to be adjusted. Where the market is not properly established, the quoted market price may not necessarily correspond to the fair value of the asset. In certain circumstances, where the volume of trading is relatively limited, the value of the asset may be established by an independent property evaluator. In other cases (also in the cases where a quoted market price is not available), other valuation methods providing sufficiently reliable fair values may be employed.
The valuation methods established in financial markets are based on the market value of essentially identical asset or liability, discounter cash flow analysis and the option pricing model. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for a financial asset having substantially the same terms and characteristics including the contractual interest rate, the remaining term to repayment, and the currency in which the settlement is to be effected.
The fair value of a financial asset or financial liability may be established using valuation methods applied in financial markets. The chosen valuation method shall refer upon the inputs used by market participants for the purpose of calculation of fair values, including the prepayment rates, or estimated interest or discount rates. Where the average market indicators or prices are not available entities shall calculate the average indicators and average market prices by reference to the information published by banks or financial brokers.
The fair value cannot be the amount that an entity would receive or pay in a forced transaction, i.e., in an involuntary liquidation or distress sale.

4.1 Intangible Assets

According to BAS 13 "Intangible Assets", an intangible asset is an *"identifiable non-monetary asset without physical substance disposed by the enterprise expecting to obtain direct and indirect economic benefits from* *the use of such asset"*. Intangible assets should be recognized if they satisfy the definition of intangible assets and the following three recognition criteria:

- The enterprise can reasonably expect to obtain future economic benefits from the assets;
- The historical (production) cost of the assets can be reliably measured and distinguished from the value of other assets;
- The enterprise can dispose such assets, control them or limit the others' right to use such assets. Intangible assets are carried at the acquisition (production) cost [12].

Overall, BAS 13 is consistent with IAS 38 'Intangible Assets' but the difference between them is that intangible assets cannot be revaluated under BAS 13. There are no intangible assets with unlimited useful life.

4.2 Tangible Assets

BAS 12 identifies non-current tangible assets as *"tangible assets which rendering economic benefits to the enterprise for a period exceeding one year and the acquisition (production) costs of which are not lower than the minimum value of non-current tangible assets estimated by the enterprise"*. Although main provisions of the standard are very similar to those of IAS 16 'Property, Plant and Equipment' and IAS 40 'Investment Property', there are some differences. For example, BAS 12 defines an additional criterion for recognition of non-current tangible assets: the acquisition (production) cost of the asset should be not lower than the minimum cost of a non-current tangible asset estimated by an enterprise per each group of assets. The next difference is that interest is not included in the asset acquisition (production) cost. It is recorded under expenses of corresponding periods. There is no separate standard for non-current tangible assets held for sale, so BAS 12 includes principles for accounting non-current tangible assets held for sale.

4.3 Leases

The main provisions of BAS 20 "Operating Lease, Financial Lease and Loan-From-Use" with regards to the principles of accounting for financial and operating leases correspond to the provisions of IAS 17 "Leases", except for the possibility to recognize as investment assets the sub-leased assets acquired under operating lease; however, such a possibility is not provided. But there are some differences. According to IAS 17, the lease term covers the major part of the economic life of the asset even if the title is not transferred, while according to BAS 20 the lease term covers the major part of the economic life of the asset, in any case for at least 75 percent of the economic life of the asset.

According to IAS 17, at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset, while according to BAS 20 the present value of the lease payments is equal to the fair value of the leased asset or accounts for at least 90 percent thereof. According to IAS 17, the initial direct costs of the lessor are recorded as assets and are distributed through the entire lease term, while according to BAS 20 such costs are attributed to the costs of the period at the time of the conclusion of the lease contract.

Also, BAS 20 contains the chapter on principles of accounting for assets transferred or acquired under loan-for-use, which is not covered in IAS 17.

4.4 Financial Assets, Financial Liabilities and Derivatives

Financial assets include cash and cash equivalents, contractual right to receive cash or other financial assets from another entity, and securities issued by another entity.

Cash and cash equivalents are cash on hand and in bank accounts, and their equivalents in various currencies. Cash equivalents include short-term (up to 3 months) liquid investments into securities, traveler's cheques and other financial assets that meet the definition of cash equivalents. If an entity enters into a short-term crediting agreement and it is allowed to make payment transactions that exceed its bank account balance, the value of a financial asset is equal to zero, and the amount exceeding the closing balance is recognized as a financial liability.

There are no essential differences between the procedure of recognition of and accounting for derivatives set forth under BAS 26 "Derivatives" and IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement".

Also, the principles of accounting for financial assets and financial liabilities established under BAS 18 “Financial Assets and Financial Liabilities” and IAS 39 are very similar. However, for the purpose of recognition and measurement, BAS 18 classifies financial assets into the following three groups:

- Intended-for-sale
- Held-to-maturity
- Originated loans and receivables

Whereas, according to IAS 39, financial assets are classified in one of the following categories:

- Financial assets at fair value through profit or loss (this category has two subcategories: designated and held for trading)
- Available-for-sale financial assets
- Loans and receivables
- Held-to-maturity investments

Thus, BAS 18 does not include the group Available-for-sale financial assets and all financial assets that are not attributed to the categories of Held-to-maturity; Originated loans and receivables and treated as Intended-for-sale, and changes in their value are recognized as profit or loss in Income Statement.

4.5 Inventories

The main difference between BAS 9 “Inventories” and IAS 2 “Inventories” is that under BAS 9 it is possible to apply not only the FIFO and weighted average cost methods but also LIFO in some cases. For example, *“when the items of inventory which were purchased or produced last are sold first, and consequently the items remaining in inventory at the end of the period are those first purchased or produced”* [12]. The other essential differences do not exist between these standards.

4.6 Equity

There is separate standards BAS 8 “Equity” establishing the procedure of accounting for equity, and its provisions essentially correspond to the provisions of IAS 32 “Financial Instruments: Disclosure and Presentation” with regards to capital accounting. However, BAS 8 provides much more detail. It elaborates on accounting for reserves formed when distributing the owners’ profit. The standard describes in detail the accounting for revaluation reserve; the accounting for share premium; the accounting for the capital of state enterprises (which is not divided into shares), as well as it describes the accounting for capital corresponding to assets which may be only state-owned. There are special rules for accounting for this capital. The decrease of the capital, corresponding to the asset that statutorily may be only the state-owned property, shall be recorded in the accounting only when the asset that according to laws may be owned only by the State is depreciated, provided such an asset is not directly used to generate the entity's revenues. Also, the difference concerns the fact that the proportion of convertible value of bonds issued by the entity may not be shown in the equity part.

4.7 Provisions

There are no essential differences between BAS 19 “Provision, Contingent Liabilities and Contingent Assets, and Events Occurring after the Balance Sheet Date” and the corresponding IAS 10 “Events After the Balance Sheet Date” and IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”. Also, the provisions of BAS 22 “Changes in Foreign Exchange Rates” correspond to the provisions of IAS 21 “The Effects of Changes in Foreign Exchange Rates”; and essential differences between BAS 23 “Impairment of Assets” and IAS 36 “Impairment of Assets” do not exist.

5 Official Forms of Financial Statements

The purpose of financial statements shall be to satisfy the needs of information users with regards to receiving correct information about financial position, performance and cash flows of an entity. Financial statements shall provide disclosures on:

- assets
- equity
- liabilities
- income and expenses
- cash flows

The Republic of Lithuania Law on Financial Statements of Entities (RL LFSE) sets up the following financial statements: Balance Sheet; Income Statement; Cash Flow Statement; Statement of Changes in Equity; and Explanatory Notes. The RL LFSE also establishes the main requirements for the compilation of financial statements [10].

According to the RL LFSE, there are the following requirements for the compilation of financial statements:

- At the beginning of financial reports, the following particulars must be given:
    - Name, code and address of the registered office of an entity;
    - Date of financial statements;
    - The level of precision used in the presentation of figures (indicators) in financial statements (it shall be specified whether the indicators are expressed in litas, thousands of litas, etc).
- The financial statements of an entity must preserve headings of the items given in sample reports, numbering and ordering thereof.
- Entities shall draw up annual financial statements at the end of their financial year.
- Entities shall draw up interim financial statements where necessary or on a periodic basis specified by other legal acts. Newly registered entities shall draw up a balance sheet of the commencement of economic activities indicating the assets, equity and liabilities of an entity at the commencement of activities.
- Financial statements shall be drawn up using the monetary unit of the Republic of Lithuania (the litas).
- Financial statements shall be drawn up in the Lithuanian language and, where necessary, in a foreign language.
- All economic operations and economic events of an entity must be accounted prior to the drawing up of financial statements.
- Accounting data shall be based on the data of the stocktaking of assets and liabilities. The procedure for stocktaking shall be set forth by the Government or an institution authorized by it.
- The financial year of an entity shall last 12 months. Entities shall select the financial year by taking account of the nature of their activities. The financial year may be changed due to a change of the nature of activities of an entity (not more than once per five years) or due to consolidation of financial statements (in this case, a subsidiary undertaking shall be allowed to change the financial year and to agree it with the financial year of a parent undertaking) [10].

The Framework for the preparation and presentation of financial statements in Lithuania is BAS 1 “Financial Statements”. It is very similar to the IASB Framework for the preparation and presentation of financial statements. It prescribes the basic concepts by which financial statements are prepared, and provides definitions, short descriptions of the financial statements, evaluation methods of the elements of statements and references to other standards, where accounting requirements for the above financial statements are determined. According to BAS 1, “*the purpose of financial statements shall be to satisfy the needs of information users with regards to receiving correct information about the entity’s financial condition, performance and cash flows*”. However, it does not define main users of financial reporting.

5.1 Balance Sheet

The official form of Balance Sheet under Lithuanian regulation is following:

Form of Complete Balance Sheet

(entity name)

(entity identification number, address, other information)

(APPROVED)

20___ y. ______________ ___ d. BALANCE SHEET

____________________________________ No. _____

(reporting date)

(reporting period)

(Reporting currency, specify degree of accuracy)

	ASSETS	Comment No.	Financial year	Previous financial year
A.	**NON-CURRENT ASSETS**		**-**	**-**
I.	INTANGIBLE ASSETS		-	-
I.1.	Development work			
I.2.	Goodwill			
I.3.	Licences and patents			
I.4.	Computer software			
I.5.	Other intangible assets			
II.	TANGIBLE ASSETS		-	-
II.1.	Land			
II.2.	Buildings and construction			
II.3.	Plant and machinery			
II.4.	Vehicles			
II.5.	Equipment			
II.6.	Construction in progress			
II.7.	Other tangible assets			
II.8.	Investment property		-	-
II.8.1.	Land			
II.8.2.	Buildings			
III.	FINANCIAL ASSETS		-	-
III.1.	Investments in subsidiaries and associates			
III.2.	Loans to subsidiaries and associates			
III.3.	Amounts receivable after one year			
III.4.	Other financial assets			
IV.	OTHER NON-CURRENT ASSETS		-	-
IV.1.	Deferred tax assets			
IV.2.	Other non-current assets			
B.	**CURRENT ASSETS**		**-**	**-**
I.	INVENTORIES, PREPAYMENTS AND CONTRACTS IN PROGRESS		-	-
I.1.	Inventories		-	-
I.1.1.	Raw materials and components			
I.1.2.	Work in progress			
I.1.3.	Finished products			
I.1.4.	Goods for resale			
I.2.	Prepayments			
I.3.	Contracts in progress			
II.	AMOUNTS RECEIVABLE WITHIN ONE YEAR		-	-
II.1.	Trade debtors			
II.2.	Amounts receivable from subsidiaries and associates			
II.3.	Other amounts receivable			
III.	OTHER CURRENT ASSETS		-	-
III.1.	Current investments			
III.2.	Time deposits			
III.3.	Other current assets			
IV.	CASH AND CASH EQUIVALENTS			
	TOTAL ASSETS:		-	-

	EQUITY AND LIABILITIES	Comment No.	Financial year	Previous financial year
C.	**EQUITY**		**-**	**-**
I.	CAPITAL		-	-
I.1.	Authorised (subscribed)			
I.2.	Subscribed uncalled authorised capital (-)			
I.3.	Share premium			
I.4.	Own shares (-)			
II.	REVALUATION RESERVE (RESULTS)			
III.	RESERVES		-	-
III.1.	Legal reserve			
III.2.	Reserve for acquiring own shares			
III.3.	Other reserves			
IV.	RETAINED EARNINGS (LOSSES		-	-
IV.1.	Profit (loss) of the reporting year			
IV.2.	Profit (loss) of the previous years			
D.	**GRANTS AND SUBSIDIES**			
E.	**AMOUNTS PAYABLE AND LIABILITIES**		**-**	**-**
I.	NON-CURRENT AMOUNTS PAYABLE AND LIABILITIES		-	-
I.1.	Financial debts		-	-
I.1.1.	Leases and similar liabilities			
I.1.2.	To credit institutions			
I.1.3.	Other financial debts			
I.2.	Trade amounts payable			
I.3.	Received prepayments			
I.4.	Provisions		-	-
I.4.1.	For covering liabilities and claims			
I.4.2.	For pensions and similar obligations			
I.4.3.	Other provisions			
I.5.	Deferred tax liabilities			
I.6.	Other amounts payable and non-current liabilities			
II.	CURRENT AMOUNTS PAYABLE AND LIABILITIES		-	-
II.1.	Current portion of long-term debts			
II.2.	Financial debts		-	-
II.2.1.	To credit institutions			
II.2.2.	Other debts			
II.3.	Trade amounts payable			
II.4.	Received prepayments			
II.5.	Income tax liabilities			
II.6.	Liabilities related to employment relations			
II.7.	Provisions			
II.8.	Other amounts payable and current liabilities			
	TOTAL EQUITY AND LIABILITIES		-	-

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(title of the head of entity administration) (signature) (name, surname)

5.2 Profit/Loss Statement

Official form of P/L Statement in Lithuania is following:

Form of Complete Income Statement

____

(entity name)

____

(entity identification number, address, other information)

(APPROVED)

20___ y. ______________ ___ d. INCOME STATEMENT

__________________________________ No. _____

(reporting date)

________________________ ________________________

(reporting period) (Reporting currency, specify degree of accuracy)

No.	Items	Comment No.	Financial Year	Previous financial year
I.	**SALES REVENUE**			
II.	**COST OF SALES**			
III.	**GROSS PROFIT (LOSS)**		-	-
IV.	**OPERATING EXPENSES**		-	-
IV.1	Selling			
IV.2	General and administrative			
V.	**OPERATING PROFIT (LOSS)**		-	-
VI.	**OTHER ACTIVITIES**		-	-
VI.1.	Income			
VI.2.	Expenses			
VII.	**FINANCING AND INVESTING ACTIVITIES**		-	-
VII.1.	Income			
VII.2.	Expenses			
VIII.	**PROFIT (LOSS) FROM ORDINARY ACTIVITIES**		-	-
IX.	**EXTRAORDINARY GAINS**			
X.	**EXTRAORDINARY LOSSES**			
XI.	**PROFIT (LOSS) BEFORE TAX**		-	-
XII.	**INCOME TAX**			
XIII.	**NET PROFIT (LOSS)**		-	-

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(title of the head of entity administration) (signature) (name, surname)

5.3 Cash Flow Statement

BAS 5 “Cash Flow Statement” defines model forms of Cash Flow Statements for direct and indirect treatment. The model forms include separate lines for cash flows from extraordinary activities. The main difference between BAS 5 and IAS 7 “Cash flow Statements” is that under BAS 5 the completion of the cash flow form under indirect treatment should be started from the net profit, not from the profit before taxation.

Direct Method

Form of Complete Cash Flow
Statement Prepared under the
Direct Method

(entity name)

(entity identification number, address, other information)

(APPROVED)

20___ y. ______________ ___ d. CASH FLOW STATEMENT

__________________________________ No. _____
(reporting date)

____
(reporting period)

(reporting currency, specify degree of accuracy)

No.	Items	Note No.	Financial year	Previous financial year
I.	**Cash flows from operating activities**			
I.1.	Cash inflows of the reporting period (VAT included)		-	-
I.1.1.	Inflows from customers			
I.1.2.	Other inflows			
I.2.	Cash outflows of the reporting period		-	-
I.2.1.	Cash paid to suppliers of raw materials, goods and services (VAT included)			
I.2.2.	Outflows related to employment relations			
I.2.3.	Taxes paid into the budget			
I.2.4.	Other payments			
	Net cash flows from operating activities		-	-
II.	**Cash flows from investing activities**			
II.1.	Acquisition of non-current assets (excluding investments)			
II.2.	Disposal of non-current assets (excluding investments)			
II.3.	Acquisition of non-current investments			
II.4.	Disposal of non-current investments			
II.5.	Loans granted			
II.6.	Loans recovered			
II.7.	Dividends and interest received			
II.8.	Other increases in cash flows from investing activities			
II.9.	Other decreases in cash flows from investing activities			
	Net cash flows from investing activities		-	-
III.	**Cash flows from financing activities**			
III.1.	Cash flows related to entity owners:		-	-
III.1.1.	Issue of shares			
III.1.2.	Owners' contributions against losses			
III.1.3.	Purchase of own shares			
III.1.4.	Dividends paid			
III.2.	Cash flows arising from other financing sources		-	-
III.2.1.	Increase in financial debts		-	-
III.2.1.1.	Loans received			
III.2.1.2.	Issue of bonds			
III.2.2.	Decrease in financial debts		-	-
III.2.2.1.	Loans returned			
III.2.2.2.	Redemption of bonds			
III.2.2.3.	Interest paid			
III.2.2.4.	Payments of liabilities arising from finance leases			
III.2.3.	Increase in other liabilities of the entity			
III.2.4.	Decrease in other liabilities of the entity			
III.2.5.	Other increases in cash flows from financing activities			
III.2.6.	Other decreases in cash flows from financing activities			
	Net cash flows from financing activities		-	-
IV.	**Cash flows from extraordinary items**		-	-
IV.1.	Increase in cash flows from extraordinary items			
IV.2.	Decrease in cash flows from extraordinary items			
V.	**Effect of changes in exchange rates on the balance of cash and cash equivalents**			
VI.	**Net increase (decrease) in cash flows**		-	-
VII.	**Cash and cash equivalents at the beginning of the period**			
VIII.	**Cash and cash equivalents at the end of the period**		-	-

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(title of the head of entity administration) (signature) (name, surname)

Indirect method

Form of Complete Cash Flow Statement
Prepared under the Indirect Method

(entity name)

(entity identification number, address, other information)

(APPROVED)

20___ y. _______________ ___ d. CASH FLOW STATEMENT

___________________________________ No. _____
(reporting date)

____
(reporting period)

(Reporting currency, specify degree of accuracy)

No.	Items	Note No.	Financial year	Previous financial year
I.	**Cash flows from operating activities**			
I.1.	Net profit (loss)			
I.2.	Depreciation and amortisation expenses			
I.3.	Decrease (increase) in amounts receivable after one year			
I.4.	Decrease (increase) in inventories			
I.5.	Decrease (increase) in prepayments			
I.6.	Decrease (increase) in contracts in progress			
I.7.	Decrease (increase) in trade debtors			
I.8.	Decrease (increase) in amounts receivable from subsidiaries and associates			
I.9.	Decrease (increase) in other amounts receivable			
I.10.	Decrease (increase) in other current assets			
I.11.	Increase (decrease) in non-current trade amounts payable and received prepayments			
I.12.	Increase (decrease) in current trade amounts payable and received prepayments			
I.13.	Increase (decrease) in income tax liabilities			
I.14.	Increase (decrease) in liabilities related to employment relations			
I.15.	Increase (decrease) in provisions			
I.16.	Increase (decrease) in other amounts payable and liabilities			
I.17.	Elimination of results of disposals of non-current tangible and intangible assets			
I.18.	Elimination of results of financing and investing activities			
I.19.	Elimination of other non-cash items			
	Net cash flows from operating activities		-	-
II.	**Cash flows from investing activities**			
II.1.	Acquisition of non-current assets (excluding investments)			
II.2.	Disposal of non-current assets (excluding investments)			
II.3.	Acquisition of non-current investments			
II.4.	Disposal of non-current investments			
II.5.	Loans granted			
II.6.	Loans recovered			
II.7.	Dividends and interest received			
II.8.	Other increases in cash flows from investing activities			
II.9.	Other decreases in cash flows from investing activities			
	Net cash flows from investing activities		-	-
III.	**Cash flows from financing activities**			
III.1.	Cash flows related to entity owners:		-	-
III.1.1.	Issue of shares			
III.1.2.	Owners' contributions against losses			
III.1.3.	Purchase of own shares			
III.1.4.	Dividends paid			
III.2.	Cash flows arising from other financing sources		-	-
III.2.1.	Increase in financial debts		-	-
III.2.1.1.	Loans received			
III.2.1.2.	Issue of bonds			
III.2.2.	Decrease in financial debts		-	-
III.2.2.1.	Loans repaid			
III.2.2.2.	Redemption of bonds			
III.2.2.3.	Interest paid			
III.2.2.4.	Payments of liabilities arising from finance leases			
III.2.3.	Increase in other liabilities of the entity			
III.2.4.	Decrease in other liabilities of the entity			
III.2.5.	Other increases in cash flows from financial activities			
III.2.6.	Other decreases in cash flows from financial activities			
	Net cash flows from financing activities		-	-
IV.	**Cash flows from extraordinary items**		-	-
IV.1.	Increase in cash flows from extraordinary items			
IV.2.	Decrease in cash flows from extraordinary items			
V.	**Effect of changes in exchange rates on the balance of cash and cash equivalents**			
VI.	**Net increase (decrease) in cash flows**		-	-
VII.	**Cash and cash equivalents at the beginning of the period**			
VIII.	**Cash and cash equivalents at the end of the period**		-	-

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(title of the head of entity administration) (signature) (name, surname)

6 Major Differences from IFRS

Following table provides a comparative analysis of Lithuanian standards with International Financial Reporting Standards:

BAS	IAS/IFRS	Comments
	IFRS 1 First-time Adoption of International Financial Reporting Standards	There is no BAS corresponding to this Standard, as there was no need to draft it. BAS were enacted since 2004, and each standard specifies what adjustments should be made by the first-time adopters of the respective standard.
	IFRS 4 Insurance Contracts	A corresponding BAS has not been adopted yet. The insurance contracts' accounting procedure is regulated by the Rules established by the Insurance Supervisory Commission.
	IFRS 6 Exploration for and Evaluation of Mineral Resources	A corresponding standard has not been adopted and the Accounting for Exploration for and Evaluation of Mineral Resources is not regulated yet. It is included in the plans to discuss whether there is a need to establish the accounting procedure on this issue.
BAS 10 Revenue from Sales	IAS 18 Revenue	Essential differences do not exist.
BAS 11 Cost of Sales and Operating Costs		A separate IAS or IFRS corresponding to this standard does not exist. This standard establishes the principles for the recognition of the cost of sold goods and provided services as well as the principles for the recognition of operating costs.
BAS 14 Business Combinations	IFRS 3 Business Combinations	Recognition of negative goodwill is allowed. Goodwill and negative goodwill may be amortized.
BAS 15 Investments in Associates	IAS 28 Investments in Associates	Essential differences do not exist
BAS 16 Consolidated Financial Statements and Accounting for Investments in Subsidiaries	IAS 27 Consolidated and Separate Financial Statements	Investments in subsidiaries in separate financial statements of a parent undertaking may be reflected at cost or equity method. The standard establishes specimen forms of consolidated financial statements.
BAS 17 Biological Assets	IAS 41 Agriculture	Possibility is provided to use either cost or fair value less POS expenses for the purpose of accounting for biological assets.
BAS 21 Grants and Subsidies	IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	In addition to government grants, this Standard applies to the accounting for assets received gratis. The main principles of recognition of and accounting for grants correspond to those set forth by IAS, except that the possibility is not provided to select the accounting method by deducting the grant in arriving at the carrying amount of the asset.
BAS 25 Construction and Other Long-Term Contracts	IAS 11 Construction Contracts	Essential differences do not exist.
27 BAS Concession arrangements		Establishes the procedure for the recording in the accounting and presentation in financial statements of economic operations and economic events related to concession, public/private partnerships and other contracts of a similar type.
BAS 28 Liquidation of entities		Provides that financial statements of an entity under liquidation shall report such entity's assets, equity, liabilities, income, costs, cash flows and other information disclosed in the notes to the financial statements.

		The standard is applied in drawing up the financial statements of entities that are under liquidation and cannot apply the going concern principle.
BAS 29 Interim Financial Reporting	IAS 34 Interim Financial Reporting	The difference is that BAS 29 does not provide for the possibility to prepare a set of condensed financial statements for interim financial reporting purposes. According to this Standard, only explanatory notes may be condensed, while forms of other financial statements (balance sheet, profit (loss)) should be the same as for annual financial statements. For the purpose of interim reporting period information in the profit (loss) statement should be provided in the increasing order, i.e. of 3, 6 and 9 months and comparative information of the respective period of the previous financial year. Interim financial reports of 6 and 9 months separate presentation of data of Q2 and Q3 is not required.
BAS 30 Related Parties	IAS 24 Related Party Disclosures	Provisions of BAS 30 correspond to the provisions of IAS 24. The standard is binding only upon those undertakings, which prepare full financial statements. Entities preparing condensed financial statements are required to disclose information only about payments to their managers, as specified in BAS 6.
	IAS 29 Financial Reporting in Hyperinflationary Economies	A corresponding BAS does not exist.
31 BAS Employee's benefit	IAS 19 Employee Benefits	Essential differences from IAS 11 do not exist. IFRS 2 Share-based Payment
BAS 33 Financial Statements of Financial Brokerage Firms and Management Companies		This Standard has been developed in observance of the Council Directive 86/635/EEC of 8 December 1986, the annual accounts and consolidated accounts of banks and other financial institutions, Directive 2001/65/EC of the European Parliament and of the Council of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions, and Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. The Standard applies to financial broker’s and management enterprises. It establishes model forms of these financial statements and requirements for the disclosure of information in the explanatory notes. A corresponding IAS/IFRS does not exist.
BAS 34 Segment Reporting	IFRS 8 Segment Reporting	Provisions of BAS 34 correspond to the provisions of IFRS 8. The standard is binding only upon those undertakings, which prepare full financial statements.
BAS 35 Restructuring of Entities		BAS 35 does not have its counterparty among IAS/IFRS. This standard establishes the procedure of accounting and preparation of financial reports in case of restructuring of entities from one legal form to another in the manner established by laws. For example, an unlimited civil liability company is reorganized into a limited liability company, or a

		public or municipal enterprise – into a private limited liability company. In the course of such restructuring, the type of entity's operations and its owner remain the same, and all that changes is its legal form.
BAS 36 Record Keeping and Financial Reporting of Unlimited Civil Liability Legal Persons		BAS 36 does not have its counterparty among IAS/IFRS in terms of its scope, as it is aimed at very small entities of unlimited civil liability. The standard is not mandatory, because entities of such type do not produce financial statements and they are required to provide only tax returns. They shall apply this Standard only if they have included in their founding documents the provision on the preparation of financial reports. In terms of its contents this Standard is a simplified summary of BAS. This Standard does not require to apply the asset value impairment tests to long-term assets or to assess reserves at net realizable value. Non-current assets are reflected in the balance sheet at residual value, and reserves – at historical cost. The Annex to this Standard includes model forms of financial statements (balance sheet, profit (loss) statements and statement of changes in equity).
BAS 37 Accounting for Investments in Joint Ventures	IAS 31 Interests in Joint Ventures	The difference is that according to BAS such investments in consolidated statements should be reflected at equity method and that the possibility of using pro rata consolidation is excluded. .
	IAS 33 Earnings per Share	As listed entities apply IAS/IFRS, there is no need to prepare such standard.
39 BAS Accounting of collective investment undertakings and pension funds		It partly corresponds to 26 IAS, but is much more detailed.
41 BAS Splitting up of entities		It sets accounting principles when the assets and liabilities of the split-up entities are distributed to other entities that continue to operate, and the split–up entity terminates its operation. Two or more entities are incorporated on the basis of the split-up entity. The assets and liabilities of split (divided) entity are divided between the new incorporated entities, while the split-up entity terminates its operations. In this case, part of the company continuing its operations shall be split-up and one or several entities incorporated on the basis of that part of assets or liabilities.

7 Sample Case

ACCOUNTANT Ltd started its business in Lithuania in November 2010. The core business of the company is sale of goods as well as professional consulting.

The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 21 %).

For the simplicity of postings there will be used "MU" (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

Initial Balance Sheet

Balance Sheet as at 1st November 2010			
Bank account	145,000	Registered capital	145,000
		Loss	(5000)
		Short-term loans	5,000
ASSETS	**145,000**	**EQUITY+LIABILITIES**	**145,000**

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses

- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study

Fixed Assets and Financial Leases

Accounting depreciation of computer:

$$monthly\ depreciation = \frac{2{,}000}{36} = 55.56 \equiv 56$$

Tax depreciation for computer will be at the same as the same rate may be used for taxation purpose.

Op.	Transaction	Amount			Account
1	Purchase of computer	2,000 420 2,420	Dr Dr	 Cr	Equipment VAT Trade payables
2	Depreciation of computer (1 month) Depreciation is calculated from next month after purchase	56 56	Dr	 Cr	Expense (Depreciation) Equipment (Ac. depreciation)
3.	Financial lease (present value)	16473 16473	Dr	 Cr	Fixed assets (car) Finance lease liabilities (long term)
4	Lease payment	213 137 74 424	Dr Dr	 Cr	Finance lease liabilities Interest expense VAT Bank account
5	Registered current portion of long term finance lease liabilities	2696 2696	Dr Cr		Long term lease liabilities Current portion of long term finance lease liabilities

Inventories

Op.	Transaction	Amount			Account
1	Purchase of goods (6,500 @ 7.50 MU)	48,750 10,238 58,988	Dr Dr	 Cr	Goods VAT Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600 7,056 40,656	Dr Dr	 Cr	Goods VAT Bank account
3	Sale of goods (5,000 @ 12.00 MU)	60,000 12,600 72,600	 Dr	Cr Cr	Revenue (Sold goods) VAT Trade receivables
	Cost of goods sold using LIFO	39,600 39,600	Dr	 Cr	Cost of sold goods Inventory
4	Purchase of goods (3,300 @ 9.00 MU)	29,700 6.237 35,937	Dr Dr	 Cr	Goods VAT Bank account
5	Sale of goods (3,600 @ 12.00 MU)	43,200 9,072 51,840	 Dr	Cr Cr	Revenue (Sold goods) VAT Trade receivables
	Cost of goods sold using LIFO	31,950 31,950	Dr	 Cr	Cost of sold goods Inventory
6	Sale of goods (2,400 @ 12.00 MU)	28,800 6,048 34,848	 Dr	Cr Cr	Revenue (Sold goods) VAT Trade receivables
	Cost of goods sold using LIFO	18,000 18,000	Dr	 Cr	Cost of sold goods Inventory

Ending inventories

Op.	pieces			Cost	MU		
	+	-	Δ		+	-	Δ
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5700			39,600	42,750
4	3,300		9,000	9.00	29,700		72,450
5		3,600	5,400			31,950	40,500
6		2,400	3,000			18,000	22,500

For taxation purpose FIFO method has to be used
Calculation of deferred tax

Year	Inventory LIFO	Inventory FIFO	Difference	Tax rate	Deferred tax assets
2010	22,500	27,000	(4500)	15%	675

Receivables and payables

Op.	Text	Amount			Account
1	Long-term contract (12/2010)	5,000	Dr		Deferred income*
		5,000		Cr	Services revenue

*According to the requirements of BAS should discounted, but in the sample case there was no information for interest rate

Calculation of salaries expense

Gross salary	800
Social security from employer (31%)	248
Total expense	1 048

Calculation of tax payable from employee

Gross salary	800
Social insurance and health security from employee (9%)	72
Income tax	120
Net salary	608

Op.	Transaction	Amount			Account
Nov	Gross salary	800	Dr		Salary expense
		800		Cr	Payroll
Nov	Social and health insurance (employer)	248	Dr		Social insurance expense
		248		Cr	SHI payables
Nov	Income tax	120	Dr		Payroll
		120		Cr	Income tax payables
Nov	Social and health insurance (employee)	72	Dr		Payroll
		72		Cr	SHI payables
Nov	Pay-off	608	Dr		Payroll
		608		Cr	Bank account
Nov	Payment of insurance	368	Dr		SHI payables
		368		Cr	Bank account
Nov	Payment of income tax	120	Dr		Income tax payables
		120		Cr	Bank account
Dec	Gross salary	800	Dr		Salary expense
		800		Cr	Payroll
Dec	Social and health insurance (employer)	248	Dr		Social insurance expense
		248		Cr	SHI payables
Dec	Income tax	120	Dr		Payroll
		120		Cr	Income tax payables
Dec	Social and health insurance (employee)	72	Dr		Payroll
		72		Cr	SHI payables

Other costs and expenses

Op.	Text	Amount			Account
1	Rental payment (for November 2010)	1,200	Dr		Services expense
		252	Dr		VAT
		1,452		Cr	Bank account

1A	Rental payment (for December 2010)	1,200 252 1,452	Dr Dr	 Cr	Services expense VAT Bank account
1B	Rental payment (for January 2011)	1,200 252 1,452	Dr Dr	 Cr	Deferred expenses VAT Bank account
2	Tax advisory (November 2010)	200 42 242	Dr Dr	 Cr	Services expense VAT Bank account
2A	Tax advisory (December 2010)	200 200	Dr	 Cr	Services expense Accrued expense*
3	Telecommunication services (November 2010)	1,000 210 1,210	Dr Dr	 Cr	Services expense VAT Bank account
3A	Telecommunication services (December 2010)	1,000 1,000	Dr	 Cr	Services expense Accrued expense*
5	Interests received	920 920	Dr	 Cr	Bank account Interests revenue
6	Bank charges	5,300 5,300	Dr	 Cr	Operating expenses Bank account

*There is no VAT as invoice with VAT will be received only next month

Calculation of corporate income tax

Revenues	137,920
Expenses	101,939
Accounting profit	***35,981***
difference LIFO from FIFO	4,500
deductable incorporation expense	-5,000
Tax base	35,481
Corporate income tax (15 %)	**5,322**

Op.	**Text**	**Amount**			**Account**
1	Income tax (due)	5,322 5,322	Dr	 Cr	E – Income tax (due) Income tax payables

Profit/Loss Account as at 31st December 2010:

Profit / Loss Account as at 31st December 2010			
Sold goods	89,550	Revenues from sold services	5,000
Services	10,100	Revenues from sold goods	132,000
Salaries	1,600	Interests received	920
Social insurance	496		
Depreciation	56		
Interest expenses	137		
Income tax (due)	5,322		
Income tax assets (deferred)	-675		
EXPENSES	***106,586***	***REVENUES***	***137,920***
Profit	**31,334**		
TOTAL	137,920	TOTAL	137,920

Balance sheet as at 31st December 2010

Assets		***Equity and Liabilities***	
Computer	1,944	Registered capital	145,000
Car	16,473	Profit	26,334
Inventories	22,500	Long term financial lease liabilities	13,564
Trade receivables	159,720	Current portion of lease payments	2,696
Deferred expenses	1,200	Short-term loan	5,000
Deferred income	5,000	Liabilities related to employment relations	1,048
Deferred tax assets	675	Income tax liabilities	5,322
		Other liabilities	8,548
TOTAL	**207,512**	**TOTAL**	**207,512**

Ratio analysis

Assets (total)	207 512
EBIT	36 118
EAT	31 334
Equity	171 334
Current assets	189 095
Current liabilities	22 614
Inventories	22 500

Profitability ratios:

$$ROA = \frac{EBIT}{\sum Assets} = \frac{36118}{207512} = \mathbf{17.41}\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{31334}{171334} = \mathbf{18.29}\ \%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{189095}{22614} = \mathbf{8.36}$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{189095 - 22{,}500}{22614} = \mathbf{7.37}$$

8 Dictionary

English	**Lithuanian**
Accelerated Depreciation	spartusis nusidėvėjimas
Account	sąskaita
Account Payable	kreditinio įsiskolinimo sąskaita
Account Receivable	debetinio įsiskolinimo sąskaita
Accountant	buhalteris
Accounting	apskaita
Accounting Change	apskaitos pasikeitimas
Accounting Policies	apskaitos politika
Accounting Profit	apskaitos pelnas
Accrual Basis	kaupimo principas
Accumulated Depreciation	sukauptas nusidėvėjimas
Additional Paid in Capital	akcijų priedai
Amortization	amortizacija
Annual Report	metinė ataskaita, atskaitomybė
Annuity	anuitetas

Asset	turtas
Auditor	auditorius
Auditors’ Report	auditoriaus išvada
Available-For-Sale Financial Assets	laikomas parduoti finansinis turtas
Balance Sheet	balansas
Bond	obligacijos
Book Value, Carrying Amount	buhalterinė vertė
Borrowing Costs	skolinimosi išlaidos
Budget	biudžetas
Business	verslas
Business Combinations	verslo junginiai
Business Segment	verslo segmentai
Capitalized Cost	kapitalizuotos išlaidos
Capitalized Interest	kapitalizuotos palūkanos
Cash	gryni pinigai
Cash Basis	pinigų principas
Cash Equivalents	pinigų ekvivalentai
Cash Flows	pinigų srautai
Cash-generating Unit	iplaukas kuriantis vienetas
Closing Rate	baigiamasis įrašas
Consistency	pastovumo principas
Consolidated Financial Statements	konsoliduotos finansinės ataskaitos
Consolidation	konsolidavimas, jungimas
Contingent Asset	nenumatytas turtas
Contingent Liability	nenumatyti įsipareigojimai
Contingent Rent	nenumatyta nuoma
Continuing Operations	tęsiama veikla
Control	kontrolė
Convertible Share	konvertuojamos akcijos
Cost	išlaidos
Cost Accounting	išlaidų apskaita
Cost Method	išlaidų metodas
Costing	savikainos kalkuliavimas
Costs of Disposal	perleidimo išlaidos
Credit Risk	kredito rizika
Creditor	kreditorius
Currency Risk	valiutos rizika
Current Asset	trumpalaikis turtas
Current Liability	trumpalaikiai įsipareigojimai
Current Tax	einamasis mokestis
Debit	debetas
Debt	skola
Debt Security	skolos vertybiniai popieriai
Debtor	debitorius
Deferred Income	būsimojo laikotarpio pajamos
Deferred Income Taxes	būsimojo laikotarpio pajamų mokesčiai
Deferred Tax Assets	būsimojo laikotarpio turto mokestis
Deferred Tax Liabilities	atidėtųjų mokesčių įsipareigojimas
Depreciable Amount	nusidėvimoji suma
Depreciation	nusidėvėjimas
Derecognition	pripažinimo nutraukimas
Derivative	išvestinė priemonė
Detection Risk	susekimo rizika

Development	vystymas, kūrimas
Direct Costs	tiesioginės išlaidos
Disclosure	atskleidimas
Discontinued Operation	nutraukiamoji veikla
Discount	diskontas, nuolaida
Discount Rate	diskonto (nuolaidos) norma
Discounted Cash Flow	diskontuoti pinigų srautai
Dividends	dividendai
Double–Entry Bookkeeping	dvejybinis įrašas, dvejybinė apskaita
Due Date	atsiskaitymo data
Earnings Per Share (EPS)	pelnas akcijai, akcijos pelnas
Economic Life	ekonominio tarnavimo laikas
Effective Interest Rate	efektyvi palūkanų norma
Equity	nuosavybė, nuosavas kapitalas
Equity Instrument	nuosavybės instrumentas
Equity Method	nuosavybės metodas
Equity Securities	nuosavybės vertybiniai popieriai
Estimated Tax	numatytas mokestis
Estimation Transactions	numatytos operacijos
Events after the Balance Sheet Date	ivykiai po balanso sudarymo datos
Exchange Difference	keitimo skirtumas
Exchange Rate	keitimo norma
Expenditure	sąnaudos
External Reporting	išorės atskaitomybė
Extraordinary Items	ypatingieji straipsniai
Factoring	faktoringas
Fair Market Value	tikroji rinkos vertė
Fair Value	tikroji vertė
Finance Lease	finansinė nuoma
Financial Asset	finansinis turtas
Financial Institution	finansinės institucijos
Financial Instrument	finansinis instrumentas
Financial Liability	finansinis įsipareigojimas
Financial Risk	finansinė rizika
Financial Statements	finansinės ataskaitos
Financing Activities	finansinės veiklos
First in, First out (FIFO)	pirmas įeina, pirmas išeina
Fiscal Year	fiskaliniai metai
Fixed Asset	ilgalaikis turtas
Forecast	prognozė
Foreign Currency	užsienio valiuta
Fraud	klaida
Functional Currency	veikianti valiuta
Funding	fondų valdymas
Future Contract	ateities sandoriai
Gain	pagautė, ypatingasis pelnas
General Ledger	didžioji kmyga
Generally Accepted Accounting Principles	bendrai priimti apskaitos principai
Going Concern	veiklos tęstinumas
Goodwill	prestižas
Gross Income	bendros pajamos
Group	grupė
Guaranty	garantijos

Hedge	apsidraudimas
Hedge Effectiveness	apsidraudimo veiksmingumas
Hedged Item	ap
Hedging Instrument	apsidraudimo priemonė
Held-To-Maturity Investments	iki išpirkimo termino laikomos investicijos
Highly Probable	labai tikėtinas
Historical Cost	istorinės išlaidos
Impairment Loss	nuvertėjimo nuostolis
Impracticable	neįvykdoma
Improvement	vystymas, tobulinimas
Inception of the Lease	nuomos laikotrapuo pradžioje
Income	pajamos
Income Statement	pelno ir nuostolių ataskaita, Pajamų ataskaita
Indirect Costs	netiesioginės išlaidos
Initial Direct Costs	pradinės tiesioginės išlaidos
Installment	eilinė įmoka
Intangible Asset	nematerialusis turtas
Interest	palūkanos
Interest Cost	palūknų išlaidos
Interest Rate Risk	palūkanų normos rizika
Interim Financial Report	tarpinis finansinis pranešimas
Interim Financial Statements	tarpinės finansinės ataskaitos
Interim Period	tarpinis laikotarpis
Internal Audit	vidaus auditas
Internal Control	vidaus kontrolė
Internal Rate of Return	vidinė palūkanų norma
International Accounting Standards Board	Tarptautinė apskaitos standartų valdyba
International Financial Reporting Standards (IFRSs)	Tarptautiniai finansinės apskaitos standartai (TFAS)
Intradepartmental Price, Internal Transfer Price	vidaus kainos, vidaus transferinės kainos
Inventories	atsargos
Investing Activities	investavimo veiklos
Investment Property	investicijos
Investor in a Joint Venture	investuotojas į bendrą įmonę
Joint Venture	bendra įmonė
Journal	žurnalas
Last in, First out (LIFO)	paskutinis įeina, pirmas išeina
Lease	nuoma
Lease Term	nuomos terminas
Lessee	nuomininkas
Lessor	nuomotojas
Liability	isipareigojimas
Liquid Assets	likvidus turtas
Liquidation	likvidavimas
Liquidity Risk	likvidavimo rizika
Loans and Receivables	paskolos ir gautinos sumos
Loans Payable	mokėtinos sumos
Long–Term Debt	ilgalaikės skolos
Loss	nuostolis
Lower of Cost or Market	savikaina arba realizavimo verte, ta kuri mažesnė
Management Accounting	valdymo apskaita
Margin	marža
Market Risk	rinkos rizika
Marketable Securities	rinkos vertybiniai popieriai

Mark–to–Market	ženklas rinkai
Master Budget (Company Budget)	meistro biudžetas, kompanijos biudžetas
Materiality	reikšmingumas
Matching Principle	palyginimo principas
Merger	susijungimas
Minority Interest	mažumos dalis
Monetary Assets	monetarinis turtas
Monetary Items	monetariniai straipsniai
Net Assets	grynasis turtas
Net Income	grynosios pajamos
Net Realizable Value	grynoji galimo realizavimo vertė
Non-cancellable Lease	neatšaukiama nuoma
Non-current Asset	ilgalaikis turtas
Non–for–Profit Organization	nepelno organizacijos
Notes	pastabos
Notional Value, Face Value	nominali vertė
Objectivity	objektyvumas
Obligations	isipareigojimas
Onerous Contract	nuostolinga sutartis
Operating Activities	einamoji veikla
Operating Cycle	veiklos ciklas
Operating Lease	veiklos nuoma
Option	opcionas
Other Comprehensive Income	kitos pajamos
Parent Company	motininė kompanija
Partnership	partnerystė
Penalty	bauda
Plan Costing	sąmata, savikainos kalkuliavimo planas
Preferred Share	privilegijuotoji akcija
Present Value	tikroji vertė
Presentation Currency	prezentacinė valiuta
Prior Period Errors	ankstesnio laikotarpio klaidos
Probable	tikėtinas
Profit or Loss	pelnas ar nuostolis
Property, Plant and Equipment	ilgalaikis materialusis turtas
Prospective Application	perspektyvinis taikymas
Provision	aprūpinimas
Public Offering	viešas pasiūlymas
Qualifying Asset	išankstinis turtas
Ratio Analysis	santykinė analizė
Receivables	gautinos sumos
Reconciliation	suderinimas (sąskaitų)
Recoverable Amount	atsiperkamoji vertė
Reinsurance	perdraudimas
Related Party Transaction	susijusių šalių sandoriai
Reorganization	reorganizavimas
Repairs	remontai
Reporting Date	ataskaitinė data
Reporting Entity	ataskaitinis vienetas
Repurchase Agreement	atpirkimo sandoris
Research	tyrimas
Residual Value	likvidacinė vertė
Responsibility Accounting	atsakomybės apskaita

Restructuring	restruktūrizavimas
Retained Earnings	nepaskirstytasis pelnas
Return on Investment (ROI)	investicijų pelningumas
Revenue Recognition	pajamų pripažinimas
Revenues	pajamos
Risk Management	valdymo rizika
Securitization	kapitalizavimas
Security	garantas, užstatas
Separate Financial Statements	atskiros finansinės ataskaitos
Settlement Method	ivykdymo metodas
Share (Stock)	akcija
Short–Term	trumpalaikis turtas
Significant Influence	žymi įtaka
Spot Exchange Rate	sandorio keitimo norma
Start–up Costs	veiklos pradžios išlaidos
Statement of Cash Flows	Pinigų srautų ataskaita
Statement of Comprehensive Income	Išsami pajamų ataskaita
Statement of Financial Position	Finansinės būklės ataskaita
Statement of Changes in Equity	Nuosavo kapitalo pokyčių ataskaita
Straight–Line Depreciation	tiesinis nusidėvėjimo būdas
Subsequent Event	vėlesni įvykiai
Subsidiary	filialas, dukterinė įmonė
Swap	mainai
Tangible Asset	materialusis turtas
Tax	mokestis
Tax Base	mokesčių bazė
Tax Expense	mokesčių sąnaudos
Tax Income	mokestinės pajamos
Tax Loss	mokesčių nuostatai
Tax Year	mokestiniai metai
Taxable Income	apmokestinamosios pajamos
Taxable Profit	apmokestinamasis pelnas
Taxpayer Identification Number (TIN)	mokesčio mokėtojo identifikacinis numeris
Temporary Differences	laikini skirtumai
Term Loan	terminuota paskola
Total Comprehensive Income	visos pajamos
Transaction Costs	sandorių (ūkinių operacijų) išlaidos
Unearned Income	neuždirbtos pajamos
Useful Life	naudingo tarnavimo laikas
Value in Use	naudojimo vertė
Venture Capital	bendrasis kapitalas
Work in Progress	nebaigta gamyba
Working Capital	apyvartinis kapitalas
Yield to Maturity	laikomas iki išpirkimo
Zero–Coupon Bond	nulinio kupono

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Financial Reporting in Poland

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Poland. Due to the globalization of business and international harmonization of financial reporting also Poland experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Poland.

Country
Poland
(Polska)
Location
Central Europe
Area
312,685 km^2
Population
38,463,689 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
zloty (PLN); 3.972 PLN/EUR (as at 31.12.2010)

1 Country Introduction

Poland is a country located in Central Europe. It borders on Germany, Czech Republic, Slovak Republic, Ukraine, Belarus, Lithuania and Russia. The origins of the Polish date back to the 10th century. Kingdom of Poland, deepened the union with Lithuania in 1569, was one of the most powerful European states, but disappeared in the triple division of Poland (1772-1795). In 1918 Poland was restored as a republic. After the World War II, which affected the country very badly, Poland was the socialist republic until 1989. After the fall of the political regime in late 80 years of the Twentieth Century, Poland has adopted a shock therapy in order to transform its economy - the rapid privatization of state-owned enterprises and the dismantling of price and currency controls.

Over the past two decades, Poland has experienced substantial and dramatic changes in its economic, political and social environment. The most important political change was the transition to democracy at the beginning of the 1990s. Since then, Poland has undergone a political, social and economic revolution, and the democratization of the country and radical economic reforms have been successfully completed.

The economic environment has been dominated by liberalization of the economy through a large-scale privatization program supported by substantial foreign investment. The reforms and the relatively stable political climate have attracted the international capital needed to complete the shift from a centrally-planned economy to a market economy. The outcome of the reform program has been largely successful, and since the

beginning of the 1990s, the Polish economy has shown one of the strongest growth rates of all the former communist states in Central and Eastern Europe.
The economy has performed strongly since Poland joined the EU on 1st May 2004, but is now slowing down in consequence of the global credit crisis, cooling domestic demand, tighter credit conditions and rising unemployment. Although excess demand was substantial prior to the crisis, the external imbalance was modest relative to some neighbors' and contagion was contained. Macro-policy responses to the slowdown were largely appropriate, and the sharp depreciation of the zloty cushioned the impact of the foreign shock, but contributed to the postponement of euro adoption. The slowdown even cooled off residual inflationary pressure, while the swift turnaround in wages helped limit job losses. A number of issues should be addressed, however, to strengthen Poland's position in a globalizing world and ensure sustainable growth, given the prospects of future euro adoption, persistently large EU transfers and desirable inflows of foreign direct investment. The Polish economy has contracted in 2009, but is likely to start recovering during 2010. While growth is likely to remain relatively lackluster in both 2009 and 2010, the long-term prospects for the Polish economy remain good, especially if the reform process continues. Economic growth is expected to average 4-5% y/y over the next decade.
Current government understands that regulation hurts small business disproportionately by raising barriers of entry. Fortunately for Poland, a multi-year program of deregulation has been a boon for small businesses, and has given the country the most entrepreneurs of any state in Europe. This may explain the country's resilience in the face of the global economic crisis.
In late January 2010 the government presented the Plan for the Development and Consolidation of Finances 2010-11. The government wants to achieve the consolidation of the public finance by: strengthening fiscal institutions; broadening the tax base; reducing the generosity of support to farmers; extending the retirement age, especially for women; further diminishing early retirement; saving on disability benefits; improving public-administration efficiency; and generating substantial privatization revenues.
Incipient capital outflows based on reduced appetite for the heightened risks nevertheless triggered a significant depreciation of the "zloty", which cushioned the downturn, but also contributed to the postponement of euro adoption. The prominent role played by foreign-owned banks may have protected the financial system, while still limited financial development explains the low penetration of the complex financial products that were at the core of the global crisis. In this context, the flexible credit line agreed with the IMF in April 2009 helped to restore capital-market confidence.
Poland has become the largest beneficiary of EU cohesion policy in absolute terms. Over 2009-15 EU transfers will represent an average of 3.3% of GDP per year (including Common Agricultural Policy transfers). They provide a unique opportunity to modernize the economy, but absorbing them efficiently and managing the macroeconomic repercussions will be a challenge. While various leakages will dampen the demand effect, these transfers are expected to raise real growth by an average of 0.5 to 1.5 percentage points per year. Unless there is available slack, this will generate inflationary pressure, especially if this period coincides with euro-adoption prospects that might raise investors' confidence, leading to a real exchange-rate appreciation, a shift in activity in favor of the non-tradable sectors and an enlarged trade deficit.

2 Legal System

2.1 Business Law

Like many other continental European legal systems, the Polish legal system is based on Roman law (civil law) rather than common law, the foundation of the Anglo-Saxon system.
As an EU member state, Poland is of course subject to EU directives, and to the rulings of the European Court of Justice in Luxembourg. In many areas, Polish legislation has been harmonised with the total body of EU law, known as the Acquis Communautaire.
When operating in Poland, it is important to remember the country's impressive transition over the past 20 years. The process included the legal system, which continues to adjust to the demands of a complex 21st century market economy. Today, the Polish legal system offers an acceptable level of protection for modern businesses, although some elements are still lacking. The legal system in Poland has undergone appreciable changes in a very short time, but the judicial apparatus still has its drawbacks, and Polish civil courts are not always the best choice for solving international business disputes.

In Polish business legal system are defined these types of business entities: personal companies (partnerships), capital companies (corporations), civil partnerships, sole traders, cooperatives, branches and representative offices.

<u>The short characteristic of companies</u>
The ”Commercial Companies Code” dated September 15, 2000, Official Journal 2000, No. 94, item 1037, amandet, and the “Act on Freedom of Economic Activity” on July 2, 2004, Official Journal 2004, No. 173, item 1807, allow the following form of companies:

- **Personal companies (partnerships)**
  - General(Registered) Partnership
  - Professional Partnership
  - Limited Partnership
  - Limited Joint Stock Partnership
- **Capital companies**
  - Limited Liability Company
  - Joint Stock Company

In order to harmonize Polish provisions with European law and to implement Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006, amendments were made to the Code of Commercial Companies on June 13, 2008. The main aim of the amendments was to update the regulations on share capital. Other key changes relate to the financing by joint-stock companies of own share acquisitions. The amendments came into force on 5 October 2008.

General (Registered) Partnership (spółka jawna) is established for the purpose of operating business on a larger scale. It must be established and conducted by minimum of two individuals or legal persons or organizational units without legal personality which was granted a legal capacity on the basis of specified act. Minimum capital is not determined. Each partner is liable without limitation, for the debts and obligations of the partnership jointly with other partners and the partnership, to the extent of his or her entire property (subsidiary liability of the partner). Each partner has right to represent a company. Registered partnership may also be represented by a proxy.
Professional Partnership (spółka partnerska) is established for the purpose of pursuing a profession in the form of a partnership, which conducts business under its own business name. This form is designated only for a limited number of professions, so-called '**free professions**'. Founders must be established by at least two individuals qualified to pursue the given profession. Minimum capital is not determined. A partner is not liable for the debts and obligations of the partnership incurred by the pursuit of a profession by other partners, or resulting from the actions or omissions of the partnership's employees who at the time of providing a service related to the company's business were commissioned by and answerable to another partner. The deed of partnership may provide that one or more partners are liable for the debts and obligations of the partnership to the same extent as that of a partner in a registered partnership. Every partner shall be liable for obligations of the partnership with all his assets jointly and severally with the remaining partners and with the partnership for obligations which not have arisen with relation to practising liberal profession by the remaining partners.
Limited Partnership (spółka komandytowa) is established for the purpose of conducting business under its own business name. It must be established and conducted by at least two individuals or legal persons or organizational units without legal personality which was granted a legal capacity on the basis of a specified act (for example partnerships). Minimum capital is not determined. At least one partner is liable to the creditors for the debts and obligations of the partnership without limitation (the general partner - GP) and at least one partner has a limited liability (limited partner – LP). However, if a business name of a limited partnership includes a name or a business name of a limited partner, this partner is liable for obligations of a partnership without any limitation. In the same way is liable limited partner performing act in law in the name of partnership without disclosing his power of attorney or when he acts without authorization or beyond the scope of authorization.
The GPs are, in all major respects, in the same legal position as partners in a conventional firm, i.e. they have management control, share the right to use partnership property, share the profits of the firm in predefined proportions, and have joint and several liabilities for the debts of the partnership.

Limited joint stock partnership (spółka komandytowo-akcyjna) is established for the purpose of operating a business under its name (usually a larger-scale business for example large family enterprises). It must be established and conducted by at least two individuals or legal persons or organizational units without legal personality which was granted a legal capacity on the basis of specified act. Minimum capital is 50,000 PLN. At least one partner is liable to the creditors for the debts and obligations of the partnership without limitation (the general partner) and at least one shareholder is not liable for debts and obligations of a partnership. However, if a business name of a limited joint-stock partnership includes name or a business name of a shareholder, this shareholder is liable for obligations of a partnership without any limitation. In the same way is liable limited partner performing an act in law in the name of partnership without disclosing his power of attorney or when he acts without authorization or beyond the scope of authorization.

Limited Liability Company (spółka z ograniczoną odpowiedzialnością) may be established for any purpose allowed by law (including conducting a business) unless other is provided by acts. It might be established by one or more individuals or legal persons or legal persons or organizational unit without legal personality which was granted a legal capacity on the basis of a specified act (for example partnerships). However, it may not be established solely by another single-member limited liability company. Minimum capital is 50,000 PLN, and 100% must be paid in on incorporation, divisible into shares of equal or unequal value subject to a minimum share value of PLN 50. The Company is liable for its debts and obligations with its whole property without any limitations.
The shareholders are not liable for the company's obligations; they bear a risk up to the value of shares contributed. Where execution against the company has proved ineffective the members of the management board shall be liable jointly and severally for the obligations of the company. A member of the management board may extricate himself from the liability by showing that a petition for declaration of bankruptcy was filed or arrangement proceedings were instituted in due time, or that a failure to file a petition for declaration of bankruptcy or institute arrangement proceedings was not due to his fault or that the creditor suffered no damage even though no petition for bankruptcy was filed or no arrangement proceedings were instituted.
Superior authority of a company is Shareholders Meeting, which appoints, according to principles laid down in a company deed or a company charter, the Management Board (consisting at least of one person). This board ensures the operative management of the company. Optionally may be appointed also Supervisory Board or Audit Commission. In limited liability companies whose initial capital exceeds 500,000 PLN and the number of share holders exceeds 25 the Supervisory Board or Audit Commission shall be compulsory. The Supervisory Board is generally elected by the General Meeting, but the articles of association may specify other rules of election. The board must have at least three members. There are no requirements as regards their nationality or domicile. A member of the Management Board may not simultaneously be a member of the Supervisory Board.

Joint-Stock Company (spółka akcyjna) is established for the purpose of operating business on a large scale. It might be established by one or more persons; exception: it may not be established solely by a single-member limited liability company. Minimum capital is 500,000 PLN - of which 25% must be paid in on incorporation, divided into equal nominal shares of at least PLN 0.01. Capital may be obtained through issuance of shares. Shares may be registered, bearer, common or preferred. Preferential shares may, in particular, be related to voting rights, rights to dividends, or the form of participation in the distribution of assets in the event of liquidation of the company. Preferential voting rights may not grant any person more than three votes per share. Preferential shares may not entitle the holder to dividends exceeding the dividend attributable to non-preferential shares by more than half. The right of holders of preferential shares to receive dividends does not rank above the right of holders of non-preferential shares, unless otherwise provided in the articles of association. The amended Code introduces the fair value concept for non-cash contributions. The Company is liable for its debts and obligations with its whole property without any limitations. The shareholders are not liable for the company's obligations they bear a risk up to the value of shares taken up.
Authorities of a company:

- *General Assembly* - is the superior authority of a joint stock company. General Assembly is the decision-making body in matters of great importance to the company. Its meetings may be ordinary or extraordinary. An ordinary general meeting should take place once annually and should be held during the first six months of the financial year. Extraordinary general meetings may be held at any time or when required by due process of law. The ultimate power over the company rests with the general meeting, which must be convened in Poland. A shareholder cannot be represented at a general meeting by a proxy who is a member of the executive board or an employee of the company.

- *Executive Board* **-** Polish joint stock companies are not required to appoint a board of directors. They may instead establish an audit committee. All members of the board may be appointed for a common term of office. If a member is appointed during such a term, the term of office of that member will end when the term of office of the other members expires. Such provision may apply only if clearly stated in the articles of association. In certain matters, such as signing the application to the register of entrepreneurs, signing the list of shareholders or signing the annual report, the signatures of all members of the board are required, irrespective of the powers of representation stipulated in the articles of association. The executive board is usually appointed by the general assembly. The board may consist of one or more members. The members of the management board may be shareholders, foreigners, or Polish nationals. In its dealings with third parties, where it has more than one member, the company's management board must be represented by at least two members, or one member and a proxy acting jointly. A member of the management board must not, without the permission of the company, engage in competitive activities, be a member of the managing or supervisory bodies of a competitor company or be a partner in a partnership which is a competitor.
- *Supervisory Body* **-** A joint stock company must obligatory appoint either a Board of Directors or an Audit Committee. Where the company's statute, or deed allow this a supervisory board or an audit commission, or both may be appointed. It monitors all aspects of the company's operations. The powers of the supervisory board also include suspension – on good grounds – of some or all members of the management board. Supervisory board members are appointed and removed by the general meeting. Employee-nominated supervisory board members are elected in a general and direct ballot by the employees. As the law does not distinguish between different kinds of supervisory board members the rights of employee representatives are the same as those of other board members (including remuneration).

2.2 Accounting Law

Rapid economic transition and development in Poland over the past 20 years left little time for accounting regulations and practices to evolve from an initial fiscal reporting function to a source of relevant economic information for investors. Still, accounting regulation underwent deep modifications every five years, bringing it ever closer to International Accounting Standards.

At the beginning of the transition, Poland had different accounting regimes and different reporting objectives for different entities. As a result, there were different groups of accountants and auditors with different training and examination backgrounds. With time, however, both the profession and regulation evolved and converged with European and international standards.

The first "**Accounting Act**" of September 29, 1994, Official Journal 1994, No. 121, item 591, brought Polish accounting more in line with the European Union accounting directives implemented selected International Accounting Standards, and allowed Polish companies listed on foreign capital markets to use IAS or US GAAP instead of Polish regulation. The accounting directives form the legal base for national regulation related to company accounts in EU member states and include the Fourth Directive, which deals with annual accounts of companies with limited liability (78/660/EEC of 25 July 1978) and the Seventh Directive, which deals with consolidated accounts of companies with limited liability (83/349/EEC of 13 June 1983).

However, the Act differed significantly from international standards in that it was conservative and rule-based. Valuation was dominated by the historical cost principle, and details such as source documents, books, control, record retention, computerized accounting and inventory count were regulated. Little or no attention was given to more complex issues such as long-term construction projects, mergers and acquisitions, or financial instruments and leases. Where national regulation was lacking, the Act instructed accountants to use International Accounting Standards. It also regulated the format and content of financial reports and auditing.

New amendments of Accounting Act were introduced on November 9, 2000, Official Journal 2000, No. 113, item 1186 and had constituted a thorough redefinition of accounting regulation; out of a total of 83 articles, 72 were amended. Among other changes, new terminology for unregulated areas was introduced, and terminology for existing provisions was modified.

With the Accounting Act of 2000, Polish accounting took the first step away from a tax-oriented system toward becoming a tool for decision-making by implementing a "substance over form" principle. The information needs of various stakeholder groups became the focus of financial reporting, and the Act introduced a significant increase in transparency and public disclosure of accounting policies. It also put greater emphasis on fair value instead of historical cost accounting.

Major changes introduced by the Accounting Act of 2000:

- New terminology and significant changes
    - Fair value concept
    - Substance over form
    - Consolidation (valuation of assets of the acquirer, purchase accounting method)
    - Investments (valuation of investments and financial instruments, main categories of investments)
    - Long-term contracts
    - Inventory and CGS valuation
    - Lease (definition, valuation and profit determination methods for leases)
- Modification of existing provisions
    - Deferred tax
    - Reserves and provisions
    - Foreign currency translation
    - Fixed and intangible assets
- New disclosure requirements
    - The statement of changes in equity
    - Indirect and direct method for preparation of cash-flow statement
    - Items of related parties disclosed separately
    - Extension and categorization of the contents of the notes to the accounts as an introduction to the financial statements and additional information and notes to the financial statements.
    - Public dissemination of policies and methods of valuation of assets and liabilities

The Accounting Act of September 29, 1994, and its comprehensive amendment adopted on November 9, 2000 have brought Polish Accounting Regulations (PARs), which are issued in the form of act of law, ordinances and decrees, more in line with the International Accounting Standards (IASs). The accounting regulations have moved the focus of Polish accounting away from the emphasis on tax compliance toward a more business-oriented approach aimed at meeting the information needs of various stakeholders in a market economy.

Most enterprises are required to maintain books of account and prepare financial statements according to the provisions of the Accounting Act. These enterprises include commercial companies, banks, insurance companies, investment funds and investment fund companies, pension funds, pension fund companies, foreign corporate bodies, foreign entities without legal personality, and those other business enterprises (sole proprietorship and various types of partnerships) that had revenue during the preceding financial year amounting to at least the Polish zloty equivalent of EUR 800,000.

Appendices to the Accounting Act provide sample formats of balance sheet, income statement, statement of changes in equity, and cash flow statement. Deviation from these formats is allowed provided that the financial statements fairly and clearly presents the financial position and results of operations in accordance with the rules of accounting practice as stipulated in the Accounting Act. The publicly traded companies are required to prepare financial statements in accordance with the formats prescribed in the Decree of the Council of Ministers concerning public issue of securities.

Next amendment of the Accounting Act from August 23, 2001 mandated also the Finance Ministry to establish an Accounting Standards Committee (ASC). The ASC was established under Minister of Finance in April 2002. The main task of the ASC covers the issuance of Polish Accounting Regulations independently from tasks performed by the Ministry of Finance. The ASC provides a forum for exchange of views on the most problematic issues that appear during the changes process in the national accounting system. Polish Accounting Regulations set by the ASC will take into account the Polish specific economic circumstances, as well as the European Union pre-access adjustments requirements.

When provisions are not covered, the Accounting Act provides for potential application of accounting standards issued by ASC, and the eventual application of IAS in cases when Polish Accounting Regulations are lacking coverage. Thus the jurisdiction of ASC and the Polish Accounting Regulations will extend to all entities covered by the Accounting Act. In addition to the accounting requirements stipulated in the Accounting Act, there are some specific accounting and disclosure requirements set in decrees issued by the Finance Minister for some financial institutions including banks, insurance companies, investment funds, pension funds, and brokerage houses. Moreover, the separate decree issued by the Council of Ministers requires additional disclosures by the publicly traded companies.

The amended Accounting Act has eliminated audit requirement for small-size enterprises. The threshold for an enterprise to be subject to annual statutory audit is meeting at least two of three conditions during the immediate past financial year:

- annual average of 50 full-time equivalent employees;
- total assets at fiscal year-end of at least the PLN equivalent of EUR2,500,000; and
- net sales revenue and financial income of at least the Polish zloty equivalent of EUR5,000,000.

Prior to the amendment, a large number of smaller-size enterprises were required to have a statutory audit once every three years—at present, this requirement does not exist. The Accounting Act also requires an annual statutory audit of banks, insurance companies, publicly traded companies, investment funds, pension funds, holding companies, and joint stock companies.

Statutory auditors are appointed at the annual general shareholders' meeting unless the articles of association provide for the supervisory board to make such appointments. Moreover, the Commercial Code provides shareholders of limited companies, who represent at least ten percent of the company's share capital, the right to appoint auditors to conduct an investigative audit.

The top management of companies is legally responsible for the financial statements. According to the Accounting Act, a fine or a penalty of imprisonment for two years may be imposed on the top management of the company in cases of failure to maintain books of account and to prepare and present financial statements in accordance with the Accounting Act.

Financial statements must be prepared within three months of the date on the balance sheet, and should be presented for approval at the annual general shareholders' meeting within six months (eight months in the case of consolidated financial statements of a group). The audited financial statements, including the audit report and other information, should be filed with the registration court and published in the official gazette, Monitor Polski B, within 15 days of approval at the annual general shareholders' meeting.

There are additional reporting requirements for the publicly traded companies. Publicly traded companies are required to have semi-annual financial statements reviewed by independent auditors and to submit these statements to the Securities and Exchange Commission (SEC). At the end of 2001, these companies were required to include in the financial statements a description of major differences between the adopted accounting policies and IAS requirements, and reconciliation of both the net profit and net equity figures in the financial statements to that which would arise under IAS. A decision was made in early 2002 to suspend these additional disclosure requirements.

Membership in EU entailed incorporating EU accounting legislation, including the requirement for companies listed on European stock markets to prepare their consolidated accounts according to the IAS/IFRS beginning in 2005. The Accounting Act amending on April 30, 2004, Official Journal 2004, No. 145, item 1535 also permits the use of IAS/IFRS in consolidated statements of:

- issuers pending admission to public trading and,
- companies that are part of a group in which a parent company prepares consolidated financial statements under IAS/IFRS.

There is an option of using IAS/FRS in separate financial statements of:

- issuers of securities admitted to public trading and the issuers pending admission to public trading and
- companies who are members of a capital group for which a parent company prepares consolidated financial statements under IAS.

The implementation of IAS/IFRS required overcoming social and cultural differences in the perception of accounting, accountants and their role in the economy. The standards were translated into Polish by the Polish Accounting Association, but translation of the IAS does not by itself cause a shift in accounting education, theory and practice. Whether the implementation of IAS/IFRS has been a success is still subject to discussion. The scope and quantity of information provided by companies have increased, but most companies choose not to disclose or provide information in a more narrative form if it is not directly required.

Next amendments of the Accounting Law were issued on August and December 2004, on December 2005 and on Mart, July and October 2008 [14].

The "Act on the study and the publication of financial statements and of auditors and their self-government", dated October 19, 1991, amended by the "Act on Auditors and their Self-Governing Body", dated October 13, 1994, and the subsequent amendment – the "Act on Auditors and their Self-Governing Body, on entities authorized to audit financial statements and on public supervision", dated Mai 7, 2009, Office Journal 2009. No.77, item 649, regulate the audit profession in Poland. This Acts provides legal framework for the creation, governance, and operation of the National Chamber of Statutory Auditors (NCSA). The Ministry of Finance is responsible for supervision of the NCSA; the finance minister may lodge a complaint against the NCSA to the District Court for the city of Warsaw if it violates the legal requirements or departs from its statute.

The NCSA is legally authorized to set auditing standards in consultation with the Ministry of Finance and the Securities and Exchange Commission, and in relation to banks after consultation with the Banking Supervision Commission. When drafting auditing standards, efforts are made to adapt internationally recognized standards to country circumstances. To date, the NCSA has issued eight auditing standards:

- general principles on auditing of annual financial statements;
- auditor's report and long-form auditor's report on annual financial statements of an entity other than a bank or an insurance company;
- auditor's report and long-form auditor's report on annual financial statements of an insurance company;
- auditor's report and long-form auditor's report on annual financial statements of a bank;
- auditing of consolidated financial statements of a capital group;
- general principles in relation to the review of interim financial statements;
- auditing of annual financial statements of entities not subject to the mandatory annual audit (this norm related to small entities that were subject to audit every three years; currently this norm is not applied in practice since the obligation for smaller companies to have an audit of financial statements every three years has been revoked);
- auditor's report and long-form auditor's report on annual financial statements of investment or pension funds [7, 12].

According to a 2009 International Federation of Accountants (IFAC) publication, auditors in Poland are required to use Polish auditing standards developed by the National Chamber of Statutory Auditors; in matters not covered by the national standards, International Standards on Auditing (ISAs) as issued by the International Auditing and Assurance Standards Board (IAASB) are followed. Per this IFAC report, ISAs have been translated into Polish since 1996 and the latest version of ISAs issued as a result of the Clarity Project has also been translated. The IFAC report as well as a 2006 NCSA self-assessment, observed that Polish auditing standards are primarily based on the ISAs. However, in its 2005 assessment the World Bank found the national auditing requirements to be an "abbreviated" and "incomplete" version of international standards and recommends the wholesale adoption of ISAs in Poland. Polish auditing practices, however, were likely to change with the implementation of the European Commission (EC) Directive 2006/43/EC, which is expected to require application of ISAs by all member states. Per a 2009 EC publication, Poland has fully transposed the above-mentioned Directive into its national legislation. In its Action Plan prepared in 2008 as part of the IFAC International Member Body Compliance Program, the NCSA stated that it will develop an action plan to support the adoption and implementation of ISAs in Poland and reiterated its commitment to convergence with the IAASB pronouncements.

2.3 Tax Law

The key constitutional provision concerning tax matters is art. 84 of the Constitution according to which, everyone shall comply with his responsibilities and public duties, including the payment of taxes, as specified by statute. The Constitution further provides that the imposition of taxes, as well as other public imposts, the specification of those subject to taxation, of the object of taxation and rates of taxation, as well as the principles for granting tax reliefs and remissions, along with categories of taxpayers exempt from taxation, must be by means of statute [1, 9].

Polish Constitution sets forth the rule of exclusivity of statutory regulation of tax matters, which means that only the Parliament is empowered to impose taxes and other public duties – in the form of a statute. All the basic elements of taxes (like subjects, objects and rates of taxation, the principles of granting tax reliefs and remissions, the categories of taxpayers exempt from taxation) must be specified by statute.

Regulations concerning tax matters (issued mainly by the Minister of Finance) should only contain rules of more technical character, being simply the implementation of tax statutes.

Poland is a unitary state, thus taxes may only be levied by the Parliament. Units of local government do not have the competence to impose taxes, but they are entitled to receive public funds adequate for the performance of the duties assigned to them. The sources of revenues for units of local government must be specified by statute. As regulated in the “Revenues of the Units of Local Government Act” on November 13, 2003, Official Journal 2003, No. 203, item 1966, amended, revenues from all taxes and other public duties are divided between the state and units of local government. This division of revenues means that units of local government either participate to some extent in revenues of the State Budget derived from given kinds of taxes (and receive some percentage of these revenues) or that revenues from other kinds of taxes flow directly and exclusively to local budgets. They all participate to certain percentage in revenues from personal income tax and corporate income tax. But there are also taxes which generate revenues due exclusively to communes.

Taking into account the criteria of the budget receiving tax revenues, all taxes imposed in Poland may be divided into: state taxes and local taxes (at present: communal taxes only).

The **state taxes** are **-** personal income tax, corporate income tax, tonnage tax, tax on goods and services, excise duty, gambling tax.

The **local (communal) taxes** and duties are **-** tax on civil law transactions, inheritance and gift tax, immovable property tax, agricultural tax, forest tax, tax on means of transport, duty on possession of dogs, stamp duty, market duty, tourist and health resort duty.

The tax on goods and services, excise duty and gambling tax belong among the indirect taxes whereas all other taxes belong among the direct taxes.

Units of local government have the right to set the level of local taxes and duties only to the extent established by statute. Thus communes are entitled to set the level of some communal taxes and duties (e.g. immovable property tax), within the statutory limits.

Also the collection and assessment of taxes is divided between state and communal tax authorities. However some communal taxes (tax on civil law transactions and inheritance and gift tax) are administered by state tax authorities.

Corporate income tax is regulated by the “Corporate Income Tax Act” (CITA), on February 15, 1992, Official Journal 2000, No. 54, item 654, amended. Generally CIT is imposed on income of legal persons and certain kinds of organizational units.

In general CIT is levied on the aggregate income from all sources (reduced by deductions) at the rate of 19 %. Besides, income from some sources is taxed separately e.g. interests (final withholding tax of 20 %), dividends (final withholding tax of 19 % credited against the corporate income tax on the total income), royalties (final withholding tax of 20 %).

Tax on goods and services is regulated by the “Tax on Goods and Services Act” (TGSA) on March 11, 2004, Official Journal 2004, No. 54, item 535, amended. It is a Polish value added tax (VAT), harmonized with the provisions of European law.

From the January 1, 2011, basic tax rate is 23 %. Reduced rate of 8 % applies to some health care products, hand-made traditional items, most foodstuffs, tourist services (e.g. hotel and restaurant bills), passenger transportation services (e.g. bus tickets), children-care goods, books, newspapers and magazines, construction and renovation, communal services (e.g. water distribution) and fertilizers. Rate of 5 % applies (temporarily) to some agricultural products and unprocessed food. Rate of 0 % (equivalent to exemption with the right to reduce the output tax by the input tax) applies above all to export of goods, intra-community supply of goods, international transportation of goods and passengers and (temporarily) to books and specialist periodicals.

2.4 Sector of SMEs in Poland

As far back as in 1995, the Polish Government adopted new policies and legislation to stimulate growth in its SME sector. The Polish Foundation for the Promotion and Development of SMEs was established, a national register of services for SMEs was created, and the National Loan Guarantee Fund was launched to improve conditions for SME development. Other measures were adopted in subsequent years to improve competitiveness, stimulate exports, and increase investor spending. Additionally, over 140 centres were set up to provide training, information, and financial services for small business owners.

The SME sector includes an economic operator, irrespective of its legal form. In particular, they are self-employed people, family businesses engaged in craft or other activities, or companies or associations regularly engaged in economic activity.

According to data collected by the Central Statistical Office (CSO) for 30.06.2008 there were 3 576 951 SME registered in Poland. For comparison in the end of 2005 there were

3 501 114, the next year there were 3 517 898 and in the end of 2007 there were 3 564 602. At the same time in 2007 the number of closing enterprises decreased by 10.6% in comparison to previous year. It shows a constant increase tendency in the number of SME in Poland. In the years 2005-2007 the fastest increase was observed among registered enterprises with 10-49 employees.

The fastest increase in the number of active enterprises (data collected in 2006) was observed in Educational sector (7%), the next was Construction (5.9%), then there were Transport and Trade (4.5% and 2.9% respectively). Number of micro enterprises in industry has only increased by 1.3% and the number of enterprises with 10-49 employees decreased by 2.3%. There was a significant increase in the number of medium enterprises in industry (2%) and even greater (5.3%) in the number of big industrial enterprises.

From the general number of all active SME, the majority was Trade and services (35.7%), next was Real estate and company services (16%), Industry (11.5%), Construction (10%) and Transport (8.4%) [10].

The CSO research shows clearly that it is the most difficult for an enterprise to survive the first year of activity. In 2001-2006 this was the period after which 35-40% of enterprises closed. In 2006 the conditions for new enterprises were similar to those considering the existing enterprises. The first year survival ratio for new enterprises decreased slightly by 1.1 percentage point. The healthcare enterprises had the greatest survival chance among all the enterprises started in 2006. Transport and Real estate enterprises' survival ratio was also above average. On the long-term basis it was hardest to survive for Trade and Tourism enterprises.

In the long-lasting perspective enterprises with legal personality and those employing staff from the beginning of their existence had higher survival ratio. Usually such enterprises are bigger and stronger from the very beginning of their activity.

The above stated is a constant tendency not dependant on time.

According to CSO research, 52.5 % SMEs established in 2006 faced no development barriers. This makes nearly 3.5 % more than in the previous research. Among the barrier-facing SMEs 27.5 % had problems with demand, 14.6 % - with both demand and supply. Only 5.4 % of the problem-facing enterprises had problems with supply exclusively.

Among different difficulties concerning demand, competition was the most often mentioned by enterprises after a year of activity (72 %). Similarly to the previous research this barrier was mentioned by entrepreneurs not depending on a branch of craft, location of neither the enterprise nor the owners' characteristic. A bit more than 50 % records covered problems resulting from price-lowering policy of the competing companies (high competition on the market again). Among supply problems insufficient own resources were mentioned together with qualified workers. 66 % of construction, 42 % industry and 42 % service enterprises complained about the lack of employees.

Another problem is a proper availability of external sources of funding (e.g. loans and EU financial support).

In 2005 the overall incomes of enterprises (excluding agriculture, forestry, fishing and public administration) reached level of 2 257 202 PLN and were 3.2 % higher than the year before. The incomes increase rate in 2005 was moderate in comparison to that from 2004, when the overall incomes of all companies increased by 12.6 %. In 2006 the rate of increase in incomes was even higher than two years ago (13 %), which gave a total of 2 551 193 million PLN. Such a spectacular increase in incomes in 2006 took place mainly due to quick increase in sale in three main sectors of economy: Construction (21.6 %), Transport (14.1 %) and Industrial processing (13.3 %), but also in two other sectors with a relatively low number of enterprises active and people employed, which are Financial mediation (53.4 %) and Education (21.5 %).

In 2006 there was the highest incomes increase among micro enterprises and big enterprises – in both groups about 15.1%. The increase rate was lowest for small enterprises with 10-49 employees (5.5%), while in medium size enterprises it was 11.9%. In all enterprises groups according to size the incomes were increasingly growing in those from the above mentioned branches (e.g. Construction, Transport, Industrial processing and financial mediation). The only exception was an income decrease among small enterprises (10-49 employees) in financial mediation sector.

Data collected by CSO considering SMEs situation in 2005-2006 show a great improvement in SMEs condition. The number of active SME increased. The number of employees in micro enterprises increased. The number of employees of medium enterprises also has been growing increasingly. The expansion of hypermarkets has not caused significant decrease in the number of employees in micro- and small enterprises. The average monthly wages in SMEs have increased and the rate of increase was almost two times faster than in 2005. The micro enterprises incomes increase rate was similar to that of big enterprises.

The investment outlays rate have also increased among SMEs (in micro- and small app. 20 %, and in medium enterprises – up to 30 %), while compared to the previous year, in 2005 the investment outlays decreased in small and medium enterprises and in micro enterprises increased just about 4 %.
However, the micro- and small enterprises developed in a shadow of big and medium enterprises. They only took advantage of the fast rate of evolution of Polish economy stimulated by bigger enterprises and other external factors since 2004, not having direct influence on such situation.
Reasons for low economical productivity of micro- and small enterprises are well-known and were often pointed out by different economists. Different researches highlighted restrictive conditions of enterprises existence, such as: the time needed to register a new enterprise, government and local authorities' attitude towards entrepreneurs, complicated formal regulations (Labour Code), high labour expenses, number of control and assessment institutions and the range and terms of control.
Big and medium enterprises are more likely to get through the obstacles being able to use professional advisory services, while micro- and small enterprise owners cannot afford such expenses, not having required knowledge and competence at the same time. In the face of increasing economical crisis any obstacles met by small entrepreneurs become more disruptive and may possibly cause a decrease in the number of active enterprises.

3 Evolution of Accounting after 1989

Accounting in Poland is a mixed system because the system has the characteristics of Anglo-Saxon and continental system, but is returned in the direction of the continental system. In the course of history, Poland developed its own meaning of "true and fair" value, which became a compulsory requirement of financial reporting on adoption of EU directives and IAS/IFRS. Polish "Accounting Policies and Practices in Valuation and Income Measurement" are guided by three main principles introduced in the Accounting Act in 1994. Book entries need to reflect the actual position of the entity and therefore present the assets, financial situation and result and profitability of an entity fairly (rzetelnie), correctly (prawdiłowo) and clearly (jasno). The first two descriptive adjectives seem closer to the French sincere, rather than the broad English understanding of "fair" developed in the course of common law application. The Act however states that purpose of financial accounting standards is giving a "true and fair view" of the economic condition, financial result and profitability of the entity. The word "clearly" is the extra requirement, implemented during the translation processes. In broad understanding "clearly" should prevent financial statements from being incomprehensible and/or unclear. This is an extra step in defining an own understanding of the true and fair concept bringing it slightly towards the British understanding [11].
With regards to uniformity principle, it seems to be assumed that the uniformity applies to pre- 2005 and the flexibility to the post- 2005 Polish accounting. Observed domination of the stewardship and prudence in accounts (which can be thought of as a proof for uniformity) in Poland is rooted in the practice of one and only set of accounts to serve all purposes. The principles applicable until 2004 and adopted in the Act 1994: accrual basis, going concern, conservatism, consistency, comparability and materiality do not give a uniform answer to attest to either. The codified law practice and aiming at fulfilling the requirements of free economy, disciplined prepares of accounts to comply with the substance over form principle while obeying the letter of the law.
The traditional and preferred sources of funding for Polish enterprises were bank loans and the government subsidies, making these parties the two main information users. State was the main guarantor of loans and subsidies and there was little incentive and scope for secretive practices. With the democratization of the market in 1990's and process of privatization, the will to continue with enhanced transparency, to differentiate from competitors and gain trust, was. Privatization process of the 1990s enforced a major shift in making business and urged development of alternative strategies for acquisition of funds. Shift in the economy model changed the providers of finance and therefore information users. After regaining independence banks themselves became overburdened with debt, involuntarily forcing businesses to look for funding elsewhere. A program called the Enterprise and Bank Restructuring Program (EBRP) in 1993 established the short- and long-term policies to change the fundamental incentives of the industry and aid the problem.

The re-birth of Warsaw Stock Exchange (WSE) enabled firms to obtain financial resources from share offerings. Following, shareholders entered the scope of users of financial statements affecting the clarity of disclosure. The language and form of financial statements of this period assumed high level of knowledge of the users, at whom it was directed. This suggests that the shareholders were expected to be institutionalized rather than individuals, placing Poland with countries like Germany rather than UK-US in this respect. This has changed over time and later years witnessed expansion of private investor base, which however still constitutes only 17% of the total (WSE data for year 2008). Out of the foreign investor base, UK brokers constitute 72% of the total (Czech Republic being next in line with 11%, WSE data for year 2008). Such significant holdings make UK a major finance provider to WSE listed companies; they also make UK brokers a user of financial information. Informational expectations of British brokers will most likely be those of adherence to IFRS embedded accounting principles as understood in the UK.

The prevailing accounting rules in current Polish accounting system are:
- the principle of true and fair view,
- accrual principle,
- principle of proportionality costs and revenues,
- precautionary principle.

Accounting in business entities has to play many diversified roles which come out from its mission described as a holistic information system. A superior aim of accounting is to elaborate the information associated with the business activity. Because of that, the information function is a basic function of accounting. It depends on creating the information connected with business processes and adjustment to information needs of users in order to appropriately formulate opinions and make proper decisions.

Current Polish accounting system is oriented both on internal (from an enterprise) information users, and on external users from enterprise environment. The performance of internal informative function is observable in provision of economic and financial information which are prepared periodically in order to properly manage the enterprise with consideration of various hierarchy and organizational levels. This information is passed on to managers in the form of financial statements and periodical reports. Accounting, through fulfillment of internal informative function, allows users and the system itself to run information services for all management functions: planning, organizing, coordinating motivating and control.

On the other hand, accounting through the external informative function, provides information for appropriate entities from enterprise environment, especially for shareholders, co-owners, and other investors, banks (creditors), contracting parties, local societies, and government agencies (ministries, statistical offices etc.). Much information generated by accounting that is useful for external users in assessment of company's financial situation, are included in financial statements.

Informative function of accounting, which is appropriately realized, enables to perform the following detailed functions:
- **reporting** - which concerns the final product of data processing in accounting system, that is preparation of reports, financial statements and statistical statements, adjusted to needs of internal and external recipients. Information are presented both in statements which show the general overview of entity's activity (for instance balance sheet, profit and loss account), and in reports or statements related with particular problems. Those reports and statements are basic carriers of information provided by accounting system.
- **evidential** - which is expressed in book-keeping and recording the appliances and devices in a way which enables to present in any case all documents, accountancy books and financial statements on the court, crime squads, or offices of inland revenue demand, as reliable evidence in legal and tax proceedings. Thanks to the obligation to keep the accounting documents a possibility to find the evidence of every business action in enterprise occur.
- **optimizing** - which is characterized as a need for creation of foundation for choosing optimal activity scenario by providing the information, which describe various decisive situations in business entities. In optimizing issues, such categories as: costs, revenues and financial results are often a choice criterion and a parameter of decision-making model. Sometimes, these categories refer to determining the most profitable relation between expenditures and results.
- **control** - which is most visible in provision of information about costs, revenues and results for various management levels regarded as responsible centers, in order to assess the progress in obtaining scheduled tasks and the level of exploitation of funds dedicated for these tasks, and also for control over produced costs. On the basis of provided information, some conclusions associated with future activities are formulated. Control function of accounting can be realized in the form of three kinds of

control: initial control, performed before the business activity really starts, and before any costs, revenues or profits are noticed, current control, performed during the performance of business activities and final control, performed after all activities have been completed in order to check all documents and assess revenues, costs and profits.

- **analytical** – associated with investigation and interpretation of information obtained from accounting in various sectional views in order to assess the financial standing, financial results and efficiency of business entity activities, and in order to determine the relations, reasons and outcomes of these elements.

Financial Reporting in Poland which result from the Accounting Act [6, 8]:

- provides rules for the implementation of the report dates for reports,
- provides patterns of the reports in the Annexes of Act,
- gives the definition of components that fall within the scope of the report, the methods of their valuation,
- procedure for approval and publishing of the financial statements,
- includes a method of testing and publication of the financial statements,
- determine a criminal responsibility.

3.1 Accounting Reforms

Changing the economic system in Poland caused the need for reform in many areas, including accounting.
The main objectives of accounting reform in Poland were:

- creating a basis that will promote a fair and accurate picture of the condition of individuals and groups of individuals linked to one another, which is a prerequisite to the inflow of foreign capital in our country,
- harmonization of national accounting legislation with the relevant EC Directives, which conditioned the membership of Poland in that organization and with IAS (IFRS), unless they are conflict with the previous,
- harmonization of accounting rules by all entities obliged to do so, which is notably related to the preparation and audit of the financial statements and to ensure comparability of information,
- creating a coherent, modern and transparent system of laws relating to accounting, corresponding to the requirements of the modern economy,
- issuing of the rules on accounting in the form of the Act to emphasize the importance and role of accounting in a market economy.

The process of harmonizing Polish accounting regulations in force in the European Union began in 1991, with the adoption by the Minister of Finance Regulation on the principles of accounting. The Regulation took into account the modifications of the Polish Commercial Code of 1934 and undertook the incorporation of series of the solutions of the Fourth EEC Directive. The new act of 15 January 1991 contained general rules applicable in the field of documentation, bookkeeping, valuation of assets and liabilities and determining the financial result. He changed the layout of balance sheet, also introduced two variants of determining the financial result of accounting entity - comparative and calculating.
Further changes took place in 1994 and were related to the entry into force the Accounting Act on 1 January 1995, which became the basic document regulating the accounting and procedures audit of financial statements on Polish territory. At the same time, the accounting acquired the statutory rank, which authorized the use of the term “Polish balance right ".

The publication of this legislation was the next step in customizing the Polish accounting to international standards, but also contributed to the increasing of the security of trade in goods and capital market. This resulted in a final normalization and stabilization of the basic accounting terms on a national economy scale. The Act also set out detailed rules of the bookkeeping in business units, taking into account the specificity of banks and insurers and fully recognized the supreme principle of “true and fair value” view. For the first time it was introduced in Poland the duty, to prepare full financial statements (balance sheet, profit and loss account and additional information). One of the most important changes made then was adding a cash flow statement to the financial statements. The preparation of this account was compulsory for the entities, obliged to let verify their annual

financial statements by the auditor. In the Act of 29th September 1994 for the first time was codified the question of the consolidation of financial statements and developed rules for bookkeeping on the computer. The scope of issues covered by the law corresponded to the Fourth Directive. Both acts exempted from complying with the provisions of the act small enterprises whose annual turnover for the sales and financial operations do not exceed Polish currency equivalent of EUR 800 000. However, the scope of the Polish legislation was much broader, because both the principle of bookkeeping (including computer), and the question of cash flow were not discussed in the EU Directives.
Further changes in Polish accounting were associated with a radical amendment of the Polish balance sheet law. The changes enacted 9 November 2000 and came into effect from 1January 2002 [13, 15]. The main reason for these amendments was the development of international cooperation and more free movement of capital, the need to consider in the financial statements the impact new risky transactions associated with developing forms of financial market, as well as the need to harmonize the rules of reporting on an international scale.
In the amendment, the legislator appealed directly to International Accounting Standards and specified, that in matters unregulated by the Act, the accounting entities may apply national accounting standards issued by the Accounting Standards Committee. In the absence of appropriate national standard, individuals can use IAS. Act of 9 November 2000 amending the Accounting Act was not the last step in the change the accounting law. Following the announcement of the Regulation No. 1606/2002 by the European Union, all Polish companies authorized to trading on regulated market within the European Economic Area were required to prepare consolidated accounts in accordance with International Accounting Standards no later than the beginning of 2005. In addition:

- since 2005 was introduced the obligation to prepare consolidated financial statements in accordance with IFRS for the issuers of securities approved to enter the public marketing and for banks,
- was established the right to prepare consolidated financial statements in accordance with IFRS, starting in 2005, for issuers applying for admission to public marketing or marketing in one market regulated by the European Economic Area and for units included in the group, where a parent company prepares reports in accordance with IAS,
- it was also laid down the right to prepare financial statements for issuers of securities, authorized to public marketing or marketing on one of the regulated markets of the European Economic Area, and issuers, applying for admission to public marketing or marketing on a regulated markets of the European Economic Area, as well as for individuals within the capital groups, where a parent company prepares a consolidated accounts report in accordance with IAS.

The decision, whether the financial statements should be prepared in accordance with IFRS for units mentioned above, was left to the body responsible for approving the financial statements.

3.2 Introduction of Fair Value Approach

Fair value is defined in the Accounting Act in 2001 for balance sheet valuation purposes. The act specifies the use of fair value for valuation of the assets of the acquired companies when the consolidated financial statements are creating.
The valuation carried out at the frame of some transaction may have the fair value character if the transaction was made:

- on market terms (including a hypothetical transaction, if not the actual transaction occurs),
- between interested parties, which means that the parties want to make this transaction, but neither party is in a forced situation,
- between knowledgeable parties, which means that both parties of the transaction have sufficient knowledge and information to enable them objective valuation of the subject of transaction,
- between not together linked companies which are not in a hierarchical relationship against each other.

The fair value according to the amended Accounting Act is used to the valuation of assets and liabilities in the cases of:

- the revaluation of fixed assets,
- the determining the purchase price in case of replacement of assets,
- the settlement of the merger using the purchase method,
- the permanent value impairment,
- the valuation of investments,

- the valuation of net assets of affiliated entities in the consolidated financial statements.

Accounting Act defines the method for setting this value only for accounting in the case of merger using the acquisition method and for financial instruments, in the other case refers to International Accounting Standards.

4 Reporting Issues

4.1 Intangible Assets

Intangible assets are the property rights purchased by a unit for use in accordance with the needs of the unit, whose useful life will be longer than 12 months. They must be included in financial statements when they satisfy the following two conditions:

- there is a strong likelihood that it will be able to achieve financial benefits from them,
- there is a possibility to the credible valuation of them.

The intangible assets include:

- copyrights, related rights, licenses, concessions,
- the rights to inventions, patents, trademarks, utility and decorative models,
- know - how,
- the organizational costs associated with establishing or expanding a joint stock company,
- acquired goodwill,
- the cost of the completed development work if:
    - the product or manufacturing process are strictly determined, and the expenses that relate to development has been carefully defined,
    - the technical suitability of the product or technology has been reliably confirmed and documented in accordance with the requirements and, therefore, the unit decided to manufacture the products or to use the technology,
    - the development costs will be covered from revenues generated from the sale of products or the use of technology.

From the viewpoint of the accounting law the intangible are only the assets explicitly mentioned in the Accounting Act.

There is also difference between the balance sheet law and tax law in Poland in qualifying assets. For income tax purposes the intangible assets also includes the co-operative ownership right to quarters, co-operative right to business premises and the right to a detached house in a housing cooperative. On the other hand, the concessions and the right to emit pollutants into the air don't constitute intangible for income tax purposes (they are written off as costs).

The ways to acquisition of intangible assets:

- the acquisition in a separate transaction,
- the acquisition in a business combination,
- the acquisition by a government grant,
- the acquisition by the exchange of intangible assets.

The initial valuation of intangible assets depends on the manner of their acquisition so the initial value of intangible assets can be the price at which it was acquired (or **fair value**) or the **cost of its creation**.

The acquisition price is the purchase price of the asset, which includes the amount allowed for the seller minus the deductible tax on goods and services and excise tax, plus any other expenses directly related to the purchase and preparation of the purchased component to use, such as transportation costs and insurance. If there is no possibility of determining the purchase price, for example in the case of donations, the valuation is made according to the sales price of the same or similar goods or valuation according to market value.

The manufacturing costs are costs that are directly related to a product or constitute reasonable proportion of indirect costs associated with producing this product.

The various components of intangible assets are valued as follows:

- The acquired property rights and computer programs may be valued at the acquisition cost (at purchase), the net sales price (donation) or when they are brought by a shareholder, the purchase price, which corresponds to the real market value of the shares taken over by return.
- The costs of development works are valued on the basis of actual costs incurred.

- The costs of the company are valued by acquisition price or costs of floatation.

Goodwill represents the positive difference between the acquisition price of the company and the fair value of the company's net assets (usually the market value or determined by authorized appraiser). Goodwill only arises in the case of acquisitions and is recognized in the consolidated financial statements. Its size is equal to the difference between purchase prices. Goodwill is recognized in balance sheet as intangible assets. As a rule, is presented in a separate line. So, goodwill arises when the purchase price of the company is higher than the value of its net assets (total assets minus liabilities). That occurs when the company as a whole has a higher value for the buyer than the sum of its parts.

The initial value of intangible assets is reduced by depreciation (amortization) applied to reflect the loss of their value resulting from their use or elapsed time. The depreciation cannot start earlier than the adoption of the component to use, and its completion cannot arrive later than the value of depreciation equals the initial value, or occurs the withdrawal of the intangible asset. Further evaluation is carried out according to the initial value minus the depreciation (amortization) and any possible write-offs for impairment.

Depreciation (amortization) of intangible assets can be made in accordance with tax laws if:

- they are owned or jointly owned by the taxpayer,
- have been accepted for paid use with their simultaneous inclusion in the taxpayer's assets.

In the case of intangible assets, taxpayers may establish their own depreciation rates. The period to charge depreciation may not be less than the:

- 24 months - for a license or sublicense to the software and the copyright holder,
- 24 months - for a license to the show movies and to the emission of radio and television programs,
- 12 months - for the cost of completed development works,
- 60 months - for other intangible assets.

Some intangible assets are excluded from the requirement to depreciate, e.g. the right of perpetual usufruct of land. Intangible, which are not used due to the cessation of activities in which these components were used, are not subject to depreciation. In this case, these components are not subject to depreciation from the month following the month in which the activity ceased.

In the case of know-how, only the expenses for the acquisition of the knowledge are subject to depreciation. In any case, should be particularly careful demarcation expenditure for the acquisition of know-how and expenditure for the provision of services, particularly advisory services.

In accordance with Polish Accounting Act, the goodwill must be amortized by straight-line method over a period not longer than 5 years. Only in justified cases, it may be extended to 20 years. Extension of the period requires justification, which is given in the notes to financial statements. When goodwill arises on the acquisition of another entity under IFRS 3, then its depreciation is prohibited. In this case an impairment test on goodwill should by carry out. For other intangible the Accounting Act allows the use of different depreciation methods, such as linear, digressive or depreciation method based on use (activity). However, the tax law allows only the use of straight-line method. According to polish tax law single depreciation can be made to the intangible assets of the purchase price up to 3,500 PLN.

4.2 Tangible Assets

Tangible fixed assets (tangibles) are the fixed assets put into use (constant use and withdrawn from the use), fixed assets under construction and advance payments that are transferred to these fixed assets. Any item of tangibles may be included in the accounts as an asset if it meets the following two conditions:

- there is a good chance that it will generate profits in the future,
- its value can be measured reliably.

Tangibles are those assets of the unit, which will be used by the unit as needed, and whose life is more than 12 months. Include also objects that are owned by another company, but that a firm uses and controls, e.g. under the lease.

Tangibles include:

- the real property including any land (with the inclusion of the perpetual usufruct),
- buildings, premises and objects of civil engineering (including cooperative ownership right to residential premises and the cooperative right to commercial space),
- technical equipment and machinery, transport equipment,
- other things such as tools, instruments, movable property, equipment, livestock.

The initial valuation of tangibles consists in determining of the so-called **initial value** of these objects.

The initial valuation of tangibles can be determined:

- at purchase price for those assets which have been purchased by the company,
- according to the cost of the assets manufacturing, if the assets have been produced by the company,
- at fair value of those assets that have been received in an exchange for another assets, or have been obtained free of charge.

The initial value of an asset over time may not reflect its fair value because:

- the asset will be improved,
- the asset wear out (depreciation),
- will be made the revaluation of the asset value,
- occurs permanent loss of the asset value.

Improvement of tangibles is based on their reconstruction, expansion or modernization. The utility value of improved assets exceeds their initial utility value measured by period of use, manufacturing capacity, quality of products obtained with the help of improved assets, operating costs or other metrics.
The tangibles are consumable, and consequently reduce their net worth. There are two types of consumption:

- physical consumption - arises in connection with the use of the asset,
- economical consumption - due to technical progress.

This loss of value is transferred to the value of products produced by using amortized assets. For the determining of the consumption of fixed assets a depreciation method is used [4]. The amount of depreciation depends on the initial value of the asset, on the estimate of its useful life and on the method of depreciation calculating.
The subjects to depreciation are all tangibles except:

- lands (except lands exploited open-pit), which have an unlimited useful life,
- works of art, museum exhibits and etc. objects which increase in value over time.

Depreciation takes place not earlier, than after the adoption of a tangible for use, in the month of inclusion in the accounting and is completed at the time when depreciation is equal to its initial value or in the case of its liquidation, sale and finding a shortage. Depreciation write-of is made in monthly installments. Tangibles seasonally used are depreciated during their use.
Depreciation rates are included in the “Schedules of depreciation rates”, annexed to the law on income tax from legal persons and natural persons. A taxpayer may raise these rates by the following principles:

- for buildings and constructions used under aggravated conditions - by the use of ratios no higher than 1.2,
- for buildings and constructions used in bad conditions by applying ratios no higher than 1.4,
- for machinery, equipment and means of transport, with the exception of the marine fleet of vessels that are used more intensively in relation to the average conditions or requiring special technical efficiency - by applying ratios no higher than 1.4,
- for machinery and equipment subject to rapid technological progress - by applying ratios no higher than 2.0.

Withdrawal from the use of an asset may be due to various factors: wear, damage, economic obsolescence, selling, free of charge transfer, exchange, etc. If the discarding asset will have still the carrying worth greater than zero, then it will affect the profit or loss (it will burden other operating costs) during the period in which the removal occurred.
In the case of a sale the difference between the sale price of the asset and its balance sheet value should be determined. The profit from this sale will be recorded in the profit and loss account under "Other operating income", while the loss as "Other operating expenses".
At the time of adoption of the asset for use the period or the rate and method of depreciation. should be determine. Correctness of the used periods and rates of depreciation of assets should be periodically reviewed by the unit, causing a corresponding depreciation adjustment in subsequent financial years.
For assets with a low initial unit value the depreciation can be determined in a simplified manner by making bulk writing-off for groups of similar assets (by nature and purpose), or one-time writing-of the value of such assets.

4.3 Leases

The rapid development of the leasing business in Poland began in the 90, after the economic changes associated with the systemic transformation. Leases previously belonged to the category so-called innominate

contracts and were not regulated in the Civil Code. From the 2000, the Civil Code mentions that leasing is an agreement under which a lessor undertakes to purchase an asset from a given seller and release it to the lessee for use. Under such agreement the lessee undertakes to pay the lessor a financial consideration in agreed instalments, at least amounting to the price or consideration borne by the lessor for the purchase of the asset. Despite the above definition, the asset as a subject to the lease agreement does not necessarily have to be purchased by the lessor specifically for the purposes of the given lease agreement. It may also be owned by the lessor. Through the duration of the contract, the lessor remains legal owner of the asset.
The nomenclature used in that legal norm regarding the parties (the lessor and the lessee) was also adopted by the Accounting Act and tax law.
The Civil Code considers only the material things as a matter of the lease. This creates a problem for the classification of the leasing contracts for the intangible, which in terms of the Civil Code are not included in the leases. Unlike the Civil Code, the tax law and the balance sheets law consider the intangible assets as a subject of the lease.
Polish legislation does not use the terms “finance leases” and “operational leases” but the acts on corporate income tax and personal income tax, as well as the VAT Act consider as financial lease such lease, in which the depreciation of leased asset carries out the lessee and as operating lease such lease, in which this depreciation carries out the lessor.
For the use of the leased thing the lessee pays the leasing payments within at specified times consisting of two parts: the equity component reflecting the value of the used thing per the lease term and interest component, which is paid as a reward to the lessor.
Financial leasing consists in putting things in use for lessee by lessor, in exchange for leasing payments from lessee to lessor, while the things are owned by the lessor. The transfer of ownership can be guaranteed in the contract, usually in the form of option to sell the leased asset at the end of the contract. The leasing installment under a finance lease is divided into the capital and interest part. The interest part presents the cost of obtaining an income at the lessee, and the capital part is treated as capital for lending operation and reduces the profit after tax of the lessee. The sum of fixed charges in the lease agreement, reduced by VAT, should be at least equal to the initial value of fixed assets or intangible assets. VAT on the lease is payable in advance for the entire duration of the lease agreement (usually within 7 days after takeover of the leased thing).
Operating leases rests in the temporary transfer of capital goods to use. This time is usually shorter than the period of normative use of the leased things. Operating lease agreement should be concluded for a fixed period that is at least 40% of the regular depreciation period, if its objects are movable things or intangible, which are liable to the depreciation, or at least a period of 10 years, if its objects are depreciated immovables. Lease payments presents the cost of obtaining an income at the lessee, and the subject of the lease is not subject to amortization for him. VAT is paid with each installment of the lease. In the operating lease contract the lessee may have a guaranteed right to purchase the leased asset at the end of the contract, for the predetermined residual value plus the VAT.

Finance leases and operating leases at the **tax law**:

	Finance leases	**Operating leases**
Contract period:	given in advance (the lack of minimum contract period)	given in advance, there is a minimum duration of the contract in an amount of 40% regular depreciation period (movables) or 10 years (immovables)
Depreciation:	makes the lessee	makes the lessor
The taxable income are:	for lessor - only the interest, which are part of the leasing installments	for lessor - the entire installment of the leasing (the capital and interest part)
Tax costs are:	for lessor - interest on the taken loan, which are part of the leasing installments, for lessee - a current depreciation writing of and interest which are the only part	for lessor - a current depreciation writing of and interest on loan taken to finance lease transactions, for lessee - the entire lease installment (the capital and

	of the lease installment	interest part)
Transfer of ownership of the lease to the lessee:	may be done at any price, considerably different from the market price	may be done at the price considerably different from the market price but not exceeding the “hypothetical net value” of a things and property rights

“Hypothetical net value” equals to the initial value of the leased asset minus the sum of depreciation, using the method of digressive depreciation with the factor equal 3 for the period of the contract.

Finance leases and operating leases at the **accounting law**:

	Finance leases	**Operating leases**
Contract period:	Given in advance (the lack of minimum contract period)	Given in advance, there is a minimum duration of the contract in an amount of 40% regular depreciation period (movables) or 10 years (immovables)
Depreciation:	makes the lessee	makes the lessee
The taxable income are:	for lessor - only the interest, which are part of the leasing fees	for lessor - only the interest, which are part of the leasing fees
Tax costs are:	for lessor - interest on the taken loan, which are part of the leasing fees, for lessee - a current depreciation writing of and interest which are the only part of the installment lease	for lessor - interest on the taken loan, which are part of the leasing fees, for lessee - a current depreciation writing of and interest which are the only part of the installment lease
Transfer of ownership of the lease to the lessee:	may be done at any price, considerably different from the market price	may be done at the price considerably different from the market price but not exceeding the “hypothetical net value” of a things and property rights
Registration of the leasing transactions in the balance sheet:	for lessor - on the assets side - at receivable, on the liabilities side - at liabilities (if the transaction was financed by external funds), for lessee - on the assets side – at fixed assets, on the liabilities side - at liabilities	for lessor - on the assets side - at fixed assets, on the liabilities side - at liabilities (if the transaction was financed by external funds), for lessee - on the assets side – at financial assets, on the liabilities side - at liabilities

4.4 Financial Assets

In accordance with the Accounting Act takes the form:

- monetary assets,
- capital instrument,
- rights to receive monetary assets,
- rights to exchange,
- rights to exchange financial instruments with another entity under favorable conditions.

Financial assets are introduced into the books at moment of concluding the contract in the acquisition price, i.e. in the fair value of the expenditure incurred or other transferred assets. In determining the acquisition price,

the incurred costs of transaction should be taken into account, such as brokerage commissions or stock exchange fees.
The fair value of financial instruments traded in an active market is the market price minus the costs associated with carrying out the transaction.
According to the Accounting Act, in the balance sheet of the entity the financial assets shall be kept, depending on maturity, in fixed assets among the long-term investment, or in current assets among the short-term investments.

Long term financial assets are financial assets acquired in order to achieve the economic benefits resulting from the increase in the value of these assets, obtaining revenue from them as interest, dividends, payable and enforceable, or intended for sale in a period exceeding one year from the balance sheet date or the date of their issue, foundation or acquisition.
Valuation of the stocks and shares - When the shares and stocks were purchased by a business entity, they are valued at the acquisition price. The acquisition price is the amount of cash, which was really issued for this purpose, increased by the possible fees associated with participation in a company such as notary, fiscal, judicial. The amount of the cash, which was used to purchase the stock and shares, can be equal, greater or less than their nominal value. If at the end of the financial year the purchase price of shares and assets are higher than the sales price possible to obtain, is the value determined according to their selling price.
The shares and assets of the listed companies denominated in foreign currencies are valued at costs, which are a product of the nominal value of these assets, the stock market rate and exchange rate, which was applicable on date of the acquisition of these assets.
The bonds are valued like stocks and shares, i.e. at the acquisition price.
Long-term loans granted are valued continuously at nominal value on the date on which they arise. At the end of the reporting period, long-term loans are valued at the amount of long-term installments that have not been repaid yet. These loans are valued and disclosed at nominal value. The basis for the correct valuation of the loan at end year, are the contractual provisions of the loan.
If the loan was granted to another entity in a foreign currency, it should be valued after its conversion in accordance with the bank selling rate, at which the entity has purchased foreign currency in order to provide a loan, and which the entity uses for the valuation of its expenses (with accordance to the method for the valuation of the currency in own foreign currency account). Long-term loans in foreign currency are valued at end of financial year at the average exchange rate of given currency, which was determined by the Polish National Bank (PNB). Resulting from this, the valuation of the foreign exchange differences, if are positive, refers to deferred revenue, and when they are negative, in the financial costs.

Own shares and stocks acquired are recorded at the acquisition date at a price no higher than their nominal price. The acquisition price of shares and stocks is the actual purchase price, which is entitled the seller plus costs directly related to the purchase, e.g. brokerage houses commissions. Shares or stocks can be acquired also by donations. In this situation, their current valuation is made at a selling price. When the stocks or shares were acquired by way of execution to satisfy the claims of the company, the acquisition price is equal to the value of the claim.
Foreign financial assets on the balance sheet date are valued at the cost or purchase (the price cannot be greater than the net selling price possible to obtain) minus the costs related to their sale.
The securities as shares and stocks of other business entities and debt securities purchased to be sold are valued continuously in their acquisition price. At the balance sheet date they are valued at acquisition cost, which, however, may not be greater than the net selling price (it can also be valued in the net purchase price, which is not greater than the net selling price, on condition that it not affect the image of the financial result) [2].

4.5 Receivables

In the accounting of economic operators the receivables are only a monetary category which represent all expected money receipts and constitute the assets of economic operator. In the balance of the receivables, they are classified as the long-and short-term.
Long-term receivables represent expected inflows of economic benefits that will occur over one year from the date of the balance sheet. To the long-term receivables are mostly included the loans to other companies, to including associated companies and to other bodies. Long-term receivables are recorded as the receivables

from related parties and from other entities. The examples of long-term receivables are deposits paid for the lease or rental premises if the relevant contracts expire later than one year after the balance sheet date.
Short-term receivables, included in current assets, represent:
- all payments for supplies and services regardless of their contractual maturity (payment),
- payments of other debts than sales.

Just as long-term, also short-term receivables should be recorded as the receivables from related parties and from other entities.
Receivables and loans provided are valued at least at the date of the balance sheet, in the amount of due payment, with prudence. The amount of receivable required to pay is determined by the nominal amount of receivable.

4.6 Inventories

In accordance with the Accounting Act, **inventories** are measured at purchase price or production cost not higher than their net selling price at the balance sheet date. The purchase price is the actual purchase price stated on the supplier's invoice, which can be increased by the cost of transport, loading and unloading. The production costs are the costs occurring in direct connection with the product, as well as part of the cost associated with the product.

Inventory valuation methods are following:
- **at average cost -** determined on the weighted average of prices (costs) of a given asset,
- according to the **FIFO** method – the issue of the assets should be valued successively at prices (costs) of these assets that the entity has purchased (produced) at the earliest,
- according to the **LIFO** method - the issue of the assets should be valued successively at prices (costs) of these assets that the entity has purchased (produced) at the latest (this method is not permitted in the case of IFRS application),
- by a detailed identification of the actual prices (costs) of those assets that relate to specific projects, irrespective of their purchase or production date.

The most commonly used method of valuation of inventories is FIFO method. Accounting is required to annually revision of inventories and in the case of inventories whose value has fallen, to make appropriate write off the lost value of inventory costs.

4.7 Cash and Equivalents

The Accounting Act defines cash as monetary assets occurring in the circulation of money or in the circulation curried out through the current bank accounts. Cash including domestic and foreign currency can be kept on hand or in bank accounts.
Cash equivalents are the monetary assets not included under money and other financial assets, which are characterized simultaneously by the following characteristics:
- high degree of liquidity, i.e. easy exchange for a specified amount of cash,
- slight risk of impairment,
- short-term maturity.

In the particular, they are monetary assets, which maturity date is no longer, than three months from the date of receipt, issue, purchase or establish deposits (checks, bills of exchange and short-term securities).
The exchange differences arising from the valuation at the date of the cash balance sheet are included in cash income or financial expenses.

4.8 Equity

Equity (equity capital, owned capital) is investors own share in the company. It is the value of economic resources, invested to the company by the owners (shareholders, partners) and the value of the funds generated by the company in the course of business. Equity comprises these main sources of financing the property:
- authorized (nominal, original, registered, share) capital,
- due but yet not paid share and payments to the share capital (negative value),
- shares in the company own (negative value),

- capital reserve, created from the sale of shares above their nominal value, from profit created by law, from optional depreciation, in accordance with the statutes of the company or by resolution of the general meeting of shareholders,
- reserve capital from revaluation of fixed assets,
- other reserve capitals, created in accordance with the statute,
- undivided net financial result from previous years,
- net financial result of the financial year.

Polish business law specifies for individual enterprises, which can be set up in Poland, the mandatory minimum amount of registered capital. The founders must put in the minimum amount of capital in the entity establishing in order that could arise. These mandatory minimum amounts for different types of enterprises are mentioned in part 2.1.

Equity with the exception of shares (stocks) in the company own, are valued at the date of the balance sheet and recorded in the balance sheet at their nominal value [5].

4.9 Provisions

Financial **provisions** are the sums that companies include in their balance sheet for prospective, future liabilities that cannot yet be fully quantified.

An enterprise should create provisions when:

- the enterprise has a present obligation (legal or customary) arising from past events,
- it is likely that the fulfill of the obligation will cause the need of outflow of resources comprising the economic benefits,
- it is possible to carry out reliable estimate of the amount of this obligation.

In accordance with the Accounting Act the provision are created for:

- certain or highly probable future liabilities that can be reliably estimated, especially for losses on business transactions, including due to given warranties, guarantees, credit operations, the effects of current legal proceedings,
- future liabilities caused by the restructuring, if the entity is obliged to carry it out under separate provisions or it is concluded a binding contract on this matter and restructuring plans allow to estimate the value of these future obligations with the reliability.

Provisions are not required to be recorded in the accounting books if they will not significantly affect the financial statements.

Provisions may be classified by different criteria. The basic division may be presented as follows:

- provision for deferred tax liabilities,
- provisions for anticipated additional costs and losses caused by the cessation or loss the ability to continue the activity,
- provisions resulting from the employee benefits regulations,
- provisions resulting from the restructuring - the condition for the creation of provisions for restructuring is formal commitment to implement the restructuring, which is stipulated by law or by concluded binding agreement and the creation of a restructuring plan that contains accurate data on which can be reliably estimate the value of those future commitments,
- other provisions and accruing.

It is important to distinguish the classical provisions from the accrued costs. These last relate to the costs falling for the current reporting period in amount of liabilities probable. They may arise in respect of services provided to the unit by the contractors, duty to execute the benefits to unknown persons, whose amount can estimate, although the time limit of liability is not known, including the benefits due the guarantee repairs and the warranty for sold products to long-term use.

According to the Accounting Act, provisions are valued at a reasonable, reliably estimated value. The Act, however, not indicate any specific method of valuation. The amount for which a provision is made should be the best estimate of the expenditure required to settle the existing obligation at balance sheet date, i.e. the amount that the entity would pay to settle the obligation at balance sheet date, or would pay to a third party in exchange for assuming the duty in this period. This standard provides that at valuation of the provision must meet these principles:

- Take into account the risks and uncertainty. The uncertainty relating to amount of the provision is taken into account by applying different statistical methods, for example, estimate the expected value or determination of the probability distribution dominant. At the same time, it is emphasized, that the existence of uncertainty may not lead to the creation of excessive provisions or a deliberate overstatement of liabilities.
- To discount the amount of the provisions if the effect of the change of money time value is substantial.
- Take into account future events, such as changes in the law and technological changes if there is sufficient evidence that such changes occur.
- To abstract from the expected revenues from the liquidation of assets, even if the expected disposal is closely linked to the event giving rise to the reserve, as well as with anticipated reimbursement by third parties.

Estimation of provisions should be made using the knowledge and previous experience of finance and accounting departments, gained in making the same or similar transactions. It is also possible to use the results of the expertise of independent experts in a particular field, but the ultimate responsibility for the amount of provisions estimates bears the management of the entity.

4.10Liabilities

A financial **liability** is an obligation resulting from past events of the entity to pass on in a future to another entity the value in the form of goods, services, money or other economic benefits. Liabilities are divided into two main groups in terms of time of their maturity:

- long-term liabilities,
- short-term liabilities.

Long-term liabilities are liabilities, that are payable after 12 months from the balance sheet date. These include:

- loans,
- liabilities arising from emission of debt securities,
- liabilities relating to the finance leases and to the fixed assets in which occurred the change of ownership, but which are still used by the body,
- other long-term liabilities.

Short-term liabilities are liabilities, that are payable within 12 month from balance sheet date. These include:

- liabilities for reason of supplies and services,
- liabilities arising from taxes, customs duties, insurance and other obligations (towards the budgets, the customs office, the social insurance institution and other public institutions),
- liabilities for reason of wages (liabilities to employees arising from the work done for the unit),
- other short-term liabilities arising from insurance schemes for such property, for costs relating to the official journeys, to the employees for their legitimate equivalents,
- special funds.

The obligation to the implementation of the benefits, which arise, is dependent on certain events, which the Accounting Act calls as contingent liability. Contingent liabilities are not recognized in the balance sheet but must be disclosed in the notes.

Liabilities are valued in nominal amount of due payment or in fair value (at liabilities, which refund, in accordance with the contract, follows by release of financial assets other than cash or by exchange for financial instruments).

5 Official Forms of Financial Statements

Within this chapter will be provided official forms of financial statements, which are currently used in common practice.

5.1 Balance Sheet

The official structure of Balance Sheet is following:

ASSETS
A. Fixed assets
I. Intangible fixed assets
1. Research and development expenditure
2. Goodwill
3. Other intangibles
4. Prepayments for intangible fixed assets
II. Tangible fixed assets
1. Fixed assets
a) freehold land (including right of perpetual use)
b) buildings and constructions
c) plant and machinery
d) vehicles
e) other tangible fixed assets
2. Assets under construction
3. Prepayment for tangible fixed assets
III. Long-term debtors
IV. Long term investments
1. Real estate
2. Intangible fixed assets
3. Long-term financial assets
a) interbranch and group investments
- stocks or shares
- other securities
- loans granted
- other long-term financial assets
b) other investments
4. Other long-term investments
V. Long-term prepayments and accrued income
1. Deferred income tax
2. Other
B. Current assets
I. Stock
1. Raw materials
2. Semi-finished goods and work in progress
3. Finished products
4. Merchandise
5. Prepayments for stock
II. Short-term debtors

1. Interbranch and group debtors
a) trade debtors with maturity date:
- up to 12 months
- over 12 months
b) other
2. Other short-term debtors
a) trade debtors
b) taxation, subsidy and social security debtors
c) other debtors
d) debtors subject to court proceedings
III. Short-term investments
1. Short-term financial assets
a) in interbranch and group entities
b) other investments
c) cash and cash equivalents
- cash at hand and at bank
- other cash and cash equivalents
- other financial assets
2. Other short-term investments
IV. Short-term prepayments and accrued income
Total

LIABILITIES
a. Equity
I. Share capital
II. Outstanding share capital contributions
III. Own shares (stocks)
IV. Capital reserves
V. Revaluation reserve
VI. Other reserve capital
VII. Accumulated profit (loss) from previous years
VIII. Profit (loss) after taxation
IX. Appropriation of the current financial year result
B. Creditors and provisions for creditors
I. Provisions for creditors
1. Deferred income tax provision
2. Retirement benefit and similar provision
- long-term
- short-term
3. Other provisions
II. Long-term creditors
III. Short term creditors
1. Interbranch and group creditors
a) trade creditors with maturity date:

- up to 12 months
- over 12 months
b) other
2. Other creditors
a) credits and loan
b) bonds
c) other financial creditors
d) trade creditors
e) advance payments received
f) bills of exchange payable
g) taxation, customs duty, social security creditors
h) payroll creditors
i) other
3. Special funds
IV. Accruals and deferred income
1. Negative goodwill
2. Other
- long-term
- short-term
Total

5.2 Profit/Loss Statement

Within this subchapter we will provide the structure of P/L Statement which is used in Poland.

Profit/Loss Statement – division by nature

A. Net revenue on sales and sales equivalents
- including that from subsidiaries and associates
I. Net revenue on sales of finished products
II. Change in stock position
III. Cost of manufacturing products for the entity's own requirements
IV. Net revenue on sales of merchandise and raw materials
B. Operating expenses
I. Depreciation
II. Materials and energy
III. External services
IV. Taxes and charges
V. Payroll
VI. Employee benefits
VII. Other cost by category
VIII. Cost of merchandise and raw materials
C. Gross profit (loss) on sales
D. Other operating revenue
I. Revenue on sale of fixed assets
II. Subsidies
III. Other

E. Other operating expenses
I. Cost of fixed assets
II. Revaluation of fixed assets
III. Other operating expenses
F. Operating profit (loss)
G. Financial revenue
I. Dividends and share in profit received
- including that from subsidiaries and associates
II. Interest received
III. Revenue on sale of investments
IV. Investment revaluation
V. Other
H. Financial expenses
I. Interest payable
- including interest payable to subsidiaries and associates
II. Loss on sale of investments
III. Investments revaluation
IV. Other
I. Profit (loss) on ordinary activities
J. Extraordinary profits (losses)
I. Extraordinary profits
II. Extraordinary losses
K. Profit before taxation
L. Income tax
M. Other obligatory charges
N. Profit (loss) after taxation

Profit/Loss Statement – division by function

No.	Item
A	Net revenues from sales of products, goods and materials, including:
-	- from related parties
I	net revenues from sales of products
II	net revenues from sales of goods and materials
B	Cost of products, goods and materials sold, including:
-	to related parties
I	Manufacturing cost of products sold
II	Value of goods and materials sold
C	Gross profit (loss) on sales (A-B)
D	Selling costs
E	General and administrative costs
F	Profit (loss) on sales (C-D-E)
G	Other operating revenues
I	Gain on disposal of non-financial fixed assets
II	Subsidies

III	Other operating revenues
H	Other operating expenses
I	Loss on disposal of non-financial assets
II	Revaluation of non-financial fixed assets
III	Other operating expenses
I	Profit (loss) on operating activities (F+G-H)
J	Financial revenues
I	Dividend and profit sharing, including:
-	from related parties
II	Interest, including:
-	- from related parties
III	Gain on disposal of investments
IV	Revaluation of investments
V	Other
K	Financial expenses
I	Interest, including:
-	for related parties
II	Loss on disposal of investments
III	Revaluation of investments
IV	Other
L	Profit (loss) on business activities (I+J-K)
M	Result on extraordinary events (M.I.-M.II.)
I	Extraordinary gains
II	Extraordinary losses
N	Gross profit (loss) (L+/-M)
O	Income tax
P	Other statutory reductions in profit (increases in loss)
R	Net profit (loss) (N-O-P)

5.3 Cash Flow Statement

In the following text we will provide the forms for the preparation of cash flow statement when using (i) indirect, and (ii) direct method.

Cash Flow - indirect method

No.	Item
A	Cash flows from operating activities
I	Net profit (loss)
II	Total adjustments
1	Amortisation and depreciation
2	Exchange gains (losses)
3	Interest and profit sharing (dividend)
4	Profit (loss) on investment activities
5	Change in provisions
6	Change in inventory
7	Change in receivables

8	Change in short-term liabilities excluding credits and loans
9	Change in prepayments and accruals
10	Other adjustments
III	Net cash flows from operating activities (I +/- II)
B	Cash flows from investment activities
I	Inflows
1	Disposal of intangible and tangible fixed assets
2	Disposal of investments in real property and in intangible assets
3	From financial assets, including:
a)	in related parties
b)	in other entities
-	sales of financial assets
-	dividend and profit sharing
-	repayment of granted long-term loans
-	interest
-	other inflows from financial assets
4	Other inflows from investment activities
II	Outflows
1	Purchase of intangible assets and tangible fixed assets
2	Investments in real property and intangible assets
3	For financial assets, including:
a)	in related parties
b)	in other entities
-	purchase of financial assets
-	long-term loans granted
4	Other outflows from investment activities
III	Net cash flows from investment activities (I-II)
C	Cash flows from financial activities
I	Inflows
1	Net inflows from issuance of shares and other capital instruments and from capital contributions
2	Credits and loans
3	Issuance of debt securities
4	Other inflows from financial activities
II	Outflows
1	Purchase of own shares
2	Dividend and other payments to shareholders
3	Profit distribution liabilities other than profit distribution payments to shareholders
4	Repayment of credits and loans
5	Redemption of debt securities
6	Payment of other financial liabilities
7	Payment of liabilities arising from financial leases
8	Interest
9	Other outflows from financial activities
III	Net cash flows from financial activities (I-II)

D	Total net cash flows (A.III. +/- B.III +/- C.III)
E	Balance sheet change in cash, including:
-	change in cash due to exchange differences
F	Cash opening balance
G	Closing balance of cash (F+/-D), including:
-	of limited disposability

Direct Method

No.	Item
A	Cash flows from operating activities
I	Inflows
1	Sales
2	Other inflows from operating activities
II	Outflows
1	Deliveries and services
2	Net payroll
3	Social security, medical insurance and other benefits
4	Taxes and charges due to the State Treasury
5	Other operating expenses
III	Net cash flows from operating activities (I-II)
B	Cash flows from investment activities
I	Inflows
1	Disposal of intangible and tangible fixed assets
2	Disposal of investments in real property and intangible assets
3	From financial assets, including:
a)	in related parties
b)	in other entities
-	sales of financial assets
-	dividends and profit sharing
-	repayment of granted long-term loans
-	interest
-	other inflows from financial assets
4	Other inflows from investment activities
II	Outflows
1	Purchase of intangible assets and tangible fixed assets
2	Investments in real property and intangible assets
3	To financial assets, including:
a)	in related parties
b)	in other entities
-	purchase of financial assets
-	long-term loans granted
4	Other outflows from investment activities
III	Net cash flows from investment activities (I-II)
C	Cash flows from financial activities

I	Inflows
1	Net inflows from issuance of shares and other capital instruments and from capital contributions
2	Credits and loans
3	Issuance of debt securities
4	Other inflows from financial activities
II	Outflows
1	Purchase of own shares
2	Dividend and other payments to shareholders
3	Profit distribution liabilities other than profit distribution payments to shareholders
4	Repayment of credits and loans
5	Redemption of debt securities
6	Payment of other financial liabilities
7	Payment of liabilities arising from financial leases
8	Interest
9	Other outflows from financial activities
III	Net cash flows from financial activities (I-II)
D	Total net cash flows (A.III. +/- B.III +/- C.III)
E	Balance sheet change in cash, including:
-	Change in cash due to exchange differences
F	Cash opening balance
G	Closing balance of cash (F+/-D), including:
-	of limited disposability

6 Major Differences from IFRS and IFRS for SMEs

Listed companies in Poland follow IFRSs in preparation of their consolidated financial statements. From 2008, IFRSs are permitted in the annual reports of listed companies and in the consolidated and annual reports of all other companies under the following circumstances - if it has applied for admission to public trading, or it is a subsidiary of a parent which prepares its consolidated accounts in accordance with IFRSs. All banks, listed or non-listed, are also required to use IFRSs in their consolidated financial statements. Companies that are not required or that choose not to apply international standards prepare financial statements in accordance with the Polish Accounting Requirements (PARs). In the absence of relevant national regulations, companies may apply IFRSs.

The UN Conference on Trade and Development (UNCTAD) report from 2008 states that “the accounting and reporting regulations are mainly covered by the accounting law of 1994 as amended in 2002, and since 2005 by IFRS”. As mentioned above, the Accounting Act incorporates provisions laid out in the Fourth and Seventh EU Company Law Directives and is supplemented by Decrees from the Ministry of Finance. The Accounting Act applies to all joint stock and limited liability companies including listed companies, banks, insurance companies, and pension and investment funds.

In its 2002 and 2005 Reports on the Observance of Standards and Codes (ROSC), which benchmarked Polish accounting and auditing practices against International Financial Reporting Standards and International Standards on Auditing, the World Bank commended Polish authorities for the progress achieved in reforming financial reporting requirements and closing the gap between Polish accounting regulations and international accounting standards. However, weaknesses persisted, and differences between Polish Accounting Requirements (PAR) issued by the Accounting Standards Committee (ASC) and IFRSs were observed.

Although PARs were found to be in line with the EU 4th and 7th Company Law Directives, the World Bank noted that "certain differences with IFRS may impede the reliability of financial statements in public interest entities". The World Bank, therefore, recommended that Polish authorities ensure the application of IFRSs in consolidated financial statements by all public-interest entities. Public-interest entities as defined by the World

Bank include listed companies, banks, insurance companies, investment funds, pension funds and large enterprises. The World Bank noted that "although the Regulations issued by the Minister of Finance have been updated based on the most recent changes to the EU Banking Accounts Directive, the ROSC team contemplates potential conflicting financial reporting requirements for some banks".
Further, with respect to insurance companies, the assessment pointed out that despite the Ministry of Finance regulations being updated in line with the changes in EU Insurance Accounts Directive, the likelihood of conflicting requirements for listed insurance companies could not be ruled out. The World Bank, therefore, recommended reviewing Polish legislation to eliminate conflicts with IFRSs. With regard to small and medium size-enterprises (SMEs), the World Bank observed in its 2005 report that PARs are adequate. However, Polish authorities must take greater advantage of the simplified reporting framework under the EU directives for SMEs.
The UNCTAD states in its 2008 report that “there are significant differences between what would have been reported under Polish GAAP (polish generally accepted accounting standards) and under IAS/IFRS”. According to the report, the differences between financial statements prepared under the two systems mainly pertain to:

- pension funds,
- share-based payments,
- financial instruments and hedging,
- impairment of goodwill,
- intangible assets,
- business combinations,
- valuation of receivables,
- valuation of revenues and liabilities,
- leasing, and
- property, plant and equipment.

Further, the UNCTAD suggests that investors, analysts and other users of the financial statements be effectively informed of the anticipated changes under the IFRSs. As per a 2009 PricewaterhouseCoopers report on IFRS adoption by country, the Polish standard setting body has not yet announced any convergence plans.
Regarding the application of IFRS for SMEs in Poland, the mandatory regulation of their use by Polish firms has not yet been implemented in the Polish accounting law. In professional community and among their potential users yet prevails an opinion, that the standards did not bring a substantial simplification of financial reporting by SMEs, they are linked too much with the IFRS for large firms and does not solve the problem of different requirements for financial reporting from the perspective of tax law.

Following table summarizes the differences between IFRS for SMEs and Polish Accounting Regulation

IFRS For SMEs	**Polish Accounting Regulation**
INTANGIBLE ASSETS	
All research and development expenses according to the IFRS for SME are filled into costs category. Intangible assets are entered as of their acquisition value, reduced of their depreciation value and/or adjusting entry, (loss from value reduction) It is not permitted to revaluate them. On the contrary, according to IFRS acquisition value of intangible assets from own activity, which are in research phase, are always recognized as costs. Acquisition value of such assets in research phase can be used as an assets value under certain conditions.	In the meaning of the Accounting Act, to the intangible assets should be included acquired property rights, goodwill and the costs of finished research and development. The definition in the Accounting Act stipulates that such assets must be acquired. This means that in this category can be classified only those property rights, which have been bought, brought as a contribution or donation, but not the ones that the entity created themselves. Exceptions are only the costs of finished research and development. The intangible assets enter in the accounts at their acquisition cost (creating costs for development). Where they have been acquired for valuable consideration, the initial value includes the purchase price and other costs, which e.g. consist of taxes and

	fees, like a tax on civil law transactions, the costs associated with adapting to use.
DEPRECIATION AND AMORTIZATION	
IFRS for SME requires that business shall test Intangible and tangible assets depreciation whenever there is a possible sign of assets value decrease. Goodwill is tested for depreciation only when there are signs of such situation. Residual value, lifespan and depreciation methods are revised only where there are signs of their changes compared with last financial statement. (full IFRS is required only after yearly revision)	National Accounting Standard No. 4 (KSR 4) in connection with the Accounting Act defines impairment of tangible and intangible assets similarly as the IFRS for SMEs.
PROPERTY, PLANT AND EQUIPMENT	
According to IFRS for SME land, buildings and equipment are appraised by their purchase cost, reduced by depreciation reserves and discretionary reserves (losses from value). IFRS for SME are giving a special attention to the matter of spare parts. Most of the assets serving for buildings repair are accounted for as inventories. Their use is entered as consumption of material that means as a cost influencing a normal financial period. But there are spare parts where business is expecting their use in more than one period. Such entry is according to IFRS for SME specified as land, buildings and equipment. If the different part of assets exists with different lifespan, it is better to account for them separately. In reality a building can be divided into more parts, such as windows, heating, roof, according to their usable life. To asses depreciation, component approach is used, each position of long-term asset is depreciated during its life (standards are not using a reason for reserve forming for long-term assets repairs.) Other assets are depreciated during their life-span as whole. Land properties are not depreciated, since they have unlimited life.	According to the Accounting Act the tangible fixed assets comprise realty, machinery, equipment, means of transport, improvements in other fixed assets, fixed assets under construction and livestock, which have expected period of economic usefulness longer than one year, are complete and are intended for the purpose of the entity. Investments are the assets held by the entity in order to achieve the economic benefits resulting from the increase in the value of these assets, obtaining revenues in the form of interest, dividends (share in profits), or other benefits, including the commercial transaction, and in particular, financial assets and those of real estate and intangible assets that are not used by the unit, but are held by it in order to achieve these benefits. Under Polish law specific spare parts are accounted as inventory, is also a lack of regulation of the purchase with deferred payment. Depending on the particular circumstances the basis for the first valuation of the fixed asset may be: • acquisition price • the cost of manufacture, • differently determined fair value is. The initial value of the fixed asset may not reflect its fair value over time because: • the object will be improved, • the object wear out (depreciation), • will be made the revaluation of its value, • occurs permanent loss of its value. Improvement of fixed assets is based on their rebuilding, expansion, modernization or reconstruction. Depreciation is a factor reducing the value of fixed assets. Fixed assets are subject to depreciation, except: • lands (except lands exploited open-pit), which have an unlimited useful life, • works of art, museum objects etc., which sometimes increase in value. The balance sheet law does not determine a particular method of depreciation, only obliges to the systematic and planned distribution of the initial value for a set

	period of depreciation. Fixed assets and intangible assets are valued at acquisition or production costs or at revalued amount (after the revaluation of fixed assets), reduced by depreciation or amortization and write-offs due to impairment Real property and intangible assets classified as investments are evaluated according to the rules applied to fixed assets and intangible assets, or at market price or at otherwise specified fair value. Assets under construction are valued at the amount of aggregate costs directly related with the acquisition or construction, reduced by impairment. Accounting Act does not contain detailed solutions for fixed assets held for sale and to discontinue an operation and does not allow reclassification of fixed assets for investment real properties.
INVESTMENT PROPERTIES	
According to the IFRS for SMEs, an entity valued at initial recognition investment property is carried at cost. Investments in property, whose fair value is reliably determinable without disproportionate cost and effort must be valued at fair value reporting at each balance sheet date. If fair value cannot be reliably and without undue cost and effort to provide these investments are accounted for as fixed assets. Cost model cannot be used.	Polish accounting rules do not regulate the investment in real estate as a separate balance sheet item. They are included in fixed assets.
FINANCIAL LEASES	
Financial lease exists when all risks and advantages of ownership are transferred to leaseholder and ownership itself can (or not) be transferred. Leaseholder must show such leasing in its balance sheet as an asset and liability. Lease is entered in real value of leased asset at the beginning of leasing. If the amount of the actual minimal lease payments is lower, this value is used. To calculate actual value of minimal lease payments as a discount factor there is used the implicit leasing interest rate, if it is available or incremental leasing rate from leaseholder. Asset value is advanced by the original direct costs spend by leaseholder. Leaseholder will divide minimal lease payments among financial costs and depreciated unpaid liabilities using effective interest rate method. Leaseholder will assign financial costs to each period during the leasing term the way that for remaining liabilities a constant interest rate is guaranteed. Leaseholder with financial leasing will recognize an asset as a claim with value of leasing net investment. Leasing payments are than lowering the claim value and are recognized as financial gain.	In accordance with National Accounting Standard No 5 for the financial lease accounting purposes under the term “lease” is meant the type of lease in which the lease period lasts a minimum of 12 months and max. 60 months. The subject of financial leasing becomes the property of the lessee. In a finance lease there is no purchase. Customer becomes the owner of the item simultaneously with the payment of the last lease installment. Subject of the finance lease is recognized in the accounts of the lessee as the depreciable assets, and as overleaf as financial liability. Depreciation deduction on the leased asset is made by the lessee. The fees set out in the lease agreement, defrayable by the lessee in the basic contract period for use of fixed assets and intangible assets, constitute the revenue of the lessor and respectively the tax deductible costs of the lessee, if that agreement meets the following conditions: • was concluded for a definite period of time that is at least 40% of the regular depreciation period, if its object is movable property or intangible, which is the subject to the depreciation or has been concluded for a period of at least 10 years if its object is real property as a subject to depreciation,

	• the sum of payment fixed in this agreement, reduced by VAT corresponds at least to the initial value of fixed assets or intangible assets.
INVENTORIES	
Accounting unit is assessing inventory acquisition value using arithmetic mean average calculation or FIFO. LIFO is not permitted. Any borrowing costs connected with inventory are entered directly as costs and it is not possible to activate them.	According to the Polish Accounting law there are basic methods of stock records: a method of specific identification, FIFO (first in - first out), LIFO (last in - first out), AVG (method of weighted average price).
FINANCIAL INSTRUMENTS	
SME can choose their financial and accounting tools according to SME Standard or Regulation IAS39, Financial Tools, Accounting and Appraisal. SME standard is distinguishing only two groups of financial tools: basic financial tools (debt tools, non-derivative character) are appraised with their residual value others (derivatives, capital tools) are appraised with their real value. It is possible to show changes in income and loss statement. Not entering financial assets is possible when accounting entity transmitted all assets related risks and benefits to another subject and control over it as well. Regulations were simplified for hedge accounting. Thanks to this SME does not need to fulfill many criteria to be able to use hedge accounting.	Financial instruments are classified at the date of their acquisition or creation of one of four categories, according to the criterion of their destination: • financial assets and financial liabilities held for trading, • loans and receivables, • financial assets held to maturity, • financial assets available for sale. Financial instruments are introduced to the accounts at the conclusion of contract. According to RMF at the conclusion of the contract: • financial assets are valued at acquisition cost, i.e. fair value expenses incurred or transferred in exchange of other property components, • financial liabilities are valued at fair value of the received amount or of the values of other obtained assets. If the date of the transaction (in the case of financial assets for trading and financial assets available for sale) is different from the settlement date of transaction, the valuation is made to the two moments and the effects of the revaluation of assets is appropriately classified as financial income or financial costs, or refers to revaluation capital (with the impact of rules on records the revaluation of short and long term investment). Financial instruments are valued at the balance sheet date. Depending on category of financial instrument this valuation is done at fair value or at adjusted acquisition price (amortized cost). Financial assets: - held for trading – at fair value, - loans and receivables – at amortized cost, - held to the maturity – at amortized cost, - available for sale – at fair value. Financial liabilities: • held for trading – at fair value, • other – at amortized cost. Adjusted acquisition price (amortized cost) is the acquisition price, at which financial asset or financial liability was first entered in the accounts (initial value), reduced by repayment of nominal value

	(registered capital), adjusted by the cumulative amount of the discounted difference between the initial value of the component and its value within maturity, calculated using the effective interest rate, and also reduced by write-downs. The effective interest rate is the rate at which follows discounting to the present value of expected future cash flows for the period to maturity associated with a financial instrument and in case of the instruments with variable interest rates - to the date of the next estimate the reference level by the market. The effective interest rate is the internal rate of return (IRR) of an asset or financial liability for a given period. During the calculation of the cumulative amount of discount on assets and financial liabilities using the effective interest rate are taken into account all fees paid or received by parties to the contract. At amortized cost are valued financial liabilities, loans and receivables and financial assets held to the maturity. Financial instruments are recorded on both the balance sheet accounts and on the off-balance sheet accounts. The balance sheet record of financial instruments in the purchaser accounting books covers the following account (divided into a short-and long-term): stocks and shares, other securities, loans, other financial assets, depreciation write-off financial assets. Exhibitor or the issuer of a financial instrument records these instruments in the accounting books in the accounts payable (short or long term) or equity as: registered capital (fund), credits and loans, liabilities arising from debt securities, other financial commitments. Off-balance sheet accounting is based on the division of the instruments to the four category specified in RMF.
PROVISIONS	
Provision shall be entered when: • all business liabilities are the results of past events • It is probable that to fulfill an obligation a decrease of resources is needed A reliable appraisal of liabilities can be made. If such conditions are not met, any provision can be stated. According to IFRS for SME businesses can state the provisions if they can withstand the test. Fiscal entity must show a reserve as a liability and simultaneously as a cost. But if another part of IFRS for SME is treating the provision as a part of assets pricing, it is included in their value. To form provisions for restructuring is allowed when detailed formalized restructuring plan is available and it was published or initiated.	The Accounting Act requires an entity to create a provision for certain or highly probable future liabilities that can be reliably estimated, especially for losses on business transactions, including due to given warranties, guarantees, credit operations and the effects of ongoing legal proceedings. Next, on the future liabilities due to restructuring, if under separate provisions the entity is required to carry it out or has concluded binding contract on this and restructuring plans allow a credible estimate the value of these future obligations.; Provisions, of which tells the Accounting Act, are respectively included in other operating costs, financial costs or extraordinary losses, depending on the circumstances with which the future liabilities are related. The provisions unused due to a reduction or

	termination of risk justifying their creation increase correspondingly other operating incomes, financial incomes and extraordinary profits per day, on which they proved to be unnecessary. The question of provisions in the accounting law and the tax law is dealt different. In accordance with the Act on Corporate Income Tax, as the costs of achieving the income are considered solely the provision created to cover the debts, which proved to be bad. General conditions for the provision' creation presented in the Polish accounting rules and IFRS for SMEs are consistent.
DEFERRED TAX	
All accounting entities must keep accounts with a deferred tax system. Deferred tax is entered for transient difference with the exception of deferred tax liability from primary statement of goodwill or primary assets or liabilities statement in transactions not of business combination or during the transaction is not influencing accounting earnings, taxable earnings or losses.	Deferred tax in accordance with the National Accounting Standard No. 2, which is consistent with IFRS, is generated owing to the appearance of temporary differences between the balance sheet value of an asset or liability and its tax base. Temporary differences may cause: the rise of amounts increasing (positive temporary differences) or decreasing (negative temporary differences) the taxable amount in future periods when balance sheet value of the asset is realized or of the liability component is accounted. The amount of provisions and assets for deferred income tax shall be determined taking into account the income tax rates applicable in the year of the rise of tax obligation. Provisions and assets due to deferred tax liabilities are reported in the balance sheet separately.
BORROWING COSTS	
According to IFRS for SME businesses must all borrowing cost enter directly into cost in period of their origination and it is not possible to activate them.	Polish legislation does not address this area. Firms act in accordance with IFRS.

7 Sample Case

ACCOUNTANT Ltd started its business in Poland in November 2010. The core business of the company is sale of goods as well as professional consulting.
The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 22 %).
For the simplicity of postings there will be used "MU" (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

Initial Balance Sheet

Balance Sheet as at 1st November 2010			
Bank account	145,000	Registered capital	145,000
Incorporation expenses	5,000	Short-term loans	5,000
ASSETS	**150,000**	**EQUITY+LIABILITIES**	**150,000**

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses
- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study

Fixed Assets and Financial Leases

Accounting depreciation of computer:

$$monthly\ depreciation = \frac{2{,}000}{36} = 55.56 \equiv 56$$

Tax depreciation of computer:

$$depreciation\ 2010 = \frac{2{,}000 \times 30}{12} = 50$$

Accounting depreciation of financial lease:

$$monthly\ depreciation = \frac{18{,}900}{60} = 315$$

Tax depreciation of financial lease:

$$Depreciation\ 2010 = \frac{18{,}900}{60} = 315$$

Calculation of deferred tax

Year	Net value (accounting)	Net value (taxes)	Difference	Tax rate	Deferred tax liability
2010	112	50	62	0.19	12

Op.	Text	Amount			Account
1	Purchase of computer	2,000 440 2,440	Dr Dr	 Cr	Movables VAT Trade payables
2	Depreciation of computer (2 months)	112 112	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)
3	Calculation of deferred tax	12 12	Dr	 Cr	E – Income Tax (deferred) Deferred Tax Liability
5	1st installment of financial lease	350 350	Dr	 Cr Cr	Trade payables Bank account
6	Financial lease	18,900 3,780 22,680	Dr Dr	 Cr	Movables VAT Trade payables
7	Financial costs	420 420	Dr	 Cr	short-term accrued costs Trade payables
8	Financial costs	1,645 1,645	Dr	 Cr	Long-term accrued costs Trade payables
9	Depreciation of financial lease	315	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)

Inventories

Op.	pieces			Cost	MU		
	+	-	Δ		+	-	Δ
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5,700			37,500	44,850
4	3,300		9,000	9.00	29,700		74,550
5		3,600	5,400			28,050	46,500
6		2,400	3,000			19,500	27,000

Op.	Text	Amount			Account
1	Purchase of goods (6,500 @ 7.50 MU)	48,750 9,750 58,500	Dr Dr	 Cr	Goods VAT Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600 6,720 40,320	Dr Dr	 Cr	Goods VAT Bank account

3a	Sale of goods (5,000 @ 12.00 MU)	60,000		Cr	R – Sold goods
		12,000		Cr	VAT
		72,000	Dr		Trade receivables
3b	Goods issue	37,500	Dr		E – Sold goods
		37,500		Cr	Goods
4	Purchase of goods (3,300 @ 9.00 MU)	29,700	Dr		Goods
		5,940	Dr		VAT
		35,640		Cr	Bank account
5a	Sale of goods (3,600 @ 12.00 MU)	43,200		Cr	R – Sold goods
		8,640		Cr	VAT
		51,840	Dr		Trade receivables
5b	Goods issue	28,050	Dr		E – Sold goods
		28,050		Cr	Goods
6a	Sale of goods (2,400 @ 12.00 MU)	28,800		Cr	R – Sold goods
		5,760		Cr	VAT
		34,560	Dr		Trade receivables
6b	Goods issue	19,500	Dr		E – Sold goods
		19,500		Cr	Goods
7	Calculation of impairment	4,500	Dr		E – Impairment
		4,500		Cr	Goods (impairment)

Receivables and payables

Op.	Text	Amount			Account
1	Long-term contract (12/2010)	5,000	Dr		Deferred income
		5,000		Cr	R – Sold services

Salaries

Calculation of salary

Gross salary	800
Social insurance (13.71%)	110
Health insurance (7,75 %)	70
Income tax	87
Net salary	**597**

Social insurance (18,71 %)	150
Health insurance (8,75%)	70

Op.	Text	Amount			Account
Nov1	Gross salary	800	Dr		E – Salaries
		800		Cr	Payroll
Nov2	Social and health insurance (employee)	180	Dr		Payroll
		180		Cr	SHI payables
Nov3	Income tax	87	Dr		Payroll
		87		Cr	Income tax payables
Nov4	Social and health insurance (company)	220	Dr		E – Social insurance
		220		Cr	SHI payables
Nov5	Pay-off	597	Dr		Payroll
		597		Cr	Bank account
Nov6	Payment of insurance	400	Dr		SHI payables
		400		Cr	Bank account
Nov7	Payment of income tax	87	Dr		Income tax payables
		87		Cr	Bank account

Dec1	Gross salary	800 800	Dr	 Cr	E – Salaries Payroll
Dec2	Social and health insurance (employee)	180 180	Dr	 Cr	Payroll SHI payables
Dec3	Income tax	87 87	Dr	 Cr	Payroll Income tax payables
Dec4	Social and health insurance (company)	220 220	Dr	 Cr	E – Social insurance SHI payables

Other costs and expenses

Op.	**Text**	**Amount**			**Account**
1a	Rental payment (for November 2010)	1,200 264 1,464	Dr Dr	 Cr	E – Services VAT Bank account
1b	Rental payment (for December 2010)	1,200 264 1,464	Dr Dr	 Cr	E – Services VAT Bank account
1c	Rental payment (for January 2011)	1,200 264 1,464	Dr Dr	 Cr	Deferred expenses VAT Bank account
2a	Tax advisory (November 2010)	200 44 244	Dr Dr	 Cr	E – Services VAT Bank account
2b	Tax advisory (December 2010)	200 44 244	Dr Dr	 Cr	E – Services VAT Trade payables
3a	Telecommunication services (November 2010)	1,000 220 1,220	Dr Dr	 Cr	E – Services VAT Bank account
3b	Telecommunication services (December 2010)	1,000 220 1,220	Dr Dr	 Cr	E – Services VAT Trade payables
4	Road tax	100 100	Dr	 Cr	E – Road tax Bank account
5	Interests received	920 920	Dr	 Cr	Bank account R – Interests received
6	Bank charges	5,300 5,300	Dr	 Cr	E – Financial expenses Bank account

Calculation of corporate income tax

Revenues	137,920
Expenses	102,423
Accounting profit	***35,497***
Tax inefficient expenses: • impairment	 4,500
Tax base	39,997
Corporate income tax (19 %)	**7,599**

Op.	**Text**	**Amount**			**Account**
1	Income tax (due)	7,599 7,599	Dr	 Cr	E – Income tax (due) Income tax payables

Closing of accounts:

Profit / Loss Account as at 31st December 2010			
Sold goods	85,050	Revenues from sold services	5,000
Services	4 800	Revenues from sold goods	132,000
Salaries	1,600	Interests received	920
Social insurance	440		
Road tax	100		
Depreciation, amortization	427		
Impairment	4,500		
Financial expenses	5,325		
Income tax (due)	7,599		
Income tax (deferred)	12		
EXPENSES	***109,853***	***REVENUES***	***137,920***
Profit	**28,067**		

Balance Sheet as at 31st December 2010					
Assets	*Gross*	*Corr*	*Net*	***E+L***	*Net*
Movables	2,000	112	1,888	Registered capital	145,000
Goods	27,000	4,500	22,500	Profit	28,067
Trade receivables	158,400	0	158,400	Deferred tax liability	12
Deferred expenses	1,200	0	1,200	Trade payables	8,058
Deferred income	5,000	0	5,000	Payroll	597
Bank account	1,509		1,509	Soc. and health insurance payable	400
Short-term deferred	420		420	Corporate income tax payable	7,599
Long- term deferred expenses	1,645		1,645	Income tax payable	87
				VAT	1,550
				Bank overdraft	1,192
TOTAL	**197,174**	**4,612**	**192,562**	**TOTAL**	**192,562**

Ratio analysis

Assets (total)	192,562
EBIT	35,666
EAT	28,067
Equity	173,067
Current assets	184,054
Current liabilities	19,483
Inventories	22,500

Profitability ratios:

$$ROA = \frac{EBIT}{\sum Assets} = \frac{35{,}666}{192{,}562} = \mathbf{18.52}\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{28{,}067}{173{,}067} = \mathbf{16.22}\ \%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{184{,}054}{19{,}483} = \mathbf{9.45}$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{184{,}054 - 22{,}500}{19{,}483} = \mathbf{8{,}29}$$

8 Dictionary

English	Polish
Accelerated Depreciation	przyśpieszona amortyzacja
Account	konto
Account Payable	płatne konta
Account Receivable	konto należności
Accountant	księgowy
Accounting	księgowość
Accounting Change	zmiana rachunkowości
Accounting Policies	zasady rachunkowości
Accounting Profit	zysk księgowy
Accrual Basis	rachunkowość memoriałowa
Accumulated Depreciation	amortyzacja skumulowana
Additional Paid in Capital	doplaty do kapitalu
Amortization	amortyzacja
Annual Report	raport roczny
Annuity	renta
Asset	aktywa
Auditor	audytor
Auditors' Report	sprawozdanie audytora
Available-For-Sale Financial Assets	aktywa finansowe dostępne do sprzedaży
Balance Sheet	bilans
Bond	dłużne papiery wartościowe
Book Value, Carrying Amount	wartość księgowa
Borrowing Costs	koszty finansowania zewnętrznego
Budget	budżet
Business	firma,przedsiębiorstwo
Business Combinations	połączenie (przejęcie) jednostek gospodarczych
Business Segment	segment firmy
Capitalized Cost	skapitalizowane koszty
Capitalized Interest	skapitalizowane odsetki
Cash	gotówka
Cash Basis	metoda kasowa
Cash Equivalents	środki pieniężne
Cash Flows	przepływy pieniężne
Cash-generating Unit	ośrodek wypracowujący środki pieniężne
Closing Rate	kurs zamknięcia
Consistency	konsystencja
Consolidated Financial Statements	skonsolidowane sprawozdanie finansowe
Consolidation	konsolidacja
Contingent Asset	aktywa warunkowe
Contingent Liability	zobowiązanie warunkowe
Contingent Rent	czynsz
Continuing Operations	działalność kontynuowana
Control	kontrola
Convertible Share	akcja zamienna
Cost	koszt
Cost Accounting	rachunek kosztów
Cost Method	metoda kosztów
Costing	kalkulacja kosztów
Costs of Disposal	koszty zbycia

Credit Risk	ryzyko kredytowe
Creditor	wierzyciel
Currency Risk	ryzyko kursowe
Current Asset	aktywa bieżące, obrotowe
Current Liability	zobowiązania bieżące
Current Tax	podatek
Debit	debet
Debt	dług
Debt Security	dłużne papiery wartościowe
Debtor	dłużnik
Deferred Income	przychody przyszłych okresów
Deferred Income Taxes	odroczony podatek dochodowy
Deferred Tax Assets	aktywa z tytułu odroczonego podatku dochodowego
Deferred Tax Liabilities	zobowiązania z tytułu podatku odroczonego
Depreciable Amount	wartość podlegająca amortyzacji
Depreciation	amortyzacja
Derecognition	wyksięgowanie
Derivative	instrumenty pochodne
Detection Risk	wykrywanie ryzyka
Development	rozwój
Direct Costs	koszty bezpośrednie
Disclosure	ujawnienie
Discontinued Operation	działalność zaniechana
Discount	dyskonto
Discount Rate	stopa dyskontowa
Discounted Cash Flow	metoda zdyskontowanych przepływów pieniężnych
Dividends	dywidendy
Double–Entry Bookkeeping	system podwójnej księgowości
Due Date	termin płatności
Earnings Per Share (EPS)	zysk na akcję
Economic Life	okres ekonomicznej użyteczności
Effective Interest Rate	efektywna stopa procentowa
Equity	kapitał
Equity Instrument	Instrumenty kapitałowe
Equity Method	metoda praw własności
Equity Securities	akcja
Estimated Tax	szacowanie podatku
Estimation Transactions	ocena transakcji
Events after the Balance Sheet Date	zdarzenie po dniu bilansowym
Exchange Difference	różnica kursowa
Exchange Rate	kurs walutowy
Expenditure	wydatki
Expenses	nakłady
External Reporting	sprawozdawczość zewnętrzna
Extraordinary Items	pozycje nadzwyczajne
Factoring	kupowanie dyskontowanych długów
Fair Market Value	wartość rzeczywista
Fair Value	wartość godziwa
Finance Lease	leasing finansowy
Financial Asset	aktywa finansowe
Financial Institution	instytucje finansowe
Financial Instrument	instrument finansowy
Financial Liability	zobowiązania finansowe

Financial Risk	ryzyko finansowe
Financial Statements	sprawozdanie finansowe
Financing Activities	działalność finansowa
First in, First out (FIFO)	First in, First out (FIFO)
Fiscal Year	rok podatkowy
Fixed Asset	aktywa trwałe
Forecast	prognoza
Foreign Currency	dewizy, waluta obca
Fraud	oszustwo
Functional Currency	waluta funkcjonalna
Funding	finansowanie
Future Contract	przyszłe umowy
Gain	przyrost
General Ledger	księga główna
Generally Accepted Accounting Principles	Ogólnie akceptowane zasady rachunkowości
Going Concern	zasada kontynuacji działania
Goodwill	wartość firmy
Gross Income	dochód brutto
Group	grupa kapitałowa
Guaranty	gwarancja
Hedge	zabezpieczenie
Hedge Effectiveness	efektywności zabezpieczenia
Hedged Item	pozycja zabezpieczona
Hedging Instrument	instrument zabezpieczający
Held-To-Maturity Investments	inwestycje utrzymywane do terminu wymagalności
Highly Probable	wysoce prawdopodobne
Historical Cost	koszt historyczny,pierwotny koszt nabycia
Impairment Loss	odpisy z tytułu utraty wartości
Impracticable	niewykonalne w praktyce
Improvement	udoskonalenie
Income	dochód
Income Statement	rachunek zyskow i strat
Indirect Costs	koszty pośrednie
Initial Direct Costs	początkowe koszty bezpośrednie
Installment	transza
Intangible Asset	wartości niematerialne i prawne
Interest	odsetki
Interest Cost	koszty odsetek
Interest Rate Risk	ryzyko stopy procentowej
Interim Financial Report	półroczne sprawozdanie finansowe
Interim Financial Statements	okresowe Sprawozdanie finansowe
Interim Period	okres śródroczny
Internal Audit	audyt wewnętrzny
Internal Control	kontrola wewnętrzna
Internal Rate of Return	wewnętrzna stopa zwrotu
International Accounting Standards Board	Rada Międzynarodowych Standardów Rachunkowości
International Financial Reporting Standards (IFRSs)	Międzynarodowe Standardy Sprawozdawczości Finansowej
Intradepartmental Price, Internal Transfer Price	wewnętrzne ceny transferowe
Inventories	zapasy
Investing Activities	działalność inwestycyjna
Investment Property	nieruchomości inwestycyjne

Investor in a Joint Venture	inwestor w spółce joint venture
Joint Venture	joint venture
Journal	dziennik księgowy
Last in, First out (LIFO)	Last in, First out (LIFO)
Lease	dzierżawa, najem
Lease Term	okres najmu
Lessee	leasingobiorca
Lessor	leasingodawca
Liability	zobowiązanie,odpowiedzialność
Liquid Assets	aktywa płynne
Liquidation	likwidacja
Liquidity Risk	ryzyko płynności
Loans and Receivables	pożyczki i należności
Loans Payable	zobowiązania z tytułu pożyczek
Long–Term Debt	dług długoterminowy
Loss	strata
Lower of Cost or Market	najniższym koszcie lub według rynku
Management Accounting	rachunkowość zarządcza
Margin	marża
Market Risk	ryzyko rynkowe
Marketable Securities	papiery wartościowe przeznaczone do obrotu na giełdzie
Mark–to–Market	mark–to–market
Master Budget (Company Budget)	budżet dla całej firmy
Materiality	istotność
Matching Principle	zasada dopasowania aktywów
Merger	fuzja
Minority Interest	pakiet mniejszościowy
Monetary Assets	aktywa pieniężne
Monetary Items	pozycje pieniężne
Net Assets	aktywa netto,aktywa czyste
Net Income	dochód netto
Net Realizable Value	wartość netto
Non-cancellable Lease	leasing nieodwoływalny
Non-current Asset	składnik aktywów trwałych
Non–for–Profit Organization	organizacja not-for-profi
Notes	informacja dodatkowa
Notional Value, Face Value	wartość nominalna
Objectivity	obiektywność
Obligations	obowiązki
Onerous Contract	umowy rodzące obciążenia
Operating Activities	działalność operacyjna
Operating Cycle	cykl operacyjny
Operating Lease	leasing operacyjny
Option	opcja
Other Comprehensive Income	inne całkowite dochody
Parent Company	spółka macierzysta
Partnership	spółka osobowa
Penalty	kara
Plan Costing	plan (kalkulacja) kosztów
Preferred Share	akcja uprzywilejowana
Present Value	wartość aktualna
Presentation Currency	waluta prezentacji

Prior Period Errors	błędy poprzednich okresów
Probable	prawdopodobny
Profit or Loss	zysk lub strata
Property, Plant and Equipment	rzeczowe aktywa trwałe
Prospective Application	prospektywnego zastosowania
Provision	rezerwa
Public Offering	publiczna oferta subskrypcji akcji
Qualifying Asset	składniki aktywów
Ratio Analysis	analiza wskaźnikowa
Receivables	wierzytelność, należności
Reconciliation	uzgodnienie
Recoverable Amount	wartość odzyskiwalna
Reinsurance	reasekuracja
Related Party Transaction	transakcje z podmiotami powiązanymi
Reorganization	reorganizacja
Repairs	poprawa
Reporting Date	terminy sprawozdawczości
Reporting Entity	jednostka sprawozdawcza
Repurchase Agreement	umowa odkupu
Research	badania
Residual Value	wartość rezydualna
Responsibility Accounting	rachunkowość odpowiedzialności
Restructuring	restrukturyzacja
Retained Earnings	zyski zatrzymane
Return on Investment (ROI)	wskaźnik rentowności zaangażowanego kapitału
Revenue Recognition	ujmowanie przychodów
Revenues	przychody
Risk Management	zarządzania ryzykiem
Securitization	sekurytyzacja, obligatoryzacja
Security	zabezpieczenie, papier wartościowy
Separate Financial Statements	jednostkowe sprawozdania finansowe
Settlement Method	sposób, metody rozliczenia
Share (Stock)	akcja
Short–Term	krótkoterminowy
Significant Influence	znaczący wpływ
Spot Exchange Rate	kurs natychmiastowy
Start–up Costs	koszty rozpoczęcia działalności
Statement of Cash Flows	Sprawozdanie z przepływów pieniężnych
Statement of Comprehensive Income	Sprawozdanie z całkowitych dochodów
Statement of Financial Position	Sprawozdania z sytuacji finansowej
Statement of Changes in Equity	Zestawienie zmian w kapitale własnym
Straight–Line Depreciation	metoda liniowa amortyzacji
Subsequent Event	późniejsze (kolejne)zdarzenia
Subsidiary	jednostka zależna
Swap	wymiana
Tangible Asset	aktywa rzeczowe
Tax	podatek
Tax Base	podstawa opodatkowania
Tax Expense	obciążenie podatkowe
Tax Income	podatek dochodowy
Tax Loss	strata podatkowa
Tax Year	rok podatkowy
Taxable Income	dochód do opodatkowania

Taxable Profit	zysk podlegający opodatkowaniu
Taxpayer Identification Number (TIN)	numer identyfikacji podatkowej
Temporary Differences	różnice przejściowe
Term Loan	pożyczka terminowa
Total Comprehensive Income	łączne całkowite dochody
Transaction Costs	koszty transakcyjne
Unearned Income	dochód z odsetek i dywidend
Useful Life	trwałość użyteczna
Value in Use	wartość użytkowa
Venture Capital	kapitał wysokiego ryzyka
Work in Progress	produkcja w toku
Working Capital	kapitał obrotowy
Yield to Maturity	dochód do daty wykupu
Zero–Coupon Bond	obligacje zerokuponowe

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Financial Reporting in Romania

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Romania. Due to the globalization of business and international harmonization of financial reporting also Romania experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Romania.

Country
Romania
(România)
Location
South-Eastern Europe
Area
238,391 km^2
Population
21,959,278 (2010 est.)
Member of European Union
since 1st January 2007
Currency
lei (RON); 4.300 RON/EUR (as at 31.12.2010)

1 Country Introduction

Romania is a European Union member since January 1, 2007, is the ninth largest country in the EU considering area and has the seventh largest population [29]. Romania's capital city is Bucharest, the largest Romanian city and the sixth largest city in the EU. Ethnically, the population is 90% Romanian followed by 7% Hungarian. The official language is Romanian, which descends from Latin, although some Slavic influences also occurred. The dominant religion is orthodox (87% of the population).

With many natural resources (such as oil and natural gas, iron, copper, gold, bauxite, large agricultural surfaces – Romania was once named 'Europe's granary'), with a large variety of natural settings (mountains, sea, fertile fields), the Romanian territories were of interest for many populations, thus having a tumultuous history which affected the economical development (which in turn delayed the development of accounting within the Romanian territory).

A brief presentation of Romania's history should begin with the kingdom of Dacia (corresponding mostly to present-day Romania) which was conquered by the Roman Empire (around 100 AD) and transformed into a Roman province. The population was organized in several principalities which were later during the Middle Ages regrouped in three main ones: Wallachia (ro. Ţara Românească, Valahia), Moldavia (ro. Moldova), and Transylvania (ro. Transilvania). Romanian territories' continuous struggle for independence, their battles and conflicts resulted in a very late economic development, starting with the XIX century. After 1900, the Romanian economy was in continuous development, reaching an upper limit between 1933 and 1939. It seems that Romanian authors and the Romanian accountancy profession at large were highly esteemed internationally then [6]. After the Second World War, Romania entered under the Soviet influence, which generated the switch to a planned and centralized economy. In that period, accounting was required to fulfill the needs of the central institutions of the planned economy. Accounting had a low status and was largely a matter of clerical bookkeeping. The Romanian accounting model in the communist period had two main functions, to inform and to provide a basis for control [22].

After the fall of communism in December 1989, Romania underwent a number of dramatic economic and accounting reforms and intended to develop closer relations with Western Europe. The main political objective after the fall of the communism was the EU-integration, objective which dominated the structural and institutional reforms. Romania applied for membership to the EU in 1993, became an associate state in 1995, an acceding country in 2004 and finally became a member of EU in 2007. Also, Romania joined NATO in 2004.

2 Legal System

2.1 Economical Evolution

The fall of the communism and the transition towards a market economy represented major events that caused significant changes in the Romanian economy. New types of entities emerged, the prices started to be market-based, and new economic relations developed. But the process of economic change was slow and with difficulties.

The period prior to 2000 was neither smooth nor well managed [29]. The average annual inflation rate between 1900 and 1999 was of 110.9% [19]. The economic development of Romania until 2000 has lagged behind other countries in Eastern Europe, because of the focus on political issues rather than on decisions affecting the economic environment [21]. In 2000, Romania was considered by some authors as being closer to Bulgaria, Russia and Ukraine than to Poland, Hungary and the Czech Republic [21]. However, there were improvements with regard to the development of the capital market and the privatization process as compared to the first group of countries.

The Romanian government tended to consider the attraction of foreign investors as being a prior objective. The **Bucharest Stock Exchange** (hereafter BSE) was officially open in 1995, but in the first years only a few entities were listed [19] and the market capitalization was very low, of app. 1% of the GDP [3]. Soon after, in 1996, the RASDAQ market has been established as an over-the-counter (OTC) market destined to list the companies subject of the Mass Privatization Program. In 1995 Romania carried out a Mass Privatization Program whereby shares in Romanian state-owned companies were distributed free of charge to all major Romanian citizens. In 2004, the Bucharest Stock Exchange and the RASDAQ market agreed to merge and started a merger process that ended on December 28, 2005. Also, agreements with the World Bank and the IMF were concluded aiming to develop the attractiveness of the Romanian economy for the foreign investors. In this context, after 1998 a process of stabilization was reported, and the turning point for the BSE was the year 2000 [19].

After a series of privatizations[2] and reforms during the late 1990s and early 2000s, government's intervention in the Romanian economy is considered to be somewhat milder than in other European economies [39]. Since 2000, Romania has attracted increasing amounts of foreign investment, becoming the single largest investment destination in Southeastern and Central Europe [39] and had one of the highest economic growth rates in Europe. After 2000, the Government implemented macroeconomic and structural policies that are supportive of growth and disinflation [38]. The economy grew at an average annual rate of 6% between 2000 and 2008; also, Romania first experienced positive GDP growth initially at 7.7% in 2006 but more recently GDP has decreased and the current account deficit widened to 13% of GDP in 2009 (up from 8.7% in 2005). Inflation decreased to 4.74% in 2009 (from 6.3% in 2008), and since 2009, Romania suffered a recession of around 6-7% [10]. The main issues Romania is facing nowadays are the debts towards IMF, the infrastructure, corruption, medical services and education[3] and the local companies deal with increased interest rates, lack of cash, and reduced demand cause generally by the financial crisis. Yet, several economic strengths remain, including: a lower cost of labor than in more industrialized economies (although some adjustment tendency manifested especially before the financial crisis was felt by the Romanian businesses), the support of the IMF, and significant currency reserves (28.3 billion euro in December 2009).

2.2 Business, Accounting and Taxation Laws

Romania is **a code-law country**. The Romanian judicial system is strongly influenced by the French model. The preparation and afterwards the adhesion to EU were accompanied by the application of European Directives. However, the legal framework in Romania is considered inadequate in a number of areas [29].

The Companies law was issued in 1990 (Law 31/1990) and undergone several updates since, including very recent ones. The law covers the forms of business organization, the registration procedures, capital and shares, administration and shareholders, dissolution, liquidation, mergers and spin-offs. The following types of business organization are presented in the Romanian legislation:

- **limited liability company** (ro. Societate cu răspundere limitată, SRL);
- **joint stock company** (ro. Societate pe acțiuni, SA);
- **general partnership** (ro. Societate în nume colectiv, SNC);
- **limited partnership** (ro. Societate în comandită simplă, SCS);
- **limited partnership by shares** (ro. Societate în comandită pe acțiuni, SCA).

Also, self-employed individuals, individual undertakings or family-owned enterprises can do business on the Romanian territory. A foreign company can do business in Romania either through a subsidiary (gaining separate legal status, considered Romanian entity) or through a branch (no legal status).

[2] The most important privatizations were that of Petrom (the Romanian oil company, the biggest oil company in Central and Eastern Europe) acquired in 2003 by OMV, and that of the Romanian Commercial Bank (ro. Banca Comercială Română (Romania's biggest bank) acquired by Erste Bank in 2005-2006.

[3] http://en.wikipedia.org/wiki/Romania

SA and SRL are the most common types of businesses in Romania. A SRL may be set up by a maximum number of 50 shareholders and the minimum capital is of RON 200 (app. EUR 47 at an exchange rate of EUR 1 = RON 4.25). Capital may be subscribed and paid in by the shareholders by contributions in cash, in kind and/or in receivables. Cash contributions are however mandatory for all types of companies. Contributions in receivables are not allowed in limited partnerships by shares, limited liability companies and joint stock companies established by public subscription. Shareholders contributing with receivables in a company will not be discharged of liability towards the company unless the latter obtains actual payment of the receivables. A SA can be set up by at least two shareholders and the capital should be more than RON 90,000. The Romanian Government may adjust, not more frequently than once every two years, the minimum level of the share capital as per the modifications of the exchange rate, so that this amount is the equivalent of EUR 25,000. Upon incorporation, each shareholder of a joint stock company must pay up at least 30% of the subscribed share capital, while the rest 70% may be paid within maximum 12 months as of the company registration date for the shares issued in exchange of cash contribution, or within maximum 24 months, for the shares issued in exchange of an in-kind contribution. The face value of one share may not be less than RON 0.10. No share may be issued for an amount less than the nominal value.

The Company Law allows companies to choose between two governance systems: the unitary system and the dualist system. In the case of the **unitary system**, companies are managed by one or several directors (always an uneven number), organized as a board of directors. The entities having the legal obligation to audit their financial statements must have at least three directors. Under the **dualist system** the company shall have a directorate and a supervisory council. The directorate is formed by one or several members (always an uneven number) and exercises the management of the company. The directors and the members of the directorate cannot be employed by the very company. Directors and members of the supervisory council are appointed and revoked exclusively by the general meeting of shareholders. The members of the directorate are appointed and revoked by the supervisory council. However, the constitutive act of the company may set forth that the members of the directorate may also be revoked by the general meeting of shareholders. The first directors and the first members of the supervisory council are appointed through the constitutional documents. The duration of the mandate of the members of the board of directors, of the directorate and of the supervisory council is established through the constitutive act and may not exceed four years. The duration of the mandate of the first members of the board of directors and of the supervisory council may not exceed two years. It is mandatory for the directors or, as the case may be, for the members of the directorate and of the supervisory council to have insurance for professional liability. No person may simultaneously be a member of more than five boards of directors and/or supervisory councils in joint stock companies having their headquarters located in Romania, unless a member of the board or of the supervisory council owns at least one quarter of the total number of shares or is a member of the board or of the supervisory council of a joint stock company that owns a quarter of the shares. According to the Company Law companies may stipulate in the constitutive act or via a decision of the general meeting of shareholders that one or more members of the board of directors be independent. Independence and professionalism conditions might be established for The Supervisory Board by the constitutive act or a decision of the general meeting of shareholders. The remuneration of the members of the Board of directors and of Supervisory Board is established by the constitutive act or by a decision of the general meeting of shareholders. The remunerations must be set up having the duties of people involved and the economic condition of the company.
The General assembly of shareholders may be ordinary (having such attributions as: to discuss and approve the financial statements and the distribution of dividends, to appoint and revoke the members of the Board of Directors or of the Supervisory Board and of the censors where case be, to establish budgets and the business plan, to appoint or revoke the financial auditor and to set the minimum period of the financial audit agreement, etc.) or extraordinary (necessary to pass decisions related to the amendment of the constitutional documents, the conversion of the bearer shares into nominative shares or vice-versa, the approval of any operation whereby a director acquires assets from or to the company whose value represents at least 10 per cent of the subscribed share capital or any other decision requiring the approval of the extraordinary general meeting).

The **main provisions** of the companies' law no. 31/1990 regarding the financial reporting of Romanian entities include:

- the financial statements should be available to the financial auditors/censors (as and where applicable) before the announcement of the annual general meeting;

- the audit report should be made available to the shareholders;
- the financial statements accompanied by the audit report had to be submitted to Trade Register Office, and the Trade Register Office is to send the annual financial statements to the Ministry of Public Finances electronically; starting 2011, the financial statements shall be submitted to the Ministry of Public Finances, which shall forward them to the National Trade Register Office;
- corporate governance compliance should be implemented by Romanian companies (i.e. internal audit departments, Audit Committee, non executive managers (Supervising Committee); the entities can stipulate in their statute if they are managed by a Directorate (in charge with daily operations) and a Supervising Committee - "dualist system"; the entities opting for the dualist management system must have their financial statements audited by independent auditors; dividends are payable out of the statutory profit of the previous year, and are paid at a date established by the general meeting. Dividends shall be distributed only out of real profits; dividends paid out of unreal profits shall be returned. Action for dividends return is subject to a statutory limitation of three years starting with their distribution. Dividends payable after a share assignment belong to the assignor, unless the parties have agreed otherwise.

Companies may merge by transferring the assets of one or several companies, which cease to exist, to a newly formed or existing company, in exchange for shares issued by such newly formed/existing company and, possibly, for a payment in cash in value not to exceed 10% of the face value of the above mentioned shares. Companies' split-offs may be accomplished by transferring the assets of a company, which ceases to exist, to two or more companies already existing or that are newly formed, in exchange for shares issued by such existing/newly formed companies and, possibly, for a payment in cash in value of maximum 10% of the face value of the above mentioned shares. The merger and de-merger decisions and the plans drafted in view of these transactions shall be registered with the National Trade Register Office and published in the Official Gazette of Romania. Any creditor of the company or companies involved in the merger or the de-merger, having claims prior to the publication date of the merger or de-merger plan, may oppose thereto. Until recently, where a creditor of the participating company/companies opposed the merger or the spin-off, the entire process was to be stayed until an irrevocable decision was ruled by the competent Court of law. Following the latest amendments, in force on and after October 4th 2010 and applicable to all merger and spin-off processes where the merger or spin-off project has been published after this date, the opposition filed by a creditor shall no longer stay the process and shall not hinder its completion. According to the Romanian Company Law, the following situations constitute generally applicable cases for companies' dissolution: expiration of the period for which the company was established, impossibility of achieving the company's object of activity, company voidance, decision of the general meeting of shareholders, severe conflict between shareholders that prevent the company's successful operation, bankruptcy, loss of one half of the share capital, decrease of the share capital below the legal threshold, decrease of the number of shareholders below the legal threshold. Upon the request of the National Trade Register Office or of any other interested person, the court may pronounce the company dissolution when: the company has no longer statutory bodies or the existing statutory bodies can no longer convene, the company failed to submit, within six months since the legal deadlines, the annual financial statements or other documents which, according to the law, must be submitted to the Trade Register, the company ceased its activity, its headquarters are unknown, its shareholders disappeared or their domicile/residence is unknown or the company failed to replenish its share capital, according to the law.

The **insolvency proceedings** are prescribed by the "Insolvency Law" no. 85/2006. The purpose of this normative act is either to accelerate the reorganization of the debtor's activity or facilitate its dissolution and safeguard creditors' rights as much as possible. The criteria for opening the insolvency proceedings are the lack of liquidities and the imminent insolvency. Law No. 85/2006 provides for two different insolvency procedures: a general procedure that places the debtor under a reorganization procedure followed by bankruptcy and a simplified procedure that places the debtor directly into bankruptcy.

Several capital market crises, mainly consisting in the collapse of some investment funds in the 1990s, as well as of the sharpening of conflicts between majority and minority shareholders within the publicly owned companies, entailed re-examination of the primary and secondary legal framework in the field, along with the strengthening of the National Securities Commission's powers. Capital market regulations have evolved significantly after 1994 when the first law on securities and stock exchange markets was adopted. Major amendments have been brought to the capital market legislation especially after 2002, pursuant to the

implementation of European Union legislation. The Law no. 297/2004 (the "Capital Market Law"), currently in force, enacted in June 2004 and subsequently amended, sets out the main legal framework applicable to capital market operations. According to the provisions of the Capital Market Law and the provisions of Emergency Ordinance no. 25/2002, subsequently amended, the National Securities Commission is the regulatory and supervisory authority of regulated markets, commodities and derivative markets as well as institutions and operations specific to these markets. Currently in Romania there are two regulated markets, respectively the Bucharest Stock Exchange (BSE), and the Monetary and Commodities Exchange Market based in Sibiu. Shares are traded on the BSE on three tiers, differentiated by the severity of the obligations which the listed companies must comply with (related to minimum capital, disclosure of information to investors, profits track record, and corporate governance standards).
In August 2001 the BSE Corporate Governance Code was adopted and the "Transparency Plus" Tier was created for companies fulfilling the requirements of the code. In order to be accepted at this category a company had to include the provisions of the code in its statute and remove all provisions that contravene to the code. Stringent requirements for implementing the Code led to a reserved attitude of the companies so only one company was listed on the "Plus" Tier. A new Corporate Governance Code was adopted in 2008 but this time the companies admitted to trading on the regulated market of the BSE may adopt and comply with the provisions of the Corporate Governance Code on a voluntary basis.
The provisions of the amendments to the Fourth and the Seventh European Directive related to Corporate Governance statements were introduced in Romania by the Order of the Ministry of Public Finances (OMFP) no. 2001/2006. The corporate governance statement applies to all companies whose securities are traded on a regulated market. This statement refers to the corporate governance code applied by the company and explains whether and to what extent the company complies with that code.
A private pension system was introduced in phases in Romania starting 2006. The Private Pension Funds Supervisory Commission was established in 2007. The private pensions in Romania can be identified in two categories: privately managed compulsory pensions under a defined contributions regime, and privately managed voluntary pensions on an individual basis.

As the superior accounting document, the **Accounting Law** no. 82/1991 [31] prescribes the main accounting obligations of businesses, while the details concerning its application are published through OMFPs. All companies doing business in Romania are required to organize their accounting system (including managerial accounting) and to publish financial statements. The Accounting Law is applicable to private companies, state companies, public institutions, non-profit organizations, other legal entities and to individuals authorized to carry out independent activities.
The accounting regulator is the Ministry of Public Finances. It issues the Orders which regulate accounting, detailing the format of financial statements, the accounting principles, the recognition and measurement rules, and the chart of accounts to be used. The latest such Order is numbered 3055/2009 [37], it is applicable starting January 1 2010 to all entities that are under the scope of the Accounting Law, except for the credit institutions, the insurance companies, the entities in the private pension system and entities supervised by the National Exchange Commission which have other specific accounting regulations.
For the first time after 1990, the current regulation [37] contains the list of users of financial statements. It is obvious that this part of the Order is based on the old version of the IASC conceptual framework. The list of users includes investors, employees, creditors, suppliers, clients, the State authorities, general public. In the same line, the qualitative characteristics of the financial information are also mentioned (i.e., understandability, relevance, reliability and comparability).
Double-entry bookkeeping is generally applicable, and in principle[4] the financial year begins on January 1 and ends on December 31. Financial records are kept in Romanian and in RON. Legal entities or individuals have to keep written evidence of all transactions and record these transactions in their accounting books. The compulsory journals required by the Accounting Law are: the General Journal (ro. Registrul Jurnal), the Inventory Journal (ro. Registrul inventar), based on an annual inventory of assets and liabilities, and the General Ledger (pertaining to each account). The books and the accounting records may be hand-written or in an electronic format and can be used as evidence in court and are subject to review by Romanian fiscal and judicial authorities. Accountants should prepare a trial balance from the General Ledger on an annual basis and

[4] Some categories of entities (e.g. subsidiaries of foreign companies) may have the financial year different than the calendar year.

this trial balance is the basis for preparation of periodic financial statements. Accounting records have to be stored for a ten-year period (except for payroll records, for which the period is 50 years). Financial statements have to be prepared within 150 days from the closing of the financial year and should be submitted for approval to the General meeting within five months from the end of the financial year.

OMFP 3055/2009 is currently applicable to entities of all sizes since January 1 2010, with differing level of disclosure relating to size and public interest consideration. Size criteria established under Order 3055/2009 are:

- total assets of EUR 3,650,000;
- turnover of EUR 7,300,000;
- an average number of employees during the financial year of 50.

Entities which in two consecutive financial years exceed two of the three size criteria, as well as listed companies (regardless of their size) are required to prepare standard financial statements including:

- the balance sheet;
- the income statement;
- the statement of changes in equity;
- the statement of cash flows;
- the notes.

The others entities are required to submit abridged financial statements including an abridged balance sheet, an income statement and notes. The preparation of the statement of changes in equity and of the statement of cash flows is optional. The financial statements are always accompanied by the administrators' report, which provides comments on the activities of the entity, its financial position and a description of the main risks and uncertainties faced by the entity. The Order 3055/2009 details the expected information that should be presented in this report.

The main accounting principles which should be applied are: going concern, consistency, prudence, matching, separate recognition and measurement of assets and liabilities, non-offsetting, materiality and substance over form. The general chart of accounts is mandatory and contains the following classes:

- Class 1 – Capital accounts
- Class 2 – Non-current assets
- Class 3 – Inventories and work in progress accounts
- Class 4 – Third party accounts (receivables and payables)
- Class 5 – Treasury accounts
- Class 6 – Expenses accounts
- Class 7 – Revenues accounts
- Class 8 – Special accounts (off-balance sheet)
- Class 9 – Managerial accounting accounts

Consolidation is mandatory in Romania only after 2006, and the current consolidation provisions are in line with those of the 7th EU Directive. A parent entity is exempt from the preparation of consolidated financial statements if the parent and the subsidiary taken together do not exceed two of the three size criteria below (except for listed companies):

- total assets of EUR 17,520,000;
- net turnover of EUR 35,040,000;
- an average number of employees 250.

Consolidated financial statements should be prepared within 9 months from the end of the financial year.

Preparation of financial statements according with IFRS is compulsory only for credit institutions and for listed entities in their consolidated financial statements (it is the transposition of the EU IAS Regulation EC 1606/2002, and companies should apply the IFRSs as adopted by the EU). Other entities that are required to prepare consolidated financial statements may prepare them in accordance with the 7th EU Directive or with IFRSs.

The general audit framework is established by the Government Ordinance no. 75/1999 with subsequent amendments. The financial statements of the entities which meet the size criteria for preparing a full set of financial statements, of joint stock companies that opted for the dualist governance system, and the consolidated financial statements, should be audited by certified financial auditors. Companies whose annual financial statements are exempt from audits performed by authorized financial auditors generally need to have them checked by censors. OMFP 3055/2009 also details the obligations concerning the internal controls of entities. In 2008, the Romanian Parliament passed the Law no. 278/7 approving EGO 90/2008 (the amended Audit Law). The new Audit Law complies with the amended Eighth Company Law Directive including provisions for (i) licensing, (ii) initial and continuing professional education, (iii) a public register of auditors and audit firms, (iv) transparency report requirements, (v) a quality assurance system, (vi) investigation and penalties, and (vii) auditor's liability. In addition to the requirements of the directive, the new Audit Law confirms the Romanian Chamber of Financial Auditors adoption of the IFAC Code of Ethics and ISA. Financial auditors are required by the Romanian Chamber of Financial Auditors to carry professional liability insurance. Auditors' civil liability is subject to the general rules regarding liability under the Romanian Civil Code (i.e., only actual damages, no consequential damages). EGO 90/2008 on statutory audit introduced a public oversight system through the establishment of the Council for the Public Oversight of the Statutory Audit Activity.

The main aspects concerning the **taxation** of businesses are:

- **VAT** was introduced in Romania in 1993. The VAT regulations are in line with the European ones. Starting the 1st of July 2010, the standard VAT rate increased from 19% to 24%. Two reduced rates are used: one of 9% for admission tickets to museums, exhibition, cinemas and other cultural events, delivery of books and newspapers, delivery of prostheses, orthopedic products, medicine and accommodation services, and 5% for real estate transactions.
- **Micro–enterprises** pay a tax of 3% of their turnover. According to the Fiscal Code, a micro enterprise is a Romanian legal person that cumulatively satisfies the following conditions: a) obtains income other than from banking, insurance reinsurance, capital market, gambling, consulting services and management, b) has 1 to 9 employees; c) obtained income did not exceed the equivalent in lei of 100,000 Euros; d) the social capital of the legal person is owned by persons other than the state, local authorities and public institutions.
- The **flat tax on income or profit is of 16%** since 2005. The taxable profit is calculated based on the provisions of the Fiscal Code, which details the deductible expenses and taxable revenues. Revenues from dividends received from a Romanian legal person and from the reversal of provisions/adjustments that were previously non-deductible, favorable differences of value for participation titles that are recorded as the result of the incorporation of reserves, benefits or issuance premiums by the legal persons where the participation titles are held, as well as by the differences of valuation of long-term financial investments, non-taxable incomes, expressly provided for in agreements and memoranda approved through legal enactments, are non-taxable. Depreciation of assets[5], protocol expenses, reimbursement of travel allowances granted to employees for travel in Romania and abroad, perishables, expenses for meal tickets granted by employers, certain reserves and provisions (such as: legal reserves within the limit of 5% of the accounting profit, provisions and reserves set up by banking institutions, in accordance with specific regulations, client provisions, related to unsecured receivables outstanding for at least 270 days against non-affiliated persons, currently up to the limit of 30% of client receivables), expenses for interest and foreign exchange differences, some social expenses up to the level of two per cent of the salaries fund, expenses incurred on behalf of an employee to an optional occupational pension scheme, expenses for private health insurance premiums, expenses for the operation, maintenance and repair of job dwellings located in the locality of the official establishment or where the company has secondary establishments, expenses of operation, maintenance and repairs related to an establishment within a dwelling owned by a person who is a physical person, used for personal purposes, expenses of operation, maintenance and repairs related to cars used by employees with management or administrative positions of the legal person have limited deductibility, while own expenses of the taxpayer for the profit tax payable, including differences from preceding years or from the current year, as well as profit tax or income tax paid abroad, fines, confiscations, late-payment additions and late-payment penalties payable to Romanian authorities, expenses related to inventories or tangible assets that are missing from stock or that are damaged and non-chargeable, for which no insurance contract was entered into, as well as related value-added tax, expenses for value-added tax related to goods granted to employees as benefits in kind, expenses made in favor of shareholders or associates,

[5] The Fiscal Code makes an explicit distinction between accounting and fiscal depreciation. Also, the Order 3055/2009 allows an accounting depreciation different than the fiscal one, but generally entities use fiscal depreciation rules.

other than those generated by payments for goods delivered or services supplied to the taxpayer, at the market price for such goods or services, expenses for services of management, consulting, assistance or other supplies of services for which the taxpayer cannot justify the necessity of such supply for the purpose of carrying out the own activity and for which contracts were not concluded, expenses determined due to unfavorable differences of value for participation titles in legal persons where the participation is held, as well as unfavorable differences of value related to long term bonds, with the exception of those determined due to their sale-assignment, expenses of contributions paid in excess of established limits or that are not regulated by normative acts, expenses of insurance premiums paid by an employer on behalf of an employee that are not included in the salary income of the employee, expenses of insurance premiums that are not related to the assets of the taxpayer as well as those that are not related to the object of activity, with the exception of those that relate to goods that serve as a bank guarantee for credits used in carrying out activities for which the taxpayer is authorized or those that are used within the framework of rental or leasing contracts, according to contractual clauses, losses for uncollected receivables, for the portion that is not covered by a provision, impairment of fixed assets as a result of revaluations, expenses without justifying documents or documents issued by inactive issuers or issuers having the Fiscal Certificate suspended by an order of the National Agency for Fiscal Administration, are not deductible. Sponsorship expenses are deductible within the limit of 3% of the turnover but less than 20 per cent of the profit tax. As of 2009, losses may be carried forward for 7 years.

- employees' contributions on wages can amount to 35% and to 40% for the employer [23, 27, 29].
- in respect with transfer pricing, Romanian legislation generally follows the transfer pricing methods recommended by the OECD guidelines.
- custom duties are applied to imported goods, and the applicable rates are specified under the EU Customs Tariff.
- local taxes and duties are established according to the local autonomy principle, by the Local Councils. The following categories of local taxes are defined by the Fiscal Code: buildings tax, land tax, tax on transportation means, tax for issuance of certificates, approvals and authorizations, tax for contracting publicity and advertising means, tax on shows/performances, hotel tax. The local authorities may establish additional categories of local taxes.

Taxation is very important in Romania and is significantly impacting the accounting system of Romanian businesses. Previous studies demonstrated the important influence of taxation on accounting [17] and also that usually financial statements prepared in accordance with national regulations give a fiscal image [2].

2.3 SMEs in Romania

In 2006 Romania adopted the EU approach to the definition of SMEs (by the Law no. 175/2006), the thresholds being:

- net turnover of EUR 50 mil.;
- total assets of EUR 43 mil.;
- 250 employees.

The number of Romanian SMEs was most recently[6] reported to be 615.474 companies, representing 99.68% of the total number of Romanian companies. A brief description of this population, correlated with the volume of the turnover follows:

Turnover	**Number of employees**				**Total**
	0-9	10-49	50-249	> 250	
< 2 mil. Euros	556.304	42.597	4.792	170	603.863
2-10 mil. Euros	1.582	4.552	3.948	682	10.764
10-50 mil. Euros	122	428	1.023	746	2.319
> 50 mil. Euros	13	26	87	333	459
	558.021	**47.603**	**9.850**	**1.931**	**617.405**

[6] Data were available for 2007.

Based on this table, we may notice than more than 1,000 SMEs[7] were required to prepare, audit and publish the entire set of financial statements as required by the Order 3055/2009, while the others were allowed to prepare and publish the abridged form.
According to [15], Romanian SMEs employ 63.6% of the number of employees and have a value added of 49.6%, these values being below the values of other European ex-communist countries in the region (such as Hungary or the Czech Republic).
Romania struggled to create a favorable environment for the development of SMEs, especially considering the preparation for EU accession (for example, during 2004-2008 a governmental strategy was implemented as part of the commitment to improve the competitiveness in this sector – [24]). The EU accession created opportunities for SMEs, such as the increase in sales, new markets, new technologies, opportunities in accessing funds [7]. But SMEs still face difficulties such as bureaucracy, decrease in the internal demand, excessive taxation, and high cost of credits (Idem).
Only 50% of Romanian SMEs ended the financial year 2007 on profit, the most profitable being those with more than 10 employees [7]. A study conducted by [8] indicated a severe degradation of the general Romanian business environment and of the SMEs' sector for the first semester of 2009, via the computation of an entrepreneurial factor, the estimation being that over 90% of the over 600,000 Romanian SMEs were negatively affected by the crises.
SMEs have been affected by the decrease of demand and liquidities and difficulties in obtaining credits [24] which added negatively on their reduced solvability for 2007-2008 [7]. In this context, many Romanian SMEs (and especially micro-enterprises) declared or are close to declare bankruptcy (the pessimistic estimates indicate that 40% of SMEs will go on bankruptcy) [24]. This situation is to some extent caused by the fiscal conditions, because before the end of 2009, micro enterprises enjoyed special taxation conditions, yet 2010 was a year with a higher tax burden, when a minimum income tax had to be paid (500 Euros), regardless of the outcome of their operations. After many such entities went out of business, at the end of 2010 the government relaxed the fiscal system.
Romanian SMEs encountered the following difficulties during the financial crisis [9]: a decrease of internal demand, an excessive taxation, bureaucracy, corruption, difficult access to credit, delays of invoice payment from private companies, excessive controls, the high cost of credit and an increase of salary expenses. The evolution of the legal framework and the unpredictability of the environment were perceived as problems by SMEs. According to this study Romanian SMEs perceive as the main positive effects of Romania's accession to EU: the better access to markets, the existence of cheaper suppliers, improved legislation, access to structural funds and access to new technologies. The proportion of entities intending to access structural funds is high but entities identified the following obstacles in this process: the bureaucracy, the instability of regulations and reporting requirements, the insufficient information related to available funds, the insufficient funds to ensure co-financing, the high cost of credit, the restrictive eligibility criteria, and the low managerial and technical expertise for implementation. According to the same study [9], SMEs use mainly own funds, bank loans and leasing contracts to finance their activities. The study identified a correlation between enterprise's size and the financing forms in the way of their diversification and decrease of self financing proportion.

3 Evolution of Accounting after 1989

After the fall of communism at the end of 1989, Romania underwent several steps in its accounting reform. We should interpret accounting evolution in its economic, political and social environment and consider the survival and development of any particular regulatory system as dependent on its suitability for the functions which it is required to provide [4]. These general arguments prove to be very relevant in the case of Romania, which undergone several influences and stages in its accounting reform.
The process of accounting regulation in Romania is a public one, even after the revolution of 1989. The most important Act is the Accounting Law no. 82/1991 [31] stating the general context in which accounting should be organized, while second-level Ministerial Orders are issued by the Ministry of Public Finances. They detail accounting principles, recognition and measurement rules, the layout of financial statements and the chart of

[7] We included in this figure the entities with a turnover superior to EUR 10 mil.; of course, there is a part of the EUR 2 to 10 mil. of turnover range that should also prepare the full set of financial statements.

accounts. Unlike other countries, only one layout of financial statements was permitted in Romania (no option regarding the presentation existed) and the chart of accounts was mandatory.
The accounting regulations after December 1989 had various sources of influence, such as the French and the British accounting models, IAS/IFRSs, and the European Directives respectively. Several Romanian and foreign authors were interested in the changes of the Romanian accounting model [e.g. 1, 5, 11, 13, 16, 18, 20, 21, 25, 28] and their work is considered for the purpose of our presentation, besides the textual analysis of all issued accounting regulations available thus far.

3.1 The First Step: French Influence

The **Accounting Law was passed in 1991** and the Government Decision no. 704 was issued in 1993 to implement the Accounting Law [32]. According to the statement of reasons for the Accounting Law, it aimed introducing an accounting system appropriate for the new established market economy designed to allow an efficient control of the legality of transactions and of the fulfilling of fiscal obligations [20]. Between 1990 and 1993 there was a transition period from the Soviet model towards a French inspiration model [5]. These new accounting regulations of French inspiration were applied starting 1994.
It was advanced that Romania looked for a Western source of inspiration because of its political objective, meaning the preparation for eventual adhesion to the EU. France was chosen because of the long-term friendship relations between the two countries, but also due to several similarities regarding the legal system, the historical roots, but also some political considerations [11]. Hence the focus was therefore on EU Directives [30], as interpreted by France.
The set of financial statements included:

- the balance sheet;
- the income statement;
- the notes (named annexes, as translated from French).

The Accounting Law also introduced in the Romanian legislation the concept of true and fair view (ro. imagine fidelă), which obviously translates directly from French (fr. image fidèle). Many other influences of the French model manifested during this first stage of the reform, such as:

- the Romanian chart of accounts was based on the French one;
- the layout of the balance sheet was very much similar to the French one (table, with the same main headings);
- the concept of (ro.) ‘patrimoniu’ (fr. patrimoine) was used (it is also used in France, but it had also been used in Romania before the communism;
- the income statement had a by nature presentation of operating expenses, and included the “exceptional” items with the same meaning as in France (for example, the fines and penalties were exceptional expenses);
- government grants for assets were included in shareholders’ equity, as it was in France;
- the same treatment for unrealized exchange differences relating to transactions in foreign currencies was used, as being differed into the balance sheet and not recognized as expense or revenue.

During that period, the most important accounting principles were prudence, the accrual-based accounting and the evaluation at historical cost. Also, taxation was very important; for example, only a few companies accounted for impairment if it was not considered deductible [19]. [21] also noticed that even though the accounting law and the tax law have been developed separately in Romania, the de facto difference was less clear.
It should be also noted that during this period the most difficult transition was undertaken, that from the previous macroeconomic role of accounting towards a microeconomic perspective. Publishing accounting data was a very difficult exercise in the context of an economy previously based on the secrecy of businesses and where accounting data were not used for decision making. Also, during the same period the professional body of accountants (CECCAR) was re-established in 1991 and there is a huge need to develop the competencies of the accounting profession. The company law required public companies and some private companies to have an uneven number of censors elected by shareholders, of which one censor had to be expert accountant. The censor was empowered to supervise the administration of the company, verify the legality of company’s operations and make sure that financial statements are prepared in accordance with supportive documents. No professional body or specific auditing requirements existed.

3.2 The Second Step: IASs and British Influence

As presented in the description of the economic environment, there was an acute need to attract foreign investments before 2000. In that period, the economic environment suffered from inflation, lack of financial resources and political issues. As [21] underline, ***"the desire to move more rapidly to a market economy"*** and "the urgency to secure foreign investment" influenced the new accounting reform which actually began in 1996. The Know-How Fund provided assistance to the Romanian regulator to modernize the accounting model, and the chosen consultant was The Institute of Chartered Accountants of Scotland (ICAS). The team concluded, after analyzing the first step of accounting reform that "the work undertaken earlier by French consultants had been done within the context of the EU Fourth Directive. Those consultants had managed to achieve a partial enactment of the directive, while retaining the strength of the Chart of Accounts at bookkeeping level" [21].

The objective of the new project was to assure complete enactment of the EU Directives into the Romanian accounting regulations and the focus on "international acceptance" rather than one-country specific influence [21]. The strategy as presented by these authors was to apply the IAS in full by listed and large non-listed companies and some IAS measurement base for small companies, exclusive of all the disclosure required by the IAS. This strategy was supported by the World Bank and the IMF to secure loan facilities to Romania. The implementation team prepared accordingly an Order to be applied by Romanian large companies; it was firstly published in 1999 (Order no. 403/1999) [33] and tested on some entities, and republished with few amendments in 2001 (Order no. 94/2001) [34]. These Orders intended the harmonization with the European Directives and International Accounting Standards. Some size criteria were set so as to lead to a growing number of companies to apply the Order[8].

The Order had four volumes (which included the Order itself (containing the layout of financial statements, the measurement rules, and the general chart of accounts), the conceptual framework, the IASs translated and Professional Guides and allowed explicitly carve outs for IAS 29 and IAS 27. The main Anglo-Saxon influences manifesting were:

- the introduction of the principles of materiality and of substance over form, and the capitalization of financial leases (which led in time to the elimination of the concept of 'patrimoniu' from the text of accounting regulations);
- the vertical layout of the balance sheet begun to be required (very close to the British model), with government grants for investments classified as deferred income;
- the income statement remained presented by nature, but exceptional items were replaced by extraordinary items;
- the introduction of the cash flow statement and of the statement of changes in equity;
- the introduction of deferred taxation in the accounting regulations.

The entities that fell under the scope of the Order 94/2001 had to prepare a full set of financial statements comprising: the balance sheet, the income statement, the statement of cash flows, the statement of changes in equity, and the notes, based on those provisions of the Order that intended to ensure harmonization with the European Directives, and with those intended to ensure harmonization with IAS, even though sometimes difficulties were met to harmonize both. [20] advance that over 1,700 non-financial enterprises had to apply the new regulations (including IASs) by 31 December 2003 while the number of listed companies was of around 65. Considering that many companies that fell under the scope of harmonized regulations did not have users that required such information, and that the cost of IAS application was high, it is understandable why the IAS were not actually totally implemented in Romania during that period. Previous studies [3] show that IASs implementation was difficult and usually only partially accomplished; and that practices such as the use of fiscal treatments (for depreciation etc.) and the valuation at the historical cost persisted.

Actually "a tax application of IAS/IFRS was often made" [20] and the implementation team, the regulator and the World Bank were very aware of this [2, 3]. We may assert that even though a de jure harmonization between national regulations and IASs existed, the de facto application of IASs was limited due to a number of factors among which the preeminence of coercive factors (World Bank and IMF recognized as global promoters of IAS implementation), a low demand for quality accounting information from the users, and low competencies of the accounting profession [3].

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[8] For example, for 2001 the criteria were: EUR 9 mil. of turnover, EUR 4.5 mil. of total assets and 250 employees; for 2005, these thresholds referred to EUR 5 mil. turnover, to EUR 2.5 mil. of total assets and to 50 employees.

Also, the World Bank and IMF required that the institutional setting for auditing be established. Thus, the Romanian Chamber of Financial Auditors (ro. Camera Auditorilor Financiari din România – CAFR) was created in 1999, and standards of auditing were issued. The financial statements of all the entities falling within the scope of the Order 94/2001 had to be audited.

For the entities falling outside the scope of the Order 94/2001, the Order 306 was issued in 2002 aiming the harmonization with the European Directives. These entities were required to prepare a set of financial statements composed of: a balance sheet, an income statement and notes. The layout of the financial statements, the chart of accounts, the accounting principles[9] and the valuation rules were generally in line with those in the Order 94/2001. Since this Order was aimed to reduce the differences between the accounting model applicable for large companies and the one applicable to SMEs, many definitions and policies included in the Order 306/2002 also originated in IASs.

With regard to consolidated financial statements, an experimental Order (Order 772/2000) was applied by 5 groups, but we may only infer that it was unsuccessful because nothing happened afterwards.

This phase of the accounting reform had its advantages and its disadvantages. Some argued that IAS application increased the attractiveness of the Romanian economy for foreign investors. But others, such as [26, 28] noticed some conflicts and confusions caused by mixing a French-based philosophy with IASC content.

3.3 The Third Step: Compliance with the EU Directives

After 2005 a decentralization of the accounting regulatory process took place, in the sense that the supervisors started to be charged to set accounting regulations for the entities they supervise. Thus, the Ministry of Finance establishes the accounting regulations for the business sector, while the regulations for credit institutions, insurance undertakings, pension funds and entities operating on the capital market are elaborated by the National Bank of Romania, the Insurance Supervisory Commission, the Private Pension Funds Supervisory Commission and the National Securities Commission respectively, and are issued by these institutions after endorsement by the Ministry of Public Finances.

Considering Romania's permanent intent of adhesion to the European Union, the Romanian regulator prepared accordingly the accounting regulations issued in 2005 and 2006. The OMFP no. 1752 was issued in 2005 [35], and was applied starting 2006 for the individual and consolidated accounts of Romanian businesses. It intended to achieve the conformity of national regulations with the European Directives, but many provisions of IASs/IFRSs were maintained (to the extent they were not conflicting with the ones in the European Directives, as the representatives of the Romanian regulator explain in [2]). The new Order was to be applied by all entities, with some simplified disclosure requirements according to company size.

For credit institutions, including banks, the Order no. 5/2005 of the Romanian National Bank Governor transposed the Bank Accounts Directive, and stipulated that credit institutions and non-bank financial institutions must prepare their individual financial statements in accordance with the Bank Accounts Directive, and their consolidated financial statements in accordance with endorsed IFRS. The Order no. 5/2005 was superseded from January 1 2009 by the National Bank Governor Order no. 13/2008, with the latter being modified and supplemented several times after its issuance.

The Insurance Supervisory Commission Order no. 3129/2005 with subsequent amendments and supplements (Order no. 7/2007) transposes the Insurance Accounts Directive and stipulates that insurance undertakings must prepare their individual financial statements in accordance with the Insurance Accounts Directive. Consolidated financial statements must be prepared in accordance with either EU-endorsed IFRS or accounting standards compliant with the Seventh Company Law Directive.

The norms no. 14/2007 and 18/2007 issued by the Private Pension Funds Supervisory Commission regulate the pension plans accounting standards in accordance with the Fourth and Seventh Company Law Directives respectively. Consolidated financial statements for these entities must be prepared in accordance with either EU-endorsed IFRS, or the accounting regulations in compliance with the Seventh Company Law Directive.

The Orders no. 75/2005 and 74/2005 issued by the National Securities Commission transposed respectively the Fourth and Seventh Company Law Directives for companies regulated and supervised by the National Securities Commission. Listed companies regulated by the National Securities Commission are required to prepare their consolidated financial statements under EU endorsed IFRS.

[9] The principles of materiality and substance over form were however not included.

Starting 2007 IFRSs became mandatory for consolidated financial statements of listed entities along with an application of the applicable Order for the preparation of individual statements. The provision of the OMF 907/2005 requiring that banks had to prepare a set of consolidated financial statements in accordance with IFRS for the year 2006 has been confirmed by the OMF 1121/2006 [36] for subsequent periods (however in accordance with EU endorsed IFRS). In addition, OMF 1121/2006 also establishes EU endorsed IFRS as the mandatory accounting standards for consolidated financial statements of listed companies starting 2007. Public-interest entities, other than banks and listed companies, prepare their consolidated financial statements in accordance with either endorsed IFRS or accounting regulations compliant with the Seventh Company Law Directive. Public interest entities may prepare a second set of separate financial statements under IFRS for specific informational needs. The Accounting Law defines as public-interest the following entities: credit institutions, non-bank financial institutions defined according to legal regulations and registered at the Trade Register, insurance, insurance-reinsurance and reinsurance companies, entities authorized, regulated and monitored by the Private Pension Funds Supervisory Commission, companies providing services in connection with financial investments, investment managers and mutual funds authorized by the National Securities Commission, companies having securities admitted to trading on a regulated market, national companies and legal entities that belong to a holding group and enter into the consolidation scope of a parent company that applies IFRS.

Consequently some banks used to draw up two sets of financial statements, one in compliance with national regulations and the other under IFRS. In the context of the financial crisis the differences between banks' financial reporting under IFRS compared with Romanian regulations increased significantly. This was mainly because of the discrepancy between the figures for loan impairment provisions under IFRS and the more prudent Romanian regulations. For statutory purposes, in accordance with the national regulations, loans granted by banks are classified as standard, watch, substandard, doubtful and loss, based on the financial performance and debt service of the borrower. For the first four categories, the necessary provision for impairment is calculated by applying a rate to the outstanding loan balance and related accrued interest after deducting the fair value of any collateral obtained by the Bank from the borrowers. Due to the difficult economic conditions, the differences between the profit under IFRS and Romanian regulations increased, some banks reporting losses under national regulations and profits under IFRS. Following the requirements of banks representatives and recommendations received from the World Bank and the International Monetary Fund, the National Bank of Romania issued the Order no. 9/2010 stating that endorsed IFRS will be have to be applied for the preparation of the individual financial statements of credit institutions starting 2012. In order to inform regulators during the transition period credit institution are required to prepare a second set of individual financial statements for 2009, 2010 and 2011 under endorsed IFRS. The National Bank of Romania issued the Order no. 27/2010 containing accounting regulations in conformity with IFRS. The Order becoming effective starting January 1 2012 is to be applied together with the Accounting Law, IFRSs as well as with other applicable regulations.

At the end of 2009 the OMFP no. 3055 was issued to replace the OMFP no. 1752/2005, and continued the harmonization with the European Directives but includes even more provisions from IFRSs. OMFP no 3055/2009 [37] was supplemented and modified by the OMFP no 2.869/2010. The financial statements prepared in accordance with OMFP no. 3055/2009 shall give a true and fair view (ro. 'o imagine fidelă') of the entity's assets, of liabilities, of the financial position, and of profit or loss. Also, the administrators need to sign a declaration by which they assume responsibility for the preparation of the financial statements and confirm that:

- the accounting policies used when preparing the financial statements comply with applicable accounting regulations;
- the financial statements give a true and fair view of the financial position, financial performance and other information pertaining to the company's activity;
- the legal person is a going concern.

As previously mentioned, many of the definitions, recognition and valuation rules are inspired from IFRSs, which may suggest that Romania is following a process of convergence towards IFRSs. Only indirectly IFRSs influence accounting regulations (and hopefully practices) through some of the provisions of the Order. However, [3] conclude that the application of IAS in the first phase was very limited (despite the large de jure application) and that the change process towards IFRS is more visible nowadays, because users begin to require better accounting information, auditors are more demanding, and preparers become better qualified.

However, taxation is in practice very linked to accounting and even though the tendency is to increase the role of professional judgment, Romanian accountants apparently still prefer rule-based accounting regulations [2]. For example, local taxes on land and buildings drive the revaluation of fixed assets in financial statements (the incentive being determined by the fact that an increased tax rate applies when land and buildings are not revalued). In a presentation of the financial reporting in Romania, [14] adds as considerations for investors and users that the primary function of accounting was considered for a long time as being taxation compliance, thus the reported information reflects “form over substance”. Also, as reported by the World Bank, the quality assurance system and enforcement mechanisms for general purpose financial statements and audit requirements remain weak [38].
Generally, we can conclude that the post-communist Romanian accounting model suffered various and sometimes contradictory sources of influence (namely, French, British, IAS/IFRSs and European Directives), but the process of accounting change in practice was rather slow. Taxation, the orientation towards the State as the main user, the preference for rule-based regulations still characterize Romanian accounting practice. Reliance by lenders and investors on financial statements prepared according to national regulations still appears limited. This conclusion is in line with those arguing that the quality of the financial reporting depends on local institutional factors such as the improvements in the capital market regulations, economic development policy or corporate governance [12].

4 Reporting Issues

In Romania it is the Order of the Minister of Public Finance no. 3.055/2009, November, modified in 2010, December (further referred as OMFP 3055), which currently foresees accounting principles and rules to be applied in recognizing, measuring, derecognizing and presenting the elements of annual financial statements. We will further synthesis these provisions based on OMFP 3055 as well as on a comparative study of the Romanian Accounting Regulations and the International Financial Reporting Standard for Small and Medium-sized Entities that was developed through the Body of Expert and Licensed Accountants of Romania (CECCAR) [40].

4.1 Intangible Assets

An **intangible asset** must be recognized within the balance sheet in case it is estimated that it will generate future economic benefits for the entity and its cost can be determined in a reliable manner. In order to establish if an internally generated intangible asset fulfils the recognition criteria an entity classifies the asset’s generating process into a research phase and a development phase. In case such a distinction cannot be made, the entity will consider all expenses being caused by such an internal project of generating an intangible asset as belonging to the above mentioned research phase. Research costs (or those belonging to the research phase of an internal project) are expensed. An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use it or sell it;
- its ability to use or sell the intangible asset;
- the manner in which an intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate either the existence of a market for the output of the intangible asset or for the intangible asset itself, or, if it is to be used internally, the usefulness of the intangible asset;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset;
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Intangible assets are initially recognized at **acquisition cost** or **production cost**. An element which was recognized as expense within a reporting period cannot subsequently be recognized as part of an intangible asset’s cost. Subsequent expenditure on an intangible asset after its purchase or completion is recognized as expense on their incurrence. Only in case such subsequent expenditure is probable to enable the asset to generate future economic benefits that exceed its originally assessed standard of performance and the expenditure can be measured in a reliable manner, then the corresponding intangible asset's cost will include the expenditure.

Start-up costs may be capitalized, in which case they must be amortized over a maximum period of 5 years. If the start-up costs have not been completely amortized, no distribution of profits shall take place unless the amount of the reserves available for distribution and of the retained earnings (profit) at least equals that of the expenses not written off.

Intangible assets are carried at **cost less any accumulated amortization and any accumulated impairment losses**. All intangible assets are considered to have finite lives. The residual value is always zero.

An intangible asset must be derecognized on disposal or when no future economic benefits are further expected from its use or disposal. Entities are required to recognize separately the proceeds from the disposal and the expenses for the net carrying amount and cost related to the disposal, but they have to determine and present the gain or loss arising from derecognizing an intangible asset in the income statement as "Other operating income" or "Other operating expenses".

4.2 Tangible Assets

Tangible assets must meet the following criteria:

- are held for use in the production or supply of goods or services, for rental to others, or
- for administrative purposes; and
- are used for a period that exceeds 1 year, and are initially measured at cost. Subsequent expenditure must usually be recognized as expense once it occurs. The cost of repairing tangible assets with the purpose of their continuous use must also be recognized as expense once it occurs. Only in case such subsequent expenditure is probable to enable the asset to generate future economic benefits that exceed its originally assessed standard of performance it can be recognized as a component of the corresponding tangible asset. The investments in rented tangible assets should be capitalized and depreciated over the period of the contract. Cash discounts are not subtracted from the acquisition cost, but recognized as financial income. Trade discounts received in subsequent invoices adjust the operating charges. There are no discounting requirements if payment is deferred beyond the normal credit terms. Borrowing costs may be capitalized for assets that necessarily take a substantial period of time to get ready for their intended use or sale.

Tangible assets' cost is being allocated over their useful life, Romanian Accounting Regulations having no requirements of subtracting the residual value. Depreciation is calculated and recorded starting with the next month after the one when the asset is put into service. Four depreciation methods are mentioned within accounting regulations: the straight-line method, the diminishing balance method, the accelerated method and a method based on usage, such as the units of production method when the assets' nature justifies the use of such a method. In accordance to the accelerated method up to half of the asset's value is depreciated during the first year and the remaining value is depreciated under the straight-line method by considering the remaining years of useful life. Since the recorded depreciation must be correlated with the manner in which assets are being used and considering the fact that it rarely happens for a tangible asset to be 50% consumed during its first year of service, the accelerated method is more rarely used with accounting purposes. The depreciation method is considered an accounting policy.

In order to establish tangible assets' useful life we must make use of the Government' Decision No. 2139/2004, November (published in January 2005) approving the Catalogue regarding tangible assets' classification and useful life. The useful life as defined within the catalogue represents assets' service period throughout which their cost is being recuperated from a fiscal point of view through depreciation. The catalogue actually establishes the minimum and maximum limits of the interval within which companies must establish tangible assets' useful life in accordance to the manner in which they are being used. Meanwhile OMFP 3055 defines the useful life of an asset as representing:

- the period throughout which an asset is foreseen to be available so that it can be used by an entity; or

- the number of units being produced or of similar units that are estimated to be possible to obtain by the entity through using the above mentioned asset.

Expenses generated while recording tangible assets' depreciation are considered deductible in accordance to certain provisions of Law 571/2003, December regarding the Fiscal Code. The Fiscal Code imposes a certain fiscal value that needs to be exceeded in order for a tangible asset to be considered non-current. Currently this value is 1.800 RON. The Fiscal Code's rules with respect to establishing the depreciation methods are as follows:

- the straight-line method applies for buildings;
- when considering plant and machinery, motor vehicles as well as computers the tax payer may choose between the straight-line method, the diminishing balance method and the accelerated method;
- for any other tangible asset the tax payer may choose between the straight-line method and the diminishing balance method.

The **Fiscal Code** also describes how fiscal depreciation must be calculated by considering all the mentioned depreciation methods. When considering the straight-line method, depreciation is calculated by applying the straight-line depreciation rate (r) to the tangible asset's fiscal value (TAFV) on the date it entered the entity.

$$depreciation = TAFV \times r_{sl} = TAFV \times \frac{1}{UL_t} \quad (1)$$

where:
TAFV - the tangible asset's fiscal value;
UL_t – total useful life
r_{sl} – depreciation rate for straight-line method

When considering the diminishing balance method, the straight-line depreciation rates are multiplied with one of the following coefficients (k):

- 1,5 if the tangible assets' useful life is between 2 and 5 years;
- 2,0 if the tangible assets' useful life is between 5 and 10 years;
- 2,5 if the tangible assets' useful life is more than 10 years.

$$depreciation = min\left[\left((TAFV - CD) \times r_{db}\right); \frac{TAFV-CD}{UL_r}\right] \quad (2)$$

$$depreciation = min\left[\left((TAFV - CD) \times r_{sl} \times k\right); \frac{TAFV-CD}{UL_r}\right] \quad (3)$$

where:
TAFV - the tangible asset's fiscal value;
CD – cumulated depreciation
UL_r – remained useful life
r_{sl} – depreciation rate for straight-line method
r_{db} – depreciation rate for diminishing balance method

When considering the accelerated method, the depreciation being recognized for the first year mustn't exceed 50% of the tangible asset' fiscal value on the date it entered the entity while the remaining value is depreciated under the straight-line method by considering the remaining years of useful life. Fiscal amortization is also calculated starting with the next month after the one when the asset is put into service. Depreciation deductions are determined without consideration of the accounting depreciation.

$$depreciation_{y_1} = TAFV \times \frac{1}{2} \quad (4)$$

$$depreciation_{y_{2-n}} = TAFV \times r_{sl} = TAFV \times \frac{1}{UL_t} \quad (5)$$

where:
TAFV - the tangible asset's fiscal value;
UL_t – total useful life
r_{sl} – depreciation rate for straight-line method
y_1 – first year of depreciation
y_{2-n} – second and the following years of depreciation

Tangible assets are carried at **cost less any accumulated depreciation and any accumulated impairment losses**. In addition, there is a revaluation model option, according to which classes of tangible fixed assets are carried at a re-valued amount less any accumulated depreciation and subsequent accumulated impairment losses. If a revaluation results in a value increase, it should be credited to a revaluation reserve, unless it represents the reversal of a revaluation decrease of the same asset previously recognized as an expense, in which case it should be recognized as income. A decrease arising as a result of a revaluation should be recognized as an expense to the extent that it exceeds the existing revaluation reserve relating to the same asset. The revaluation reserve is not distributable. When a re-valued asset is disposed of, any revaluation reserve is transferred directly to other reserves. The transfer may be done during the useful life for the amount of the additional depreciation generated by revaluation. Revaluation is permitted only at the end of the year.

A tangible fixed asset should be removed from the balance sheet on disposal or when no future economic benefits are expected from its use. Entities are required to recognize separately the proceeds from the disposal and the expenses for the net carrying amount and costs of disposal, but they have to determine and disclose the gain or loss arising from the disposal in the income statement as “Other operating income” or “Other operating expenses”. In case of a partial or complete destruction of tangible fixed assets, the receivables or indemnifications to be received from third parties, the acquisition and construction of new assets are different transactions that are recorded separately.

In order to establish if intangible assets and tangible assets are impaired at the balance sheet date, besides actual findings, some external and internal sources of information can be considered. In terms of external sources of information accounting regulation mention the following:

- during the period, an asset’s market value has declined significantly more than would be expected as a result of the passage of time or normal use;
- significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

Meanwhile, internal sources of information are exemplified as follows:

- evidence is available regarding the obsolescence or physical damage of an asset;
- significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;
- evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

Entities should recognize a valuation adjustment for the difference between the carrying amount and the inventory value (which may be a discounted value determined by professionals). The cash-generating unit and recoverable amount concepts don’t exist in the national regulation. Impairment is determined at the balance sheet date. An impairment loss is recognized immediately in profit or loss, excepting impairment loss determined for re-valued assets. When assets are derecognized their corresponding impairment must be annulled in correspondence with income.

4.3 Leases

In accordance to Romanian Accounting Regulations a lease contract is an agreement through which the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or s series of payments. A finance lease is the lease contract that transfers most of the risks and advantages related to the asset’s ownership, while an operating lease is a lease contract that does not fall into the finance lease category. Classifying a lease contract as either finance or operating is done at the inception of the contract.

A **lease contract** can therefore be classified as a **finance lease** in case it fulfils at least one of the following conditions:

- transfer of ownership of the asset takes place by the end of the lease term;

- the lessee has the option of buying the asset at a price that is estimated to be sufficiently lower when compared with its fair value at the date when the option becomes active (the bargain purchase option); a the inception of the contract this has the role of offering a reasonable assurance of the fact that the option will be used;
- the lease term is for the major part of the economic life of the asset even if transfer of ownership did not take place;
- at the inception of the lease the total of minimum lease payments (excluding accessory costs) is greater than or equal to the cost of acquisition of the leased asset for the lessor;
- leased assets are of a specialized nature, so that only the lessee can use them without major changes.

In a finance lease, the lessee recognizes the asset and the liability by considering the lessor's acquisition cost. The asset is depreciated by the lessee following its accounting policy for similar assets. For sale-and-lease back transactions resulting in a lease back of a finance lease, the asset is not derecognized and a liability is recognized for the selling price. In case the financial lease liability is expressed in a foreign currency or denominated in a foreign currency than the liability will be recognized within the balance sheet by considering the exchange rate given by National Bank of Romania.

In an **operating lease** the lessor recognizes the asset at acquisition cost. The asset is depreciated by the lessor following its accounting policy for similar assets. For sale-and-lease back transactions resulting in an operating lease, two separate transactions are recorded: the sale of the asset and the lease. The resulted gain is recognized entirely in the profit and loss account. There is no requirement to compare the selling price with fair value.

4.4 Financial Assets

The definition of a **financial asset** as presented by Romanian Accounting Regulations is actually identical to that presented through IAS 32, a financial asset being any asset that is:

- cash;
- an equity instrument of another entity;
- a contractual right:
  - to receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

Furthermore specific provisions exist for long term financial investments and short term financial investments.

Long term financial investments are initially being recognized at **acquisition cost** or the value determined through the contract of their obtaining. Long term financial investments received by donation determine the recording of a reserve. In terms of their subsequent measurement, long term financial investments are carried at **cost less any accumulated impairment losses**.

Short term financial investments are initially measured at **cost** and further carried at **cost less any accumulated impairment losses**. Only short term financial investments in securities that are traded on a regulated market are measured at the **market price** on the balance sheet date with differences (pluses or minuses) generating financial income or financial expense. Short term financial investments received by donation generate the recognition of a financial income.

The acquisition cost of both short term financial investments in securities that are not traded on a regulated market and of long term financial investments includes transaction costs that are directly attributable to their acquisition. When considering short term financial investments in securities that are traded on a regulated market, their acquisition cost does not include transaction costs that are directly attributable to their acquisition, these only generating an expense.

Fair value may be used in the subsequent measurement of financial instruments within the consolidated accounts. Fair value measurement is not used for held to maturity financial instruments, not held for trading loans and receivables issued by the entity, for interests in subsidiaries, associates, joint ventures, capital instruments issued by the entity, and for instruments resulting from contingent arrangements in business combinations. The resulting gain and loss is recognized in profit and loss, except for financial instruments used as hedging instruments and the currency exchange gains or losses resulting from the net investment in a foreign entity. When considering the later, the resulting gain and loss go straight to equity through a fair value reserve. There are no provisions on hedge accounting.

There are no detailed derecognition criteria for financial assets (nor liabilities).

4.5 Receivables

On initial recognition **receivables** are measured at **nominal value**. When considering the balance sheet date measurement the entity must establish receivables' inventory value based on the probability if their encashment. The minuses being recorded between receivables' therefore established inventory value and accounting value is recorded through adjustments for impairment. Value adjustments should be recorded for receivables for the amount that it is estimated that will not be recovered. Therefore value adjustments must also be recorded when dealing with doubtful customers or customers in litigation.

Foreign currency receivables and those denominated in a foreign currency are subsequently measured by using the exchange rate given by National Bank Romania at the end of the reporting period. Any favorable or unfavorable exchange rate differences are recognized as financial income or financial expense.

In order to derecognize receivables whose encashment dates are prescribed entities must demonstrate that all legal steps have been exhausted for their settlement.

4.6 Inventories

Romanian Accounting Regulations define **inventories** as current asset:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of raw materials and consumables that are to be used in the production process or in the rendering of services.

The accounting policies specific to inventories are also applicable to work in progress under construction contracts, buildings produced by entities whose main activity is the production and the sale of buildings, land purchased in order to build on it buildings that will be sold, biological assets, and agricultural produce. Some transfers from tangible assets to inventories or from inventories to tangible assets might be necessary in case the asset's destination changes during the accounting period. The transfer is done at the accounting value of the transferred asset. For re-valued tangible assets, the revaluation reserve is realized in the moment of the transfer. Transferring an asset from tangible assets to inventories can only be done if a change in the use of the asset incurs and it can be documented through the initiation of modernization works on the asset with the purpose of its selling. Modernization represents subsequent expenses that are recognized as part o the asset. In case the entity wants to sell a tangible asset without developing any modernization work on it then the asset continues to be recognized as tangible asset until its derecognition due to its selling. Transfer does therefore no longer apply in this case.

Inventories' initial recognition is done at cost which can be acquisition cost or production cost. These costs must include all costs that are related to inventories' purchase and processing as well as other costs that incur while bringing the inventories to their present location and condition. Cash discounts are not subtracted from the acquisition cost, but recognized as financial income. Received trade (or commercial) discounts that are comprised on the acquisition invoice adjust inventories' acquisition cost by reducing it. Trade (or commercial) discounts that are received in subsequent invoices, regardless of the period they refer to, are distinctively recorded as commercial discounts and affect third party accounts. Borrowing cost may be capitalized for inventories that necessarily take a substantial period of time to get ready for its intended use or sale.

Inventories should be written down to net realizable value if lower than the cost. This is done through the use of impairment adjustments which are determined by comparing inventories' accounting value and their inventory value. Impairment adjustments therefore bring inventories to their net realizable value.

The cost of inventories used is assigned by using one of the following: first-in, first-out (FIFO), weighted average cost formula and last-in, first-out (LIFO). The same cost formula is used for all inventories that have a similar nature and use to the entity.

4.7 Cash and Equivalents

In accordance to the Romanian Accounting Regulations the bank accounts category of assets comprises: outstanding values such as cheques payable and bills of exchange receivables; cash at bank in lei and cash at bank in foreign currencies; short term bank loans as well as interest to cash at bank and interest to loans being provided by bank into current accounts. Initial recognition is done based on the nominal value.

When filling in the inventory lists, postage and fiscal stamps, holiday vouchers, transport tickets and other such cash equivalents are presented at their nominal value. In some cases when such cash equivalents are impaired or not used the entity recognizes impairment losses. Foreign currency cash and equivalents are recognized within the balance sheet by using the exchange rate given by National Bank of Romania at the end of the reporting period. Exchange rate differences, favorable or unfavorable, generate financial income or expense.

4.8 Equity

Romanian Accounting Regulations define **equity** as the residual interest in the entity's assets after deducting all its liabilities and stipulate its components as follows: capital, share premiums, reserves, retained earnings and result of the period.

We must now also make reference to Law No. 31/1990, known as the Companies' law in order to discuss legal requirements for companies' subscriber capital. The law defines 5 types of companies and their characteristics. Among these, private limited companies or SRL (societate cu răspundere limitată) in Romanian are required to have a minimal subscribed capital of 200 RON.

Equity instruments are measured at the **issuance price**. There is no discounting requirement if payment is deferred and the time value of money is material. If the equity instruments are issued before the entity receives the cash or other resources, the entity shall present the amount receivable as an asset (receivable). There are not specific split accounting requirements for convertible loans. Convertible loans are recognized as liabilities and transferred to equity when the conversion option is exercised. The conversion premium is determined as a difference between the nominal value of the loan and the value of shares issued according to the contract.

Treasury shares purchased are deducted from the equity at the fair value of the consideration given. The entity does not recognize a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares. The amount being received or paid within such operations is recognized straight to equity (earnings connected with selling or annulment of equity instruments or losses connected with issue, buy-back, selling, cession free of charge or annulment of equity instruments). Costs related to the issuance of equity instruments are recognized within owners' equity when they don't fulfill the conditions to be recognized as start-up costs.

4.9 Provisions

Provisions are meant to cover liabilities with a clearly defined nature that the entity at the balance sheet date knows are probable to exist or is sure will exist, while these liabilities are of uncertain amount and timing. A provision can only be recognized when:

- the entity has a current obligation as a result of past events;
- it is probable (more likely than not) that the entity would be required to transfer economic benefits in settlement of the obligation;
- a reliable estimation can be made upon the value of the obligation.

Recognizing a provision involves the **recognition of the corresponding expense**. The value being recognized as a provision must represent the best estimation of the costs that are necessary to settle the current obligation at the balance sheet date. The best estimation of the costs that are necessary to settle the current obligation is the amount the entity would rationally pay in order to settle the obligation at the balance sheet date or in order to transfer the obligation to a third party at the same moment in time.

When the effect of the time value of money is material discounting is permitted. Discounting of provisions is usually done by professional evaluator. The used discount rate reflects current market assessments of the time value of money and of the risks that are specific to the liability. Entities shall exclude gains from the expected disposal of assets when measuring a provision. In case the entity estimates that some or all of the amounts required settling a provision will be reimbursed by a third party, the reimbursement must only be recognized when received. The reimbursement must be considered as a separate asset.

Provisions are recognized for elements such as:

- litigations, fines, penalties, damages and other uncertain liabilities;
- charges related to service activity during the guarantee period;
- other charges related to guarantees granted to customers;
- restructuring activities;
- pensions and similar obligations;
- decommissioning of PPE and other similar activities;
- tax;
- profit-sharing bonuses to be granted to employees according to legal or contractual prescriptions;
- benefits granted to employees for termination as a result of the decision of the entity to terminate the contract before retirement date or the decision of an employee to leave in exchange of these benefits;
- other benefits granted to employees or their dependencies which are not related to a restructuring;
- charges related to environment protection;
- obligations assumed together with an external party;
- contractual obligations to maintain the infrastructure at a certain level of functioning in service concession contracts.

Provisions must be reconsidered at each balance sheet date and adjusted so that they reflect the best possible current estimation. In case it is not probable anymore that the entity would be required to transfer economic benefits in settlement of an obligation the provision must be annulled in correspondence to income. Provisions will only be used for the purpose they were initially recognized for.

4.10Liabilities

Liabilities are initially recognized at their **nominal value**. At the balance sheet date the entity must establish liabilities' inventory value based on the probability of their payment. Any positive differences between the therefore established liabilities' inventory value and their accounting value must be recognized upon the corresponding liability.

Foreign currency liabilities and those denominated in a foreign currency are subsequently measured by using the exchange rate given by National Bank Romania at the end of the reporting period. Any favorable or unfavorable exchange rate differences are recognized as financial income or financial expense.

Salaries and social security contributions are recognized as a liability after deducting the amounts that have been paid to the employees in the period in which the employees have rendered their service. The amounts recognized are measured at the undiscounted amount of benefits expected to be paid in exchange for that service.

In order to derecognize liabilities whose encashment dates are prescribed entities must demonstrate that all legal steps have been exhausted for their settlement.

5 Official Forms of Financial Statements

In respect with the general underlying principles for the preparation of financial statements, the main differences between the provisions of OMFP no. 3055/2009 and the IFRS for SMEs are [40]:

- the Order does not recognize explicitly decision usefulness as the main purpose of the financial statements;
- the Order states the layout and the title of the financial statements, while the IFRS for SMEs only presents the information that should be included and permits the use of other titles as long as they are not misleading;
- The Order only allows aggregation of balance sheet and income statement items preceded by Arab numbers, with details being required in the notes. Presentation of material items can be done only in the notes.

5.1 Balance Sheet

The **major difference between Romanian legislation and IFRS for SMEs** are following [40]:

- the IFRS for SMEs requires the classification of assets and liabilities according to the current/non-current distinction, except when a presentation based on liquidity provides more reliable and more relevant information. The Order 3055/2009 classifies the assets in three main categories: fixed assets, current assets and prepayments, respecting the current/non-current criterion. Liabilities are classified in liabilities payable within/or in more than one year (based on their liquidity), provisions and deferred income. Two indicators are presented on the face of the balance sheet (net current assets/net current liabilities and total assets less current liabilities);
- The IFRS for SMEs requires separate presentation of biological assets, which is not explicitly required in the Order;
- The IFRS for SMEs requires financial statements items to be presented based on their informational input, while the aggregation or disclosure of additional items is a matter of professional judgment.

A			**Fixed Assets**
	I		***Intangible Assets***
		1	Set up Expenses
		2	Development Costs
		3	Concessions, Patents, Licenses, Trademarks and Similar Rights and Assets
		4	Goodwill
		5	Advance Payments to Suppliers of Intangible Assets and Intangible Assets in Course
	II		***Tangible Assets***
		1	Land and Buildings
		2	Plant and Machinery
		3	Other Fixtures and Fittings, Tools and Equipment
		4	Advance Payments to Suppliers of Tangible Fixed Assets and Tangible Assets in Progress
	III		***Fixed Financial Assets***
		1	Shares in Affiliated Undertakings
		2	Loans to Affiliated Undertakings
		3	Participating Interests
		4	Loans to Undertakings with which the Company is Linked by Virtue of Participating Interests
		5	Investments Held as Fixed Assets
		6	Other Loans

B			**Current Assets**
	I		***Inventories***
		1	Raw Materials and Consumables
		2	Work in Progress
		3	Finished Goods and Goods for Resale
		4	Advances Granted to Suppliers of Inventories
	II		***Receivables*** (amounts due after one year must be disclosed separately for each item)
		1	Trade Receivables
		2	Amounts to be Received from Affiliates
		3	Amounts Owed by Undertakings with which the Company is Linked by Virtue of Participating Interests
		4	Other Receivables
		5	Subscribed Capital – Amounts Receivable Related to Capital
	III		***Short-Term Investments***
		1	Shares in Affiliated Undertakings
		2	Other Short-Term Investments
	IV		***Cash at Bank and in Hand***
C			Prepayments
D			**Creditors: Amounts Becoming Due and Payable within One Year**
		1	Debenture Loans, Showing Convertible Loans Separately
		2	Amounts Owed to Credit Institutions
		3	Payments Received on Account of Suppliers' Orders
		4	Trade Creditors
		5	Bills of Exchange Payables
		6	Amounts Owed To Affiliated Undertakings
		7	Amounts Owed To Undertakings with which the Company Is Linked By Virtue of Participating Interests
		8	Other Creditors/Payables Including Tax and Social Security
E			**Net Current Assets/Net Current Liabilities** = (B + C – D – Deferred Income realizable in Less than One Year)
F			**Total Assets Less Current Liabilities** = (A + E)
G			**Liabilities: Amounts Becoming Due and Payable After More than One Year**
		1	Debenture Loans, Showing Convertible Loans Separately
		2	Amounts Owed to Credit Institutions
		3	Advance Payments Received From Customers
		4	Trade Creditors
		5	Bills of Exchange Payables
		6	Amounts Owed To Affiliated Undertakings
		7	Amounts Owed To Undertakings with which the Company Is Linked By Virtue of Participating Interests
		8	Other Creditors/Payables Including Tax and Social Security
H			**Provisions**
		1	Provisions for Pensions and Similar Obligations
		2	Provisions for Taxation/Taxes
		3	Other Provisions
I			**Deferred Income**
		1	Investment Subsidies
		2	Deferred Income, of which Amounts Realizable Within One Year / Amounts Realizable in More than One Year
J			**Capital and Reserves**
	I		***Share Capital***
		1	Subscribed and Paid in Share Capital
		2	Subscribed and Not Paid in Share Capital

	II		***Share Premium***
	III		***Revaluation Reserve***
	IV		***Reserves***
		1	Legal Reserve
		2	Reserves Provided for by the Articles of Association
		3	Reserves Related to the Realized Revaluation Reserve
		4	Other Reserves
			Own Shares
			Gains Related to Owners' Equity Instruments
			Losses Related to Owners' Equity Instruments
	V		***Profit or Loss Brought Forward***
	VI		***Profit or Loss for the Financial Year***
			Profit Appropriation

5.2 Profit/Loss Statement

The major difference between Romanian legislation and IFRS for SMEs are following [40]:

- the Order does not require the presentation of a statement of comprehensive income;
- the Order prescribes the classification of operating expenses by nature and a presentation by function in the notes, while the IFRS for SMEs allows the choice of the classification method;
- the Order requires separate presentation of extraordinary items.

1		Net Turnover
2		Revenue Related to the Manufacturing Cost of Finished Goods and Work-in-Progress
3		Work Performed by the Undertaking for Its Own Purposes and Capitalized (With Reference to Tangible and Intangible Fixed Assets)
4		Other Operating Revenue
		Total Operating Revenue
5	a	Expenses with Raw Materials and Consumables
		Other Expenses with Materials
	b	Other External Expenses (Electricity and Water)
	c	Expenses with Goods Bought for Resale Sold
6		Staff Costs
	a	Wages and Salaries
	b	Social Security Costs
7	a	Value Adjustments in Respect of Tangible and Intangible Fixed Assets
	a1	Expenses
	a2	Revenue
	b	Value Adjustments in Respect of Current Assets
	b1	Expenses
	b2	Revenue
8		Other Operating Expenses
		Value Adjustment for Provisions • Expenses • Revenue
		Total Operating Expenses
		Operating Profit or Loss
9		Revenue from Participating Interests • of which arising from affiliated undertakings
10		Revenue from Other Investments and Loans Forming Part of the Fixed Assets • of which arising from affiliated undertakings / out of which, within the group
11		Interest Revenue • of which arising from affiliated undertakings / out of which, within the group
		Other Financial Revenue
		Total Financial Revenue

12		Value Adjustments in Respect of Financial Assets and of Investments Held as Current Assets • Expenses • Revenue
13		Interest Expense • of which arising from affiliated undertakings / out of which, within the group
		Total Financial Expenses
		Financial Profit or Loss
14		**Current Profit or Loss**
15		Extraordinary Revenue
16		Extraordinary Expenses
17		**Profit or Loss from Extraordinary Activities**
		Total Revenues
		Total Expenses
		Gross Profit or Loss
18		Tax on Profit
19		Other Taxes Not Shown Under The Above Items
20		**Profit or Loss for the Financial Year**

5.3 Cash Flow Statement

Under the OMFP 3055/2009, the statement of cash flows and the statement of changes in equity are mandatory only for companies presenting a complete set of financial statements and optional for entities presenting abridged accounts (some SMEs) [40]. The national regulation does not permit the presentation of a combined statement of income and retained earnings as IFRS for SMEs does.

Other than that, the provisions of the Order are generally in line with those of the IFRS for SMEs in respect with the presentation of these two financial statements.

Direct method

Cash flow from operating activities
Cash receipts from customers
Payments made to suppliers and employees
Interest paid
Income tax paid
Cash receipt from earthquakes insurance
Net cash flow from operating activities

Cash flow from investing activities
Payments for investments
Payments for property, plant and equipments
Cash receipts from sale of property, plant and equipments
Interest received
Dividends received
Net cash flow from investing activities

Cash flow from financing activities
Cash received from the issuance of share
Cash received from long term debts
Payments for long term lease agreements
Dividends paid
Net cash flow from financing activities

Total net cash flow
Cash and cash equivalents as of the beginning of the year
Cash and cash equivalents as of the ending of the year

Indirect method (optional)

Profit or loss before taxation
Adjustments for:
Depreciation expense
Net modifications in adjustments and provisions
Financial expenses
Financial revenues
Loss/gain on disposal of fixed assets
Increase/decrease in trade receivables and other commercial receivables
Increase/decrease in trade payables and other commercial payables
Increase/decrease in inventories
Interest paid
Tax on profit paid
Net cash flow from operating activities

6 Major Differences from IFRS and IFRS for SMEs

We will further discuss and synthesize main differences between Romanian Accounting Regulations and the International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs) while considering the elements being discussed within the section that is dedicated to reporting issues. Once again our analysis is based on the provisions within the International Financial Reporting Standard for Small and Medium-sized Entities, that of Romanian Accounting Regulations (OMFP 3055) and also the a comparative study of the Romanian Accounting Regulations and the International Financial Reporting Standard for Small and Medium-sized Entities being developed by the Body of Expert and Licensed Accountants of Romania (CECCAR) [40]. Only main differences are briefly presented since particularities of Romanian Accounting Regulations have already been discussed.

Intangible assets

In the case of start-up activities (i.e. start-up costs) the IFRS for SMEs stipulates that an entity shall recognize expenditure incurred internally on an intangible item, including all expenditure for both research and development activities, as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in this IFRS.

In accordance to Romanian Accounting Regulations start-up costs may be capitalized and amortized over a maximum period of 5 years. Moreover, if the start-up costs have not been completely amortized, no distribution of profits shall take place unless the amount of the reserves available for distribution and of the retained earnings (profit) at least equals that of the expenses not written off. Research costs are also expensed in accordance to OMFP 3055 while an intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following [40]:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use it or sell it;
- its ability to use or sell the intangible asset;
- the manner in which an intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate either the existence of a market for the output of the intangible asset or for the intangible asset itself, or, if it is to be used internally, the usefulness of the intangible asset;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset;
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Some differences also appear when referring to intangibles’ useful life and residual value. The IFRS for SMEs stipulates that an entity shall assume that the residual value of an intangible asset is zero unless:

- there is a commitment by a third party to purchase the asset at the end of its useful life, or
- there is an active market for the asset and:

- residual value can be determined by reference to that market, and
- it is probable that such a market will exist at the end of the asset's useful life.

The useful life is determined based on the contractual period of the asset or of other legal rights and cannot be indefinite. Where management cannot determine the useful life, it is assumed to be 10 years. Meanwhile Romanian Accounting Regulations do not stipulate how an entity should handle a situation when it might be unable to make a reliable estimate of the useful life of an intangible asset. Also the residual value is always zero.

Tangible assets

The definition of tangible assets in accordance to Romanian Accounting Regulations is consistent with that of the IFRS for SMEs, without any exclusion from the scope. The provision that land and buildings are separable assets even if they are purchased together is also similar within the two sets of accounting standards. Meanwhile, Romanian Accounting Regulations explain tangible fixed assets in transit for which risks and rewards were transferred should be reflected separately. Some differences appear in terms of tangible assets' costs, the IFRS for SMEs stating that the cost of an item of property, plant and equipment is the cash price equivalent at the recognition date and if payment is deferred beyond normal credit terms, the cost is the present value of all future payments. Romanian Accounting Regulations stipulate no discounting requirements if payment is deferred beyond the normal credit terms. While the IFRS for SMEs stipulates that an entity shall recognize all borrowing costs as an expense in profit or loss in the period in which they are incurred, OMFP 3055 allows for borrowing costs to be capitalized for qualifying assets. Qualifying assets necessarily take a substantial period of time to get ready for their intended use or sale. Accounting policies that are specific to tangible assets are also applied for biological assets and agricultural produce [40].

Leases

Some differences may be observed when expressing examples of situations that would normally lead to a lease being classified as a finance lease. The IFRS for SMEs mentions that at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset while OMFP formulates at the inception of the lease the total of minimum lease payments (excluding accessory costs) is greater than or equal to the cost of acquisition of the leased asset for the lessor. The IFRS for SMEs stipulates that the assets and liabilities are recognized at fair value or, if lower, at the present value of the minimum lease payments at the inception of the lease. The present value of minimum lease payment is discounted using the interest rate implicit in the lease. In accordance to Romanian Accounting Regulations, in a finance lease, the lessee recognizes the asset and the liability at the cost of acquisition for the lessor. Other particularities of Romanian Accounting Regulations stipulate the following: for sale-and-lease back transactions resulting in a lease back of a finance lease, the asset is not derecognized and a liability is recognized for the selling price; for sale-and-lease back transactions resulting in an operating lease, two separate transactions are recorded: the sale of the asset and the lease; the resulted gain is recognized entirely in the profit and loss account; there is no requirement to compare the selling price with fair value; there are no provisions for the accounting of leasing contracts for a manufacturer lessor.

Financial assets

Romanian Accounting Regulations employ a series of particularities that were discussed in detail within the section that is dedicated to reporting issues. What we must emphasize is the fact that they don't include the term of amortized cost and don't stipulate any derecognition criteria or provisions on hedge accounting. Also fair value is stipulated as an alternative measurement for financial instruments within consolidated financial statements.

Receivables

We found no significant differences between the IFRS for SMEs and Romanian Accounting Regulations where receivables are concerned.

Inventories

Inventories related accounting policies with Romanian Accounting Regulations are also applicable to work in progress under construction contracts, buildings produced by entities whose main activity is the production and the sale of buildings, land that is purchased in order to build on it buildings that will be sold, biological

assets and agricultural produce. Some particularities appear when transferring an asset from tangible assets to inventories. This can only be done if a change in the use of the asset incurs and it can be documented through the initiation of modernization works on the asset with the purpose of its selling.
Romanian Accounting Regulations stipulate that inventories should be written down to net realizable value if lower than the cost. Meanwhile the IFRS for SMEs stipulates that an entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell. While the meaning is the same, the term net realizable value is not used by the IFRS for SMEs.
In accordance to Romanian Accounting Regulations borrowing cost may be capitalized for inventories that take a substantial period of time to get ready for its intended use or sale. The last-in, last-out (LIFO) cost formula which is not permitted by the IFRS for SMEs is allowed by OMFP 3055. In terms of techniques for measuring the cost of inventories, the most recent purchase price measurement technique is not allowed in accordance to Romanian Accounting Regulations [40].

Cash and equivalents
Romanian Accounting Regulations include short term bank loans in the cash and equivalents category, short term referring to less than 1 year. Meanwhile the IFRS for SMEs stipulates that cash equivalents are short-term, highly liquid investments held to meet short-term cash commitments rather than for investment or other purposes and therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, 3 months or less from the date of acquisition.

Equity
When referring to equity instruments, Romanian Accounting Regulations stipulate they must be measured at the issuance price, but comprise no discounting requirement if payment is deferred and the time value of money is material. Also they comprise no specific split accounting requirements for convertible loans. Convertible loans are recognized as liabilities and transferred to equity when the conversion option is exercised.

Provisions
In case some or all of the amounts required to settle a provision may be reimbursed by a third party, Romanian Accounting Regulations only allows for the entity to recognize the reimbursement as a separate asset when it is received with no maximum limit restriction regarding the reimbursement value. Meanwhile the IFRS for SMEs allows for the reimbursement to be recognized once it is virtually certain that the entity will receive the reimbursement and the amount recognized shall not exceed the amount of the provision.

Liabilities
The constructive obligation is not approached within Romanian Accounting Standards in defining liabilities. When classifying a liability as current, two of the four situations presented by the IFRS for SMEs are not stipulated by OMFP 3055, namely when the entity: holds the liability primarily for the purpose of trading and does not have an unconditional right to defer settlement of the liability for at least twelve months after reporting date [40].

7 Sample Case

ACCOUNTANT Ltd started its business in Romania in November 2010.
The core business of the company is sale of goods as well as professional consulting.
The formula used for derecognition of the goods is FIFO. The company applies the straight-line method for depreciation as well as for tax depreciation (based on Law 571/2003, December regarding the Fiscal Code). In case of differences between accounting and tax depreciation deferred tax should be calculated. The company is a VAT payer (basic rate of 24%).
For the simplicity of postings “MU” (monetary unit) will be used instead of national currency.

SOLUTION:

The entity's start-up

At the very beginning the incorporation expenses of 5 000 MU were paid and 145 000 MU were deposited on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
1.1.	01.11.2010	Loan from owners	Petty cash	=	Shareholders – current accounts	5000
2.1.	01.11.2010	Payment of setup costs	Setup costs	=	Petty cash	5000
3.1.	02.11.2010	Contributed capital	Capital reimbursement with shareholders	=	Subscribed and not paid in capital	145000
3.2.			Cash at bank	=	Capital reimbursement with shareholders	145000
3.3.			Subscribed and not paid in capital	=	Subscribed and paid in capital	145000

Tangible Assets

On November 12, 2010 a computer was purchased for 2 000 MU (due date is January 12, 2011).

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
4.1.	12.11.2010	Computer acquisition	%	=	Suppliers of non-current assets	2480
			Plant and machinery			2000
			Input VAT			480
5.1.	31.12.2010	Computer's monthly depreciation	Expenses with depreciation of non-current assets	=	Depreciation of plant and mach., motor vehicles etc.	83
Note: In accordance to the Government' Decision No. 2139/2004, November (published in January 2005) approving the Catalogue regarding tangible assets' classification and useful life, the interval within which companies must establish computers' useful life is [2,4]. Considering the manner in which Accountant Ltd. plans to use the computer, a useful life of 2 years was considered to represent a reliable estimation.						

Financial Leases

The company has decided to purchase a car through a 5 years financial lease contract. The financial lease was negotiated from December 1st, 2010 with monthly based rental payments of 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; the fair value of the car is 17 500 MU.

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS			AMOUNTS
			D		C	
6.1.	01.12.2010	Entry of the motor vehicle	Motor vehicle	=	Other loans and similar debts	17500
6.2.	02.12.2010	Recording the invoice for	%	=	Suppliers of non-current assets	434
		rental payments	Other loans and similar debts			204
			Interest expenses			146
			Input VAT			84
6.3.	31.12.2010	Invoice payments	Suppliers of non-current assets	=	Cash at bank	434

Inventories

Throughout the period of November and December 2010 the following purchases and sales of goods were made:

1	Purchase of 6500 pieces of goods @ 7.50 MU
2	Purchase of 4200 pieces of goods @ 8.00 MU
3	Sale of 5000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3300 pieces of goods @ 9.00 MU
5	Sale of 3600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from the company's bank account. Fair value of goods as at December 31, 2010 is 22 500 MU.

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS			AMOUNTS
			D		C	
7.1.	10.11.2010	Acquisition of goods *(Invoice)*	%	=	Suppliers	60450
			Commodities			48750
			Input VAT			11700
7.2.	10.11.2010	Payments of goods	Suppliers	=	Cash at bank	60450
8.1.	14.11.2010	Acquisition of goods *(Invoice)*	%	=	Suppliers	41664
			Commodities			33600
			Input VAT			8064
8.2.	14.11.2010	Payments of goods	Suppliers	=	Cash at bank	41664

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
9.1.	17.11.2010	Sale of goods	Customers	=	% Sales of commodities Output VAT	74400 60000 14400
9.2.	17.11.2010	Evidence discharging	Commodities expenses	=	Commodities	37500
10.1.	10.12.2010	Acquisition of goods *(Invoice)*	% Commodities Input VAT	=	Suppliers	36828 29700 7128
11.1.	12.12.2010	Sale of goods	Customers	=	% Sales of commodities Output VAT	53568 43200 10368
11.2.	12.12.2010	Evidence discharging	Commodities expenses	=	Commodities	28050
12.1.	14.12.2010	Sale of goods	Customers	=	% Sales of commodities Output VAT	35712 28800 6912
12.2.	14.12.2010	Evidence discharging	Commodities expenses	=	Commodities	19500
13.1.	31.12.2010	Impairment recording	Impairment losses on current assets	=	Impairment of commodities	4500

Receivables and Payables

In November 2010 a long-term (3Y) contract for consulting services was negotiated. The total amount of the contract is of 180000 MU, payable at the end of the contract, i.e. November 30, 2013.

The company has one employee, Miss Anna. Her gross monthly salary is 800 MU. The salary is payable on the 10th day of the next month.

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
14.1.	30.11.2010	Salary registration	Salary expenses	=	Employees – salaries payable	800
14.2.	30.11.2010	Entity social security contributions	Expenses with entity contribution to social security	=	Company contribution to social security	165
14.3.	30.11.2010	Entity social security contributions	Expenses with entity	=	Company contribution to	42

			contribution to health insurance		health insurance	
14.4.	30.11.2010	Entity social security contributions	Expenses with entity contribution to social security	=	Company contribution to social security	7
14.5.	30.11.2010	Entity social security contributions	Expenses with entity contribution to unemployment fund	=	Company contribution to unemployment fund	4
14.6.	30.11.2010	Entity social security contributions	Expenses with entity contribution to social security	=	Company contribution to social security	5
14.7.	30.11.2010	Entity social security contributions	Other taxes, charges and similar expenses	=	Special funds taxes and similar liabilities	6
14.8.	30.11.2010	Entity social security contributions	Other taxes, charges and similar expenses	=	Special funds taxes and similar liabilities	2
14.9.	30.11.2010	Employee social security contributions	Employees – salaries payable	=	%	293
					Employees contribution to social security	9
					Employees contribution to health insurance	5
					Employees contribution to unemployment fund	4
					Tax on salaries	275

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
14.10.	10.12.2010	Salary payment	Employees – salaries payable	=	Cash at bank	507
14.11.	23.12.2010	Contributions payment	%	=	Cash at bank	524
			Company contribution to social security			177
			Company contribution to health insurance			42
			Company contribution to unemployment			4

			fund Special funds taxes and similar liabilities	8
			Employees contribution to social security	9
			Employees contribution to health insurance	5
			Employees contribution to unemployment fund	4
			Tax on salaries	275

Other Costs and Expenses and Income

- rental payments – 1 200 MU/monthly (payable on 20th day of the month for the next month),
- tax consulting – 200 MU/monthly (payable on 25th day of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th day of the next month),
- road tax – 100 MU (payable on December 15, 2010)
- received interests – 920 MU
- bank charges – 5 300 MU

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
15.1.	20.11.2010	Invoice for payable rent	%	=	Suppliers	1488
			Royalties and rental expenses			1200
			Input VAT			288
15.2.	20.11.2010	Rental payments	Suppliers	=	Cash at bank	1488
16.1.	20.12.2010	Invoice for payable rent	%	=	Suppliers	1488
			Prepayments			1200
			Input VAT			288
16.2.	20.12.2010	Rental payments	Suppliers	=	Cash at bank	1488

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
17.1.	25.12.2010	Tax consulting invoice	%	=	Suppliers	248
			Commissions and fees			200
			Input VAT			48

17.2.	25.12.2010	Tax consulting payments	Suppliers	=	Cash at bank	248
18.1.	15.12.2010	Telecommunication services invoice	% Post and telecommunications expenses Input VAT	=	Suppliers	1240 1000 240
18.2.	15.12.2010	Telecommunication services payments	Suppliers	=	Cash at bank	1240
19.1.	15.12.2010	Road tax recording	Other taxes, charges and similar expenses	=	Other taxes, charges and similar liabilities	100
19.2.	15.12.2010	Road tax payment	Other taxes, charges and similar liabilities	=	Cash at bank	100
20.1.	31.12.2010	Received interests	Cash at bank	=	Interest incomes	920
21.1.	31.12.2010	Bank charges	Bank commissions and similar charges	=	Cash at bank	5300

Other elements at the end of the reporting period

- VAT regularization
- Profit tax
- Legal reserve

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
22.1.		VAT Regularization	Output VAT	=	% Input VAT VAT payable	31680 28320 3360
23.1.	31.12.2010	Expense accounts closing	Profit or loss	=	% Expenses with depreciation of non-current assets Interest expenses Commodities expenses Impairment losses on current assets Salary expenses Expenses with entity contribution to social security Expenses with entity contribution to health insurance Expenses with entity contribution to unemployment fund	98610 83 146 85050 4500 800 177 42 4

				Other taxes, charges and similar expenses	108
				Royalties and rental expenses	1200
				Commissions and fees	200
				Post and telecommunications expenses	1000
				Bank commissions and similar charges	5300

GENERAL JOURNAL

OP. NO.	DATE	EXPLANATION	CORRESPONDING ACCOUNTS D		CORRESPONDING ACCOUNTS C	AMOUNTS
24.1.	31.12.2010	Revenues accounts closing	% Sales of commodities Interest incomes	=	Profit or loss	132920 132000 920
25.1.	31.12.2010	Profit tax expenses	Profit tax expenses	=	Profit tax	5215
25.2.	31.12.2010	Expense account closing	Profit or loss	=	Profit tax expenses	5215
26.1.	31.12.2010	Legal reserves	Appropriation of the profit	=	Legal reserves	1716

Calculation of the legal reserve[10]*:*
Accounting profit before the profit tax = 132920 – 98610 = 34310
5% * Accounting profit before the profit tax = 5% * 34310 = 1716
20% * Subscribed and paid in capital = 20% * 145000 = 29000
1716 < 29000 → Legal reserve = 1716

Calculation of the profit tax:
Profit tax = 16% * (34310 - 1716) = 5215

[10] The Romanian Fiscal Code allows for a legal reserve that is deductible within 5% of the accounting profit before the profit tax, from which incomes that are not taxable must be deducted and their corresponding expenses added, until the reserve will reach a maximum of 20% of the entity's subscribed and paid in capital.

Financial Statements

Balance Sheet	Amounts
A. Non-current assets	
I. Intangible assets	**5 000**
1. Start-up cost	5 000
II. Tangible assets	**19 417**
1. Plant and machinery	1 917
2. Motor vehicle	17 500
III. Financial assets	**0**
B. Current assets	
I. Inventories	**22 500**
1. Commodities	22 500
II. Receivables	**163 680**
1. Customers	163 680
III. Short-term financial investments	**0**
IV. Cash and equivalents of cash	**32 477**
1. Cash at bank	32 477
C. Prepayments	
1. Prepayments	1 200
D. Liabilities: amounts becoming due and payable within one year	
1. Suppliers	36 828
2. Suppliers of non-current assets	2 480
3. VAT payable	3 360
4. Profit tax	5 215
5. Shareholders – current accounts	5 000
E. Net current assets/liabilities (B + C – D)	**166 974**
F. Total assets less current liabilities (A + E)	**191 391**
G. Liabilities: amounts becoming due and payable after more than one year	
1. Other loans and similar debts	17 296
H. Provisions	**0**
I. Deferred incomes	**0**
J. Capital and reserves	
I. Subscribed capital	145 000
1. Subscribed and paid in capital	145 000
II. Share premium account	0
III. Revaluation reserve	0
IV. Reserves	1 716
1. Legal reserve	1 716
V. Retained earnings	0
VI. Profit or loss for the financial period	27 379
1. Profit or loss	29 095
2. Appropriation of the profit	(1 716)
Entity's equity - total	**174 095**
Public estate	0
Entity's equity - total	**174 095**

Profit and loss account	**Amounts**
1. Net turnover	132 000
Sales of commodities 2. Variation in stocks of finished goods and in work in progress 3. Work performed by the undertaking for its own purposes and capitalized 4. Other operating income	132 000 0 0 0
Total operating income	**132 000**
5. a) Raw materials and consumables used b) Other external expenses	 85 050
6. Staff costs:	1 131
a) Wages and salaries b) Social security costs	800 331
7. a) Value adjustments in respect of formation expenses and of tangible and intangible fixed assets	83
b) Value adjustments in respect of current assets	4 500
8. Other operating expenses	7 700
Operating profit or loss	**33 536**
9. Income from participating interests	0
10. Income from other investments and loans	0
11. Interest income	920
Other financial income	0
Total financial income	**920**
12. Value adjustments in respect of financial assets and of investments held as current assets	0
13. Interest expenses	146
Total financial expenses	**146**
14. Current profit or loss	**34 310**
15. Extraordinary income	0
16. Extraordinary expenses	0
17. Profit or loss from extraordinary activities	**0**
Total income	0
Total expenses	0
Gross profit or loss	0
18. Tax on extraordinary profit or loss	**0**
19. Other taxes not shown under the above items	**0**
20. Gross profit or loss for the financial year	34 310
21. Profit tax	5 215
22. Net profit or loss for the financial year	29 095

Selected financial ratios

Profitability ratios

$$ROA = \frac{EBIT}{\sum Assets} = \frac{34456}{244274} = 0.141$$

$$ROE = \frac{EAT}{Equity} = \frac{29095}{174095} = 0.167$$

Liquidity ratios

$$CL = \frac{Current\ Assets}{Current\ Liabilities} = \frac{219857}{52883} = 4.157$$

$$ATR = \frac{Current\ Assets - Inventory}{Current\ Liabilities} = \frac{219857 - 22500}{52883} = 3.732$$

8 Dictionary

English	Romanian
Accelerated Depreciation	amortizare accelerată
Account	cont
Account Payable	datorii furnizori
Account Receivable	creanțe clienți
Accountant	contabil
Accounting	contabilitate
Accounting Change	schimbare contabilă
Accounting Policies	politică contabilă
Accounting Profit	profit contabil
Accrual Basis	contabilitate de angajamente
Accumulated Depreciation	amortizare cumulată
Additional Paid in Capital	prime de emisiune
Amortization	amortizare
Annual Report	raport annual
Annuity	anuitate
Asset	activ
Auditor	auditor
Auditors' Report	raportul auditorilor
Available-For-Sale Financial Assets	active financiare disponibile pentru vânzare
Balance Sheet	bilanț contabil
Bond	obligațiune
Book Value, Carrying Amount	valoare netă contabilă
Borrowing Costs	costurile îndatorării
Budget	buget
Business	întreprindere, afacere
Business Combinations	grupări de întreprinderi
Business Segment	segment operațional
Capitalized Cost	cost capitalizat
Capitalized Interest	dobândă capitalizată
Cash	numerar
Cash Basis	contabilitate de casă
Cash Equivalents	echivalente de numerar
Cash Flows	flux de numerar

Cash-generating Unit	unitate generatoare de numerar
Closing Rate	curs de închidere
Consistency	permanența metodelor
Consolidated Financial Statements	situații financiare consolidate
Consolidation	consolidare
Contingent Asset	activ contingent
Contingent Liability	datorie contingentă
Contingent Rent	chirie contingentă
Continuing Operations	operații continue
Control	control
Convertible Share	acțiune convertibilă
Cost	cost
Cost Accounting	calculul costurilor/calculația costurilor
Cost Method	metoda de calcul de cost
Costing	determinarea costului
Costs of Disposal	costul vânzării
Credit Risk	risc de creditare
Creditor	creditor
Currency Risk	risc de curs valutar
Current Asset	activ circulant
Current Liability	datorie curentă
Current Tax	impozit exigibil/impozit curent
Debit	debit
Debt	datorie
Debt Security	instrument de datorie
Debtor	debitor
Deferred Income	venituri înregistrate în avans
Deferred Income Taxes	impozite amânate
Deferred Tax Assets	active de impozit amânat
Deferred Tax Liabilities	datorii de impozit amânat
Depreciable Amount	valoare amortizabilă
Depreciation	amortizare
Derecognition	derecunoaștere
Derivative	derivat
Detection Risk	risc de detectare
Development	dezvoltare
Direct Costs	costuri directe
Disclosure	publicare
Discontinued Operation	operații întrerupte
Discount	actualizare; reducere
Discount Rate	rată de actualizare
Discounted Cash Flow	fluxuri de numerar actualizate
Dividends	dividende
Double–Entry Bookkeeping	contabilitate în partidă dublă
Due Date	dată de decontare
Earnings Per Share (EPS)	rezultat pe acțiune
Economic Life	durată de viață economică
Effective Interest Rate	rată efectivă a dobânzii
Equity	capitaluri proprii
Equity Instrument	instrument de capital
Equity Method	metoda punerii în echivalență
Equity Securities	instrumente de capital
Estimated Tax	impozit estimat

Estimation Transactions	operațiuni de estimare
Events after the Balance Sheet Date	evenimente după data bilanțului
Exchange Difference	diferențe de schimb valutar
Exchange Rate	curs de schimb valutar
Expense	cheltuială
External Reporting	raportare externă
Extraordinary Items	elemente extraordinare
Factoring	factoring
Fair Market Value	valoare justă de piață
Fair Value	valoare justă
Finance Lease	leasing financiar
Financial Asset	activ financiar
Financial Institution	instituție financiară
Financial Instrument	instrument financiar
Financial Liability	datorie financiară
Financial Risk	risc financiar
Financial Statements	situații financiare
Financing Activities	activități de finanțare
First in, First out (FIFO)	primul intrat primul ieşit (FIFO)
Fiscal Year	an fiscal
Fixed Asset	activ imobilizat
Forecast	previziune
Foreign Currency	monedă străină
Fraud	fraudă
Functional Currency	monedă funcțională
Funding	finanțare
Future Contract	contract future
Gain	câştig
General Journal	Registrul Jurnal
General Ledger	Registrul Cartea Mare
Generally Accepted Accounting Principles	principii contabile general acceptate
Going Concern	continuitatea exploatării
Goodwill	fond comercial
Gross Income	profit brut
Group	grup
Guaranty	garanție
Hedge	acoperire
Hedge Effectiveness	eficiența acoperirii
Hedged Item	element acoperit
Hedging Instrument	intrument de acoperire
Held-To-Maturity Investments	investiții deținute până la scadență
Highly Probable	cu o probabilitate mare
Historical cost	cost istoric
Impairment Loss	pierdere din depreciere
Impracticable	impracticabil
Improvement	îmbunătățire
Inception of the Lease	începerea contractului de leasing
Income	rezultat
Income Statement	cont de profit şi pierdere
Indirect Costs	costuri indirecte
Initial Direct Costs	costuri directe inițiale
Installment	rată
Intangible Asset	activ necorporal

Interest	dobândă
Interest Cost	cost cu dobânda
Interest Rate Risk	risc de rată a dobânzii
Interim Financial Report	raportare financiară interimară
Interim Financial Statements	situații financiare interimare
Interim Period	perioadă interimară
Internal Audit	audit intern
Internal Control	control intern
Internal Rate of Return	rată internă de rentabilitate
International Accounting Standards Board	Consiliul pentru Standarde Internaționale de Contabilitate
International Financial Reporting Standards (IFRSs)	Standarde Internaționale de Raportare Financiară
Intradepartmental Price, Internal Transfer Price	prețuri de cesiune internă
Inventories	stocuri
Investing Activities	activități de investiții
Investment Property	investiții imobiliare
Investor in a Joint Venture	investitor într-o asociere în participație
Joint Venture	asociere în participație
Last in, First out (LIFO)	ultimul intrat primul ieşit (LIFO)
Lease	leasing
Lease Term	durata contractului de leasing
Lessee	locatar
Lessor	locator
Liability	datorie
Liquid Assets	active lichide
Liquidation	lichidare
Liquidity Risk	risc de lichiditate
Loans and Receivables	împrumuturi şi creanțe
Loans Payable	datorii din împrumuturi
Long–Term Debt	datorii pe termen lung
Loss	pierdere
Lower of Cost or Market	minimum dintre cost şi valoarea de piață
Management Accounting (Managerial Accounting, Managerial Accountancy)	contabilitate de gestiune/contabilitate managerială
Margin	marjă
Market Risk	risc de piață
Marketable Securities	valori mobiliare de plasament
Mark–to–Market	marcare la piață
Master Budget (Company Budget)	buget consolidat
Materiality	prag de semnificație
Matching Principle	principiul conectării cheltuielilor la venituri
Merger	fuziune
Minority Interest	interes minoritar
Monetary Assets	active monetare
Monetary Items	elemente monetare
Net Assets	active nete
Net Income	rezultat net
Net Realizable Value	valoare netă de realizare
Non-cancellable Lease	leasing irevocabil
Non-current Asset	activ necurent/activ imobilizat
Non–for–Profit Organization	organizație nonprofit
Notes	note explicative la situațiile financiare
Notional Value (Face Value)	valoare nominală

Objectivity	obiectivitate
Obligations	obligații
Onerous Contract	contract cu titlu oneros
Operating Activities	activități de exploatare
Operating Cycle	ciclu de exploatare
Operating Lease	leasing operațional
Option	opțiune
Other Comprehensive Income	rezultat global
Parent Company	societate mamă
Partnership	parteneriat
Penalty	penalitate
Plan Costing	costuri standard
Preferred Share	acțiune preferențială
Present Value	valoare actualizată
Presentation Currency	monedă de prezentare
Prior Period Errors	erori din perioade anterioare
Probable	probabil
Profit or Loss	profit sau pierdere
Property, Plant and Equipment	imobilizări corporale
Prospective Application	aplicare prospectivă
Provision	provizion
Public Offering	ofertă publică
Qualifying Asset	activ calificat
Ratio Analysis	analiză pe bază de rate
Receivables	creanțe
Reconciliation	reconciliere
Recoverable Amount	valoare recuperabilă
Reinsurance	reasigurare
Related Party Transaction	tranzacții cu părți legate
Reorganization	reorganizare
Repairs	reparații
Reporting Date	dată de raportare
Reporting Entity	entitate raportoare
Repurchase Agreement	acord de recumpărare
Research	cercetare
Reserves	rezerve
Residual Value	valoare reziduală
Responsibility Accounting	contabilitate bazată pe centre de responsabilitate
Restructuring	restructurare
Retained Earnings	rezultat nedistribuit
Return on Investment (ROI)	rentabilitatea investițiilor
Revenue Recognition	recunoașterea veniturilor
Revenues	venituri
Risk Management	managementul riscului
Securitization	securitizare
Security	titlu
Separate Financial Statements	situații financiare individuale
Settlement Method	metodă de decontare
Share (Stock)	acțiune
Short–Term	termen scurt
Significant Influence	influență semnificativă
Spot Exchange Rate	curs de schimb la vedere
Start–up Costs	cheltuieli de constituire

Statement of Cash Flows	situația fluxurilor de numerar
Statement of Comprehensive Income	situația rezultatului global
Statement of Financial Position	situația poziției financiare
Statement of Changes in Equity	situația modificărilor capitalului propriu
Straight–Line Depreciation	amortizare liniară
Subsequent Event	eveniment ulterior
Subsidiary	filială
Swap	swap
Tangible Asset	activ corporal
Tax	impozit
Tax Base	bază impozabilă
Tax Expense	cheltuiala cu impozitul
Tax Income	venit din impozit
Tax Loss	pierdere fiscală
Tax Year	an fiscal
Taxable Income	rezultat impozabil
Taxable Profit	profit impozabil
Taxpayer Identification Number (TIN)	număr de identificare fiscală
Temporary Differences	diferențe temporare
Term Loan	împrumut la termen
Total Comprehensive Income	rezultat global total
Transaction Costs	costuri de tranzacționare
Unearned Income	venit nerealizat
Useful Life	durată de viață utilă
Value in Use	valoare de utilitate
Venture Capital	capital de risc
Work in Progress	producție în curs de execuție
Working Capital	fond de rulment
Yield to Maturity	randament la maturitate
Zero–Coupon Bond	obligațiune cu cupon zero

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Financial Reporting in Slovakia

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Abstract: - Small-and-medium sized enterprises (SMEs) are a driving force of each economy. This chapter deals with the current stage of financial reporting for SMEs in Slovakia. Due to the globalization of business and international harmonization of financial reporting also Slovakia experiences a shift in paradigms from historical costs accounting towards fair value measurement. Chapter provides an analysis between national accounting legislature and standard IFRS for SMEs.

Key-Words: - Financial reporting, International harmonization, Measurement, Financial statements, Small and Medium Sized enterprises (SMEs), Slovakia.

Country
Slovakia
(Slovensko)
Location
Central Europe
Area
49,035 km^2
Population
5,470,306 (2010 est.)
Member of European Union
since 1st May 2004; Schengen country
Currency
euro (EUR)

1 Country Introduction

First trace of **Slovakia** can be seen in connection with ancient Romans and their Marcomanic Wars. As soon as in first century AC there existed a Vanina Kingdom. Slovakian history is linked with their arrival in 5th century, and then entered under control of Avars. After Slavs ruler Samo´s victory in Wogatisburg Battle this territory became a part of Samo´s Empire. Two civic centers are then established, Nitrian and Moravian principalities. After a period of time they merged together into organized unit, Great Moravia.

After Great Moravia downfall at the beginning of 10th century Hungarians started settling there. First dynasty are Arpadians, their first king recognized by pope is Stephen I. After his death the borders of Hungarian Kingdom started forming. Territory sustained raids by Turks, this repeatedly for many coming centuries. Country recovery from those invasions in 13th century was connected with German settlements and with a powerful Máté Csák of Trencsén (Matúš Čák Trenčiansky). During the following years there were Hussies' invasions, followed by Matyas Corvin and Jagiellons governing, Bratislava University is established.

In 1526 Slovakia-Hungary became a part of Habsburg Empire. Hungary capital is Bratislava, where in a St. Martin Cathedral 11 Austrian- Hungarian Emperors are crowned as Hungarian Kings. After the Thirty Years War, in 1620-1648, periods of re-Catholicism, Osman Empire invasions, there came a period of Theresian and Josephine reforms, bringing an Edict of Tolerance regarding religious freedom and Abolition of Serfdom Act.

During 19th century, as well as elsewhere, in Slovakian territory efforts for national identity and independence are strengthening, nation revival is taking place, firstly thanks to the Ludovit Stur. At the same time Slovaks incline to the idea of Austrian-Hungarian Empire with equal rights for Hungarian/Slovak and Austrian nations.

During the revolution 1848-1849 Slovaks were trying to separate from Hungary and became an independent part of Empire, but without success.
After the first World War Austrian-Hungarian Empire demise as two of its successors, Czech and Slovakia became a new state - Czechoslovakia- with T. G. Masaryk as president, this country proclamation as of 28.10.1918. In 1938 in connection thanks to the Tiso Slovakian Nationalists inclining toward Hitler an independent Slovakian State is proclaimed. Slovakia is teared away from Czech where new Nazi Protectorate of Czech and Moravia is established. During the war Slovakian State is distinctively changing and by the end of the WWII, where Slovaks above all participated in Carpathian Dukla-Mountain pass operation on side of Allies and in Slovakian National Uprising, Slovakia is again joining the Czechs.
During 1948-1989 Czechoslovakia is a part of block of communist Eastern European countries under Soviet influence. Partly easing communist grip is possible in 1968, in connection with Prague Spring. Soviet invasion August 21st 1968 is than abolishing any possibilities for reforms. Communist rule is ended in November 1989, Vaclav Havel becoming a first president of free Czechoslovakia. 1.1.1993 after a referendum a new independent two separate states Slovakian Republic and Czech Republics are proclaimed. In 2004 Slovakia became a member of European Union. Later that year Slovakia enters a rate exchange mechanism ERM II, a first step for adopting the European currency. This currency is becoming an official currency in Slovakia as of 1st January 2009. Exchange rate used than was 32.126 SK (Slovakian Crown) to 1 EUR. Slovakian public and businesses were informed about switch in a campaign during the last 10 months prior to this date. Information efforts did cleared a public fear about prices increase during the conversion period.

Slovakia is based on social-market economy, but its performance is to the great extent dependent on surrounding countries since its openness, firstly on German economy as a biggest Slovakia trading partner. After the Slovakian economy depression during 2009, where above all as an external influence a world recession was showing, the performance in 2010 is confirming that an economy revival abroad is influencing positively the economy of Slovakia as well. It is expected that this year performance of Slovakian economy will be based of demand from abroad, but negatively influenced by a local demand. This demand activation depends on employment rate, but positive signals cannot be observed as of now. Introduction of non-economical and non-efficient measures to prevent a world economic recession influence on local demand is likely to expose itself this year. State subsidies in businesses without market for their products or forming new subsidized businesses without realistic manufacturing and market chances were a nucleus of local Slovakian economy drop, as can be seen after the world economic recession easing.
Current Slovakian government, (referring to a state of public budget) actual goal is this budget consolidation. Regarding this, not even 100 days after forming a government it is presenting a packet of money-saving measures to restore public budget health. Based on their calculations, Ministry of Finances resort came to the conclusion that an actual budget deficit of 7.8 GDP to fewer than 5% GDP in 2011 requires saving measures in € 1.7 bil. scale. Basic philosophy of saving measures concept was not to increase tax and as of taxing to prefer active work than consumption. Coalition did agree upon that 47% of saving measures shall be on public and the rest of the package shall be organized by state. Public expenses, their share on saving measures will be slightly lower than that of state. State savings shall be € 900 mil minimum and state revenues no more than € 800 mil [9].

2 Legal System

2.1 Business Law

Commercial Code is the basic legal regulation containing fundamental provisions on entrepreneurs, including foreign-owned businesses, business obligation relationships, as well as some other relations connected with business activities. The Commercial Code deals with business relationships between entrepreneurs, partnerships, establishes the basic types of partnerships, basic business contracts and relationships. If an entrepreneur decides to do business not as an individual, but as some of the types of partnerships, s/he shall find in this Code a way to establish the basic types of partnerships and cooperatives.
The Commercial Code divides partnerships into capital companies and partnerships:

- **partnerships** (general commercial partnership, limited partnership)
- **capital companies** (limited liability company, joint stock company)

The Commercial Code (Act No. 513/1991 Coll.), as subsequently amended (hereinafter referred to as "CC"), came into effect on 1 January 1992 and replaced the long-valid Economic Code and international trade code. The Commercial Code is closely linked to the Civil Code (hereinafter referred to as "CivC"), particularly in the sense that the provisions of the CivC apply to the relations governed by the CC subsidiary. This means that if some issues cannot be dealt with according to the Commercial Code, the Civil Code or other rules of civil law are applied. The Civil Code may be used to adjust property relations between both individuals and legal entities. Specific property relations between entrepreneurs are regulated by the Commercial Code, which in comparison with the CivC has more provisional rules and leaves the contracting parties the possibility of greater regulation of mutual relations differently from the legal provisions of the CC. Although the Commercial Code allows for an agreement between the parties to apply its provisions even to the obligation relationship between other entities such as entrepreneurs (or state, self-governing territorial unit, etc.), individuals should prefer the conclusion of contracts under the Civil Code instead of the Commercial Code. It also specifies that foreign persons (legal entities with establishment, individuals residing outside the territory of the SR) can operate in the SR under the same conditions and at the same scale as Slovak citizens. A foreign person is authorized to do business in Slovakia on the date of incorporation. For the business purposes of foreign persons in the territory of Slovakia, a limited liability company and joint stock company is formed most frequently. Terms of trade are governed by the Trade Licensing Act. Since October 2004, when an amendment to the Commercial Code was passed in compliance with the EU legislation, Slovak companies have been easily trade able even on foreign capital markets. This amendment allowed them to keep share capital and issue their shares in Euro. So the requirements of the Slovak capital market are taken into account. The Commercial Code addresses several practical problems. Judges have more jurisdictions in cancellation of inactive companies. The court may erase from the Company Register those companies, which have not filed an approved regular financial statement in the collection of documents for at least two years. Except inactive or dead companies may be also canceled companies trading non-transparently. Many non functioning companies can be erased from the Register.

The Commercial Code is divided into four parts (General Provisions; Business Companies, Partnerships and Cooperatives; Business Obligations; Common, Transitory and Concluding Provisions), which are then divided into headings, divisions and subdivisions.
The Slovak Commercial Code obliges enterprises to create a legal reserve fund of at least 5% of income after taxes for a limited liability company (10% for joint stock companies), until the reserve fund reaches at least 10% of the share capital of limited liability companies (20% of joint stock companies). Legal reserves are not paid through dividends by shareholders. Legal reserves exist for the sole purpose of covering future losses.
In the commercial register shall be entered:

- partnerships, cooperatives and other legal entities appointed by special law, legal entities incorporated under the laws of the European Communities, enterprises and organizational components of foreign-owned enterprises,
- branch offices and other organizational components of enterprises, if required by special law,
- individuals with permanent residence in Slovakia, who are entrepreneurs under this law and who are entered in the Commercial Register based on their own request or if established by special law.

A partnership is set up by signing the deed of association. According to how many founders there are, the deed of association can take the form of deed of foundation or partnership agreement. The partnership establishment is subject to registration in the Commercial Register.

General commercial partnership

- A general commercial partnership is an entity in which at least two persons carry on business activity under a common commercial name and bear joint and several liabilities for the obligations (debts) of the partnership with all their property.
- The rights and duties of the partners are governed by their partnership agreement (deed of partnership). The consent of all partners is required for any modification of the partnership agreement, unless this Code or the partnership agreement provides otherwise.
- A general commercial partnership is responsible for its debts with all its assets. Partners bear joint and several liabilities for the obligations (debts) of the partnership with all their property.

- Limited partnership
- A limited partnership is an entity in which one or more partners are liable for the partnership's obligations up to the amount of the unpaid parts of their contributions, as recorded in the Commercial Register (limited partners), and one or more partners are liable for the partnership's obligations (debts) with their entire property (general partners).
- Unless it is stipulated otherwise, limited partnerships are governed as appropriate by the preceding provisions on general commercial partnerships, while the legal status of limited partners is governed by the provisions on limited liability companies.
- A limited partner's investment contribution to the partnership is mandatory. Its amount, which cannot be less than 250 Euros, is agreed in the partnership agreement. The investment contribution is required to be paid within the deadline set by the partnership agreement, or without undue delay after the company establishment, or after the partner's participation in the company.

Limited liability company

- A limited liability company is an entity whose registered capital is made up of its members' investment contributions. A limited liability company may be formed by one person. A limited liability company may have a maximum of fifty members.
- The amount of the share capital of a limited liability company must be at least 5 000 Euros.
- The amount of a member's investment contribution must be at least 750 Euros.
- Before filing a petition for entry of a company in the Commercial Register, the full premium and at least 30% of each monetary investment contribution must be paid up. The total of paid-up investment contributions and the value of nonmonetary investment contributions must be at least 50% of the statutory minimum share capital under Section 108 Para 1. Where a company is formed by one person, it may be entered in the Commercial Register only when its share capital has been fully paid up.
- Each member shall pay up his investment contribution under the conditions (terms) and within the time-limit stipulated in the partnership agreement, but not later than five years after the company's incorporation or a commitment by the member to increase his investment contribution or make a new one. No member may be relieved of this duty. The executive officers shall, without undue delay, notify the registration court, when the contribution of each member has been paid up in full. A member who fails to fulfill his duty within the additional time-limit may be expelled from the company by a resolution of the general meeting.
- The executive officers shall make arrangements for proper upkeep of the prescribed records and accounting, maintain a list of the company's members and inform the members about the company's affairs. The executive officers submit the regular financial statement and an extraordinary individual financial statement to the general meeting for approval, together with a proposal for distribution of a profit or settlement of loss in accordance with the partnership agreement and relevant statutes. If the special law imposes the company with the obligation to prepare an annual report, the executive officers shall submit together with the regular financial statement or the extraordinary individual financial statement also the annual report to the general meeting for approval.

Joint Stock Company

- A joint stock company is a company whose registered capital is divided into a certain number of shares with a specific nominal value. The company is liable for a breach of its obligations (debts) with its entire property. A shareholder is not liable for the company's obligations.
- A joint stock company may be a private joint stock company or a public joint stock company.
- The company may be established by one founder if the founder is a legal entity, otherwise by two or more founders.
- The amount of share capital must be at least 25 000 Euros.
- The board of directors shall submit in writing to the supervisory board at least once a year information on critical business management plans for the future, as well as the anticipated development of the assets, finances and revenues, and upon the request and within the time specified by the supervisory board a written report on the business activities and assets of the company in comparison with expected development. The board of directors is also obliged, without undue delay, to inform the supervisory board on all matters that may significantly influence the development of business and

assets of the company, particularly its liquidity. Members of the board of directors are obliged upon the request of the supervisory board or its members to attend meetings of the supervisory board and provide its members with complementary additional information on submitted reports in the extent required.

Cooperative

- A cooperative associates an unrestricted number of persons (i.e. members) and is formed for the purpose either of carrying on business activity or of meeting the economic, social or other needs of its members.
- A cooperative must have no fewer than five members; this does not apply if at least two members are legal entities. The accession of additional members, or termination of membership of existing members, does not affect the continued existence of such a cooperative, provided that it meets the conditions stipulated in the preceding sentence.
- The share capital of a cooperative is made up of all the membership contributions which the members have undertaken to pay.
- Membership is conditional on payment of a membership contribution as determined by the statutes, or payment of a certain part of the basic membership contribution stipulated by the statutes. Each member may own only one membership share. The amount of a membership contribution may be stated for various members differently, however, must be expressed by a positive integer, unless specified by the law otherwise.
- The statutes shall specify the amount of the share capital to be entered in the Commercial Register. The recorded share capital must amount to no less than 1 250 Euros.

2.2 Accounting Law

Slovak **accounting principles** are embodied in the Act No. 431/2002 Coll., on Accounting, which contains basic general bookkeeping principles, accounting, valuation of assets and liabilities, profit and loss statement, the form of annual financial statement and requirements for external audit of the financial statement. Requirements result from the Commercial Code and the Ministry of Finance Regulations. All concerns, banks, insurance companies and other large enterprises are required to present their financial statements according to IFRS. For companies listed on the stock exchange, there is an option. Slovak accounting principles are gradually converging with IFRS, although there are still some differences.

According to Slovak accounting regulations, there are various prescribed charts of accounts and accounting rules for companies, banks and insurance companies. The chart of accounts for enterprises consists of the accounting classes:

0	Fixed assets
1	Inventories
2	Financial accounts
3	Receivables and short-term liabilities
4	Equity and long-term liabilities
5	Expenses
6	Revenues
7	Closing and off-balance sheet accounts

An enterprise is required to prepare its own accounting schedule, which shall contain the above accounts and may include other accounts and subaccounts, which are required for registering all accounting operations and annual financial statements. The chart of accounts is not mandatory for an enterprise, which presents its annual financial statements under IFRS.

Slovak accounting regulations do not significantly differ from accounting regulations in other countries. All books and parts of annual financial statements must be presented in the Slovak language and Slovak currency. All original documents, books of accounts, depreciation tables, inventory records, order confirmations, etc., must be archived for five years according to regulations, parts of the annual financial statements and annual report even ten years. Enterprises may use any processing methods. In the event that an enterprise keeps all accounting documents in electronic form, they must be transformed into tangible form as well. An enterprise has to calculate and approve the cash statement at least four times in the accounting period. The inventory of

tangible assets must be carried out at least once per two years. The inventory of stocks has to be done at least once a year. The final balance must be agreed and documented.
Enterprises can choose their own 12-month accounting period, which is independent of the calendar year. The competent tax authority shall be notified not earlier than fifteen days before the planned change in the accounting period.

The annual financial statement comprises a balance sheet, a profit and loss statement and notes. The balance sheet and profit and loss statement, which are annexed to the tax return, must be presented in a special form and notes must contain specific information that is defined by the Ministry of Finance. The annual financial statements together with the tax return have to be delivered to the tax office within three months after the end of the fiscal year. With prior approval of the tax office, this deadline may be extended up to three months. The annual financial statement will be submitted to the tax office twice. Firstly, together with the tax return. Secondly, after the approval of General Assembly, which is to be held within six months after the date, when the financial statements are presented. This implies that changes may occur between the date of submission and the date of approval by the partners. The annual financial statement must be published in the Commercial Register within thirty days after the approval by the General Assembly. Enterprises, which have their annual financial statement audited by an auditor, shall prepare an annual report containing the annual financial statement for the fiscal year and auditor's report.
All consolidated financial statements shall be presented under IFRS, whereas companies, whose parent company presents consolidated financial statements according to the EU legislation, are exempt from such requirements. This exemption, however, does not include companies that are legally required to publish individual financial statements under IFRS. The company must present the consolidated financial statement if it exceeds certain criteria. All consolidated financial statements must be verified. The parent company is obliged to present a consolidated annual report. To the consolidated annual reports apply the same rules as to the individual annual reports. Both consolidated and individual annual reports can be linked into one annual report. In addition, all companies that present their individual financial statement according to IFRS and all joint stock companies must have their individual financial statement verified by an auditor. This requirement also applies to other companies (e.g. Ltd.) if certain criteria were met in the previous accounting period.
Since 2006, some accounting entities must (obligation) or can (option) present individual financial statements under IFRS. The obligation to present individual financial statements under IFRS applies to banks, insurance companies and certain other accounting entities, as well as partnerships which in two consecutive fiscal periods meet at least two of the following conditions: the total amount of assets is greater than 17 000 000 Euros, net turnover is greater than 34 000 000 Euros, the average recounted number of employees of the parent accounting entity and subsidiary accounting entities for the fiscal period exceeded 250. Presentation of financial statements according to IFRS may be chosen by an accounting entity that issued securities in the accounting period or is a securities trader. If an accounting entity starts to present individual financial statements under IFRS, it must continue even after the expiration of conditions under which it began to present. Accounting entities, which will present individual financial statements under IFRS, will be required to present a so-called separate financial statement as well.

2.3 Tax Law

The Slovak tax system includes the following taxes: *personal income tax, corporate income tax, value added tax, excise tax, property tax, vehicle tax, local taxes and administrative fees*. Companies registered or having headquarters in the Slovak Republic are subject to Slovak corporate income tax. A permanent establishment may be registered in the Commercial Register in the Slovak Republic as an organizational component of a foreign subject, or may be registered only for tax purposes. A permanent establishment arises if the performance was provided in the Slovak Republic for more than six months in a period of twelve consecutive months. A permanent establishment is also created if a certain place is available from which a foreign company carries out business activities in the Slovak Republic. A permanent establishment must be registered not earlier than thirty days after the foundation. The foundation of permanent establishment is dependent on the provisions of existing agreements on abolishing double taxation. All employees of a permanent establishment are subject to Slovak income tax. The registration of companies liable to tax must follow within thirty days after obtaining a trade license for business activity in the Slovak Republic. Each company is required to inform the tax authorities of any changes in registration data within fifteen days. Agreements on abolishing double taxation concluded between the Slovak Republic and the western states correspond to the OECD model agreement.

Corporate income tax
Corporate income tax is levied on legal entities with establishment or headquarters in the Slovak Republic. They are required to tax income derived from Slovak and foreign sources. Other legal entities are obliged to tax income derived from Slovak sources. The incomes from the distribution of company profit (e.g. dividends) are basically not subject to taxation. The tax base is composed principally of gross income after deduction of expenses, but must be reduced or increased by certain prescribed statutory items. The tax rate is 19% of the tax base. Expenses on achieving, securing and maintaining taxable income are tax deductible if not specifically mentioned as non-deductible or partly deductible. Loss incurred in the year, which passed the recognition of income, may be deducted from the tax base during a maximum of five consecutive years. A company, which was dissolved without liquidation, is usually able to transfer the tax loss deduction to the successor. The tax loss deduction is to be assessed for each year separately. Depreciation is a tax deductible expense. Even and accelerated depreciation is permitted. In accounting, it is possible to use different depreciation rates. Intangible assets are depreciated for tax purposes in accordance with accounting regulations. In case of the finance lease, the lessee depreciates the leased property.

Value added tax
Taxable persons are registered for VAT in Slovakia when the total turnover for the preceding twelve months exceeds 35 000 Euros. The general tax rate is 19%; the reduced rate 10% is applicable to certain products (e.g. books, medical goods). A taxpayer has the right to deduct input VAT relating to the provision of its own taxable fulfillment. Under certain circumstances, the foreign person is entitled to a refund of Slovak VAT.
From 1.1.2011 the temporary increase in the VAT rate from 19% to 20% [2].

2.4 Sector of SMEs in Slovakia

In this chapter characteristics are presented of SME (Small and Medium-sized Enterprises) in Slovakia within a context of evolution during past years and available data comparison about business sector in Slovakia and EU as well. Out of nearly 21 million enterprises in non-financial economy sector in EU, SME share is 99.8% (with important share of micro-sized businesses of 93.7%) and labor market share of 67.1%. SME businesses sector in Slovakia is of a significant size, stabilizing part of economy and one with a biggest growth potential. Their irreplaceable position is namely forming employment, balanced regional growth and bringing innovation into daily economy practices.

SME in non-financial business economy sector are bringing jobs to more than two-thirds of active workforce and forming more than half of added value. Simultaneously, SME are very sensitive on business environment quality. Since this fact, an important task for government is to improve such environment, this influencing SME competitiveness on local or European markets. SME State support is organized by Slovak Ministry of Economy.

Economic process in Slovakia until 2009 was greatly influenced by world economic and financial crisis fallout on Slovak economy, causing its decline and unemployment growth. Such fallout was observed in SME sector as well. As of SME number growth, their number among registered legal entities was rising with the same pace as during previous years, but as of personal entities it is noted a 1% decrease from previous year. Slightly bigger was SME sector share on gross-production figures, but lover as of added value and operating results.

Decline in employment can be seen among SME or bigger businesses, where a share of SME on employment in non-financial sector was slightly down. Relatively most often with crisis signs were influenced businesses with more than 50 employees, industrial subjects and subjects with social and personal services.

As of regional point-of view, crisis events influenced more Trencin and Nitra Regions. Heavily influenced were more than others businesses from transportation, telecommunication sectors and trade. Most influenced by crisis was mostly East-Slovakia, Kosice and Presov Regions, similar situation was in Trencin Region.

2009 was for a businesses in Slovakia particularly complicated, since after preparing for EU currency introduction there was economy crisis with its drop of demand, drop of sales, influencing the ability to pay businesses loans and obligations toward their suppliers and employees. This was causing secondary insolvency, endangering other businesses performance. Banks in Slovakia reacted by caution granting loans, thus worsening the situation for SME.

During this period of difficult loans for SME, the importance of European Funds raised, with a program period of 2007-2013, assigned for investment purposes and human resources growth and support, and with an objective to increase businesses competitiveness. For a full use of this potential it is necessary to simplify and speed-up the access for SME to such resources, namely to level-down the administrative burden, speeding the evaluation processes and practical finances granting.
Toward this is aimed the creation of Slovakian Grant and Development Fund and innovative tools of financing from Structural Funds in Slovakia. Certain stabilizing of SME sector during second half of 2009 is a result of world economy recession calming, Slovakian Government measures and moves by businesses themselves. Data in Table 1 are showing selected sectors of non-financial economy (industry, construction, wholesale, retail, road and passenger transportation, selected market services as of CS NACE) for which are statistical employment data available according to business size, including self-employed tradesman profession. According to presented figures in Slovakia, out of total number of non-financial businesses sector SME is represented by 99.9%, micro-sized-MSP 94.1% and it is employing 68.6% workforce.

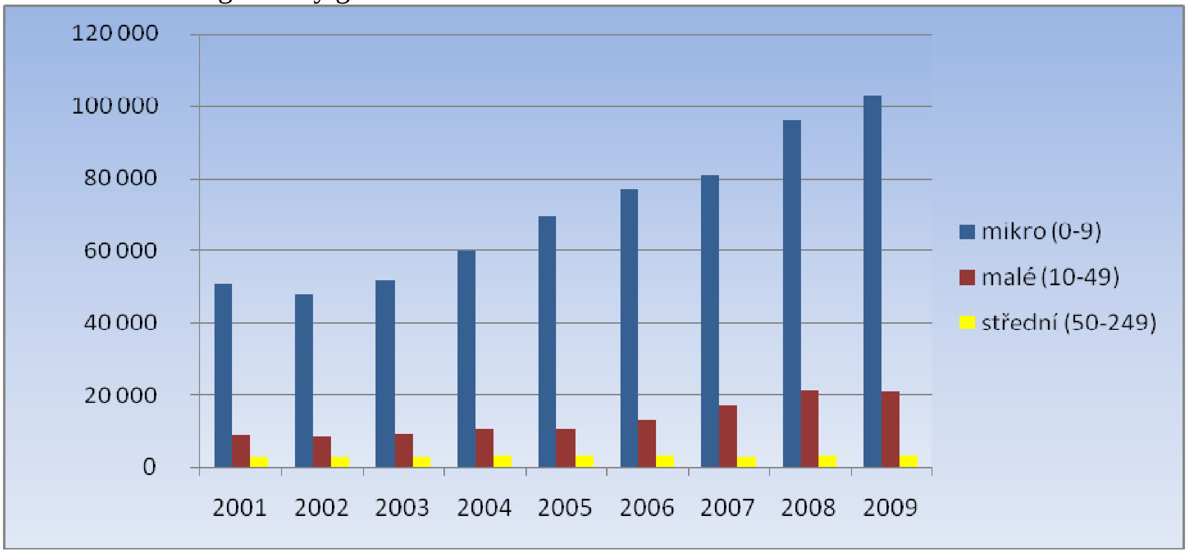
Table 1. Size structure in non-financial enterprises sector

		Enterprise Size					**Total**
		micro	**small**	**medium**	**large**	**SME**	
		0-9	**10-49**	**50-249**	**250 +**		
EU-27 (2007)	Number of businesses in non-financial economy (thousands)	19 556	1 053	227	44	20 836	20 876
	Share of total number	93.7%	5.0%	1.1%	0.2%	99.8%	100.0%
	Number of employees in non-financial economy (thousands)	44 498	22 482	22 743	43 985	89 723	133 751
	Employment share	33.3%	16.8%	17.0%	32.9%	67.1%	100.0%
Slovakia (2009)	Number of businesses in selected non-financial sector	418 156	23 197	2 394	589	443 747	444 336
	share of business	94.1%	5.2%	0.5%	0.1%	99.9%	100.0%
	number of employees in selected non-financial corporate sector	326 216	226 210	209 981	349 782	762 408	1 112 190
	share on employment	29.3%	20.3%	18.9%	31.4%	68.6%	100.0%

Source: [4]

Business category posting used in this chapter is in accordance with the European Commission Guidelines No.2003/361, valid from 1.1.2005. SME category is formed by businesses with less than 250 employees, large businesses category is with 250 or more employees. In SME category they are micro-sized businesses with 0-9, small businesses with 10-49 and medium-sized ones with 50-240 employees. In cases where micro-sized businesses category is not distinguished, small businesses are the ones with 0-49 employees. Other than number of employees European Commission Guidelines are valid for businesses categorizing and other parameters such as turnover figures, assets and tape of ownership [3].

Chart 1 - SME- legal entity growth in Slovakia



Source: [4]

Table 2. SME- legal entity growth in Slovakia

	2001	2002	2003	2004	2005	2006	2007	2008	2009
micro (0-9)	50 867	47 845	51 973	59 761	69 501	76 918	80 889	96 010	102 926
small (10-49)	8 585	8 317	9 129	10 657	10 658	12 956	17 212	21 226	20 899
medium (50-249)	2 825	2 768	2 735	3 136	2 930	2 908	2 805	3 024	2 925

Source: [4]

3 Evolution of Accounting after 1989

With a transition to market economy after 1990 wide changes were taking place in the economy as a whole, as well as in accounting. A new element there is a profession of verifiers of accounting statements, auditors.
A following period is marked by legislative modification of accounting procedures. Other than double-entry accounting it is bringing a single-entry accounting for selected entities and entrepreneurs-personal entities. Important turning point for Slovakian accounting system is 1993, with its post-revolution reform. Accounting adjusted to the new market conditions, as a root a French model was used.
To achieve the same perception and importance of accounting as in other EU countries, where it is one of most reputable, project of accountant profession was introduced. It is not just a legislative modification, but a harmonization of Slovakian accounting and it's staffing, making it acceptable anywhere in EU. To be a qualified accountant requires not only knowledge of accounting and tax regulations, but other professions as well, law, economy, statistics, managerial accounting financial tools and financial management and strategy, financial analysis, auditing techniques and knowledge of International Accounting Standards.
After 2003 is accounting guided by a new law. In a broader spectrum Slovakia is accepting a legislative obligation to compile not just consolidated (after 1.1.2005) but individual financial statements (after 1.1.2006) according to International Standards of Accounting. As of 1.1.2003 a new law was introduced regarding auditors, auditing services and Slovakia Chamber of Auditors. From 2003 some regulations were introduced allowing accounting entities an appraisal of assets by their real value.

Accounting legislation:

- **Laws**
  - Law No.431/2002 regarding accounting, as amended by later regulations
  - Law No. 513/1991 Sb., Commercial Code as amended by later regulations
  - Law No. 455/1991 Sb. Small Trades as amended by later regulations
  - Law No 47/1992 Sb. Civil Code as amended by later regulations
  - all Laws regarding tax policy, mainly Law No. 595/2003 Z. regarding
  - Income Tax

- **Provisions of Slovakia Ministry of Finance regarding mainly:**
    - accounting entities procedures in accounting and accounting plans for different types of accounting entities
    - individual financial statements by different types of accounting entities.
    - Single-entry accounting
    - methodical instructions of Ministry of Finance, guiding the accounting in accordance with Law of Accounting and measures issued [11]

4 Reporting Issues

4.1 Intangible Assets

Intangible assets are intangible in nature with useful life longer than one year and market entry price higher than 2 400 EUR.
The intangible assets include various types of assets:

- *Capitalized development costs* – the results of successful development work - design, manufacturing and testing of prototypes and pre-production models, technological processes, formulas, etc.
- *Software* – includes computer programs not purchased separately as part of the hardware, or generated internally in order to trade with them or to use them in the enterprise
- *Royalties* – are intellectual creations that have been acquired for a consideration, i.e., inventions, licenses, trademarks, copyrights, know-how, etc.
- *Goodwill* - a good company name or product on the market - reputation, quality assurance, reliability, service, etc.
- *Other intangible assets* - intangible assets valued at 2 400 Euros and less and with useful life longer than one year. This includes a purchased technological procedure at the amount of, e.g., 2 000 Euros.

Under Section 24 of the Income Tax Act, intangible assets shall be depreciated by the taxable party having the ownership title to such assets.
An accounting entity shall depreciate the intangible assets within 5 years from its acquisition in accordance with accounting rules. The period of depreciation is determined by a qualified estimate upon the time necessary for the use of intangible assets.

4.2 Tangible Assets

Tangible assets are tangible in nature, i.e., their useful life is longer than one year and they are worn down during the application process and usually have a higher value. The tangible assets include various types of assets:

- *Building structures* - are tangible assets regardless of the market entry price. These consist of, e.g., factory buildings, warehouses, roads, pipelines, gas pipelines, company apartments, etc.
- *Tangible movable assets* and sets of movable assets - their useful life is longer than one year and they are valued at more than 1 700 Euros. Individual movable assets include, e.g., machinery, instrumentation and equipment, vehicles, production line and so on. Individual movable assets with the price of 1700 Euros or less may be classified here as well, if determined by an internal regulation of the enterprise.
- *Cultivated areas* - include production units with a fertility rate of more than three years, regardless of the market entry price - such as orchards, shrubs, vineyards, hop-fields, etc.
- *Breeding and draught animals* - are tangible assets regardless of the market entry price, e.g., pigs, cattle, racehorses, etc.
- Opening of new quarries, sandpits, technical reclamation, technical revaluation and other - if they are not part of the market entry price of tangible assets, e.g., a quarry, access road to the gas station, etc.
- *Land* - involves tangible assets regardless of the market entry price, e.g., agricultural land, forests, meadows, etc.
- *Works of art* (if not included in the Building structures), collections, precious metals articles - if not considered as financial assets, they are tangible assets regardless of the market entry price, e.g., paintings, sculptures, collections of commemorative coins, etc.

Individual components of assets shall be valued at the following:

- ***purchase price*** **-** tangible assets, excluding tangible assets generated internally; shares of registered capital of partnerships; securities and derivatives; intangible assets except intangible assets generated internally
- ***own costs*** **-** tangible and intangible assets generated internally
- ***reproduction cost*** - assets acquired free of charge (donation); assets transferred from private ownership to company with the exception of cash, stamps and receivables valued at nominal value; tangible and intangible assets newly acquired after inventory and so far uncontained in accounting.
- ***fair value*** **-** assets acquired through a deposit or a purchase of enterprise or its part and assets acquired by replacement with the exception of an accounting entity with a single entry bookkeeping and an accounting entity, which has not been established for the purpose of business; securities in the possession of fund and securities held for trading and securities aimed for sale by securities traders who do not proceed according to Section 17a Para 1; commodities traded in a public market, which were not produced by the accounting entity but acquired for the purpose of reselling them in a public market; precious metals in the possession of fund.

Depreciation of tangible assets

- book depreciation,
- tax depreciation

If the difference between tax and book depreciation occurs in an accounting entity, the entity shall account for deferred tax.

Book depreciation

The basic rules governing the depreciation of assets are specified by Act No. 431/2002 Coll., on Accounting, as subsequently amended, which determines the book depreciation.

An accounting entity decides on the method of assets depreciation itself. The entity usually begins to depreciate in the month of the assets inclusion in use and the last depreciation is recorded in the last month in which the assets are inactivated. Book depreciation reflects the actual and fair depreciation of assets. They are determined by enterprise itself.

Intangible assets and tangible assets are depreciated based on a depreciation schedule indirectly through book depreciation. The residual value is determined by accumulated depreciation of intangible and tangible assets. Tangible assets are depreciated with respect to depreciation adequate to common conditions of use. According to changing conditions, the depreciation schedule is reviewed and the remaining period of depreciation or depreciation rate is adjusted.

The way of depreciation is fully within accounting entity’s competence. The depreciation life is an estimate, which is subject to management’s responsibility. The book depreciation method is described in the notes of financial statements.

Therefore, book depreciation is determined by an entrepreneur due to how long the assets will be used and what are the expectations on reduction of their lifetime.

Tax depreciation

For purposes of determining the tax base in the business activity, an accounting entity shall proceed in accordance with Act No. 595/2003 Coll., on Income Tax, as subsequently amended.

In compliance with Section 24 of the Income Tax Act, tangible assets shall be depreciated by the taxable party having the ownership title to such assets. The amount of tax depreciation is not determined by the enterprise itself. All enterprises shall comply with the same rules and the method of calculation is specified in the Income Tax Act.

Assets are depreciated as follows:

- linear depreciation - in terms of useful life
- accelerated depreciation – different depreciation rates in relation to performance

Tangible assets according to the period of depreciation:

Depreciation category 1	4 years
Depreciation category 2	6 years
Depreciation category 3	12 years
Depreciation category 4	20 years

Linear depreciation

Depreciation category	Annual depreciation (coefficient)
1	1/4
2	1/6
3	1/12
4	1/20

$$yearly\ depreciation = cost \times coefficient \qquad (1)$$

Accelerated depreciation

Depreciation category	Coefficient of accelerated depreciation		
	in the 1st year of depreciation	in subsequent years of depreciation	for increased residual cost
1	4	5	4
2	6	7	6
3	12	13	12
4	20	21	20

$$yearly\ depreciation_{1st\ year} = \frac{cost}{coefficient\ (1st\ year)} \qquad (2)$$

$$yearly\ depreciation = \frac{2 \times (cost - accumulated\ depreciation)}{coefficient\ (other\ years) -\ number\ of\ years, for\ which\ the\ asset\ was\ already\ depreciated} \qquad (3)$$

Component depreciation is depreciation of individual component parts, provided that such depreciable tangible assets of separate movable assets can be divided into individual component parts - components. Whereas, the market entry price of each component part must be more than 1 700 EUR. Individual component parts are recorded separately in order to clearly maintain the technical and value data of individual component parts and any changes in individual component parts, e.g., acquisitions and disposals, including information about the date of changes, the magnitude of change, market entry prices and residual costs of individual component parts, the total cost of tangible assets and depreciation amount, including the changes resulting from changes in market entry price for such assets.
The depreciation of individual component parts of tangible assets allows the classification of individual movable assets into smaller component parts - for example, different production lines. As for buildings and structures, the law allows devoting separate depreciation of only four types of individual component parts, i.e., distribution of computer networks belonging to depreciation category 2, passenger and freight elevators, escalators and moving sidewalks, air conditioners (belonging to depreciation category 3).

Tangible assets are disposed from the accounting of a business entity, when worn-out, no longer needed or for other reasons by:

- liquidation - due to obsolescence or wear and tear,
- sale of unneeded tangible assets,
- disposal or transfer, based on obligations of law,
- donation,
- as a result of damage or shortages,
- reassignment of assets from business to personal use,
- transfer to another partnership.

An accounting entity shall value tangible and intangible assets in accordance with Act No. 431/2002 Coll., on Accounting (Section 25), either at purchase price, own costs or reproduction cost.

Tangible and intangible assets purchased in foreign currency are valued at the equivalent to Slovak currency (euro) at exchange rate announced by the National Bank of Slovakia which is applicable as of the accounting transaction date. The increase in valuation is not applicable. A temporary reduction in tangible or intangible assets is recorded to the appropriate account of adjusting items on 31 December by comparing the book value to market value. If the assets are valued at foreign currency and the adjusting item was made in foreign currency as well, then it shall be converted into the Slovak currency (EUR) [6].

4.3 Leases

Financial leases

It is the acquisition of tangible assets under the lease contract negotiated with the purchase of a leased thing, while the ownership right passes to the lessee after the expiry of the lease without undue delay, for a price lower than the residual value of assets of even depreciation. The duration of the lease must be at least 60% of the depreciation period (minimum 3 years).

To the nature of financial leasing does not apply any type of contract amended in civil or commercial contractual relationships. Therefore, financial leasing contracts are concluded, in practice, most often as

- Innominate (unnamed) under the Commercial Code,
- Contracts for the purchase of a leased thing under Section 489 and subsequently the Commercial Code.

The principle of posting in lessor’s bookkeeping is recognition of leased assets under financial leasing through receivables of an amount equal to the net investment in assets which is the object of the financial leasing. According to the agreed payments, financial revenue is recorded representing the lessor’s reward and reimbursement of expenses for financial services provided.

The lessee reports liabilities from financial leasing and the object of the lease in his books at the present value of minimum lease payments agreed for rent. The lessee posts the settlement of services and expenses related to financial leasing to the lessor as financial expense. The lessee provides book and tax depreciation on the object of the financial leasing, because the lessee is viewed as an economic owner entitled to depreciate the object of the financial leasing with the right to use tax expenditures in rent during the lease.

The lessor administers the assets held for financial leasing as well as any other of his assets and all expenses associated with its acquisition are the investment expenditure. In the event that the object of the lease is delivered in form of supply, the purchase price is the market entry price for purposes of tax depreciation. The market entry price may include technical valuation on the object of the lease, financed by the lessor prior to the assumption of the object by the lessee. The purchase price may also include transportation, customs and assembly. With the acquisition of the lease are often related other expenses, for example:

- expert opinions
- credit interest
- exchange differences on foreign imports.

The object of the leasing contract is often a movable thing or a set of movable things forming a technological unit. Contracting parties together with the leasing contract conclude a contract for the purchase of a leased thing, which is valid after the expiry of the lease relationship. The lessee may transfer the object of the lease free of charge or for payment as follows:

- For a nominal consideration
- For a residual cost, the lessor may include it in the expenses

For a price that is higher than residual cost, but lower than the residual cost which would the object of the lease have at accelerated depreciation

- For a price that is lower than the residual cost.

Operational leases

Operational leasing is a form of short-term lease. Therefore, after the expiry of the lease (as opposed to the finance leasing), the right to purchase the leased thing by the lessee is not agreed. In compliance with the Income Tax Act, however, the leased thing may be sold upon arrangement to the lessee, a supplier or a third party after the termination of the lease. Apart from the financial leasing, the operational leasing duration is not limited. Unlike financial leasing, in case of operational leasing, the lessor is responsible in all cases for the maintenance, servicing and repair works. Operational leasing is not directly regulated by the law. The legal

nature and purpose of economic lease are close to standard lease, therefore, in practice, the operational leasing contract is often dealt by applying the Civil Code provisions, which regulate the conditions for lease of assets under a contract of lease, and separately govern provisions of business leasing. For tax purposes, the operational leasing involves any lease that does not meet the conditions of financial leasing.
The lessee does not post the object of operational leasing nor presents it in his financial statements. Individual arranged payments are recorded only, so that the amount of payments is debited to account 518 - Other services with a corresponding entry to account 325 - Other liabilities. Application of accrual principle of accruals and deferred charges of costs is subject to this type of lease, similarly to financial leasing [7].

Factor / Leasing type	Financial leasing	Operational leasing
Leasing duration	The duration of the lease is at least 60% of the depreciation period, minimum 3 years	Without limitations
Selection of the object of lease	By lessee according to his own requirements and conditions	By lessee according to his own requirements and conditions
Service and maintenance	Administered by lessee	Administered by lessor
Insurance	An insurance company may be chosen by lessor, insurance is further provided and paid by lessee	Lessor
First option	Yes, for the agreed purchase price upon the expiration of the rental relationship	No
Duty to repay the lease payments in case of failure	Yes	No
The possibility of withdrawal of the contract	Lessee - No Lessor – Yes, in case of failing payments by lessee or destruction or theft of the leased thing	Upon the agreement between the lessor and lessee

4.4 Financial Assets

Financial means held by the accounting entity for more than one year are considered to be financial assets. They include

- Investment in controlled entities/subsidiaries,
- Investments in associates,
- Shares and interest realized,
- Debt securities held to maturity, loans granted by the accounting entity in the consolidated unit,
- Long-term loans,
- Works of art, collections, and objects made of precious metals and land, administered by the entity for the long-term storage of funds.

Financial assets are a special type of investment, when the entity in achieving its strategic goals focuses on the purchase of specific assets for long-term ownership. The accounting entity buys them with the intent to obtain long-term fair return (in the form of interests and dividends), or use them to acquire a decisive or substantial influence in another entity.
Slovak legislation describes only three ways to determine the fair value (market price, qualified estimate, expert opinion).
Section 27 of the Accounting Act specifies valuation to the date of the financial statement, or another date during the reporting period as follows:

- securities are valued by market price or qualified estimate, except for securities held until maturity, non-negotiable securities acquired in primary issues, interest in share capital of enterprises, and securities issued by the accounting entity itself,
- derivatives: by market price or qualified estimate,

- financial allocations and technical provisions of accounting entities that are insurance companies and reinsurance companies by market price, qualified estimate, or expert opinion.

Valuation of securities:

- **Initial valuation**: Purchase price (security price + transaction costs)
- **The subsequent valuation**: Fair value:
- an accounting entity may apply the price determined by the weighted arithmetic average (if this method is used, the entity must calculate the weighted average at least once a month) in the valuation of loss or the method where the initial price used for the valuation of increase in the security is used as the first price for the valuation of the disposal of this security (FIFO method). This method can be applied only in respect of:
    - the same type of security
    - the same issuer
    - the same currency in which the securities are issued
- interest in capital can be valued by equity (an equity method - old Slovak term). The share is valued at procurement by purchase price. The interest is then, on the date when the financial statements are presented or any other date during the accounting period, adjusted to a value appropriate to the accounting entity's participation in the owners' equity of the company, where it has a share in share capital.

If the accounting entity has a share of less than 20% of the share capital or the voting rights in a partnership, investments may be valued by equity on the valuation date under Section 24 Para 1 Letter b) of Act. The valuation of investment will be increased by the share of profits or reduced by the share of losses. The provision governs the valuation of investments on the date on which financial statements are presented using the equity method. The wording implies that the shares, which constitute of less than 20% of the voting rights of partnerships, are not valued by equity. In connection with Section 27 Para 1 Letter a) of the Accounting Act, these shares are valued by fair value.

Under the Accounting Act, financial assets and liabilities not valued by real value are administered as follows:

- the valuation of securities held until maturity and non-negotiable securities acquired in primary issues is gradually increased by yield of interest earned from the date of their acquisition to maturity date
- the share of owners equity in a partnership can be valued by equity. If an accounting entity uses this method, it is required to apply it to the valuation of all such shares
- the valuation of securities issued by the accounting entity is gradually increased by interest costs on issued securities from the date of their settlement to maturity

Securities and shares are valued at procurement by **purchase price**. The purchase price of securities and shares is associated with the acquisition cost of securities, e.g., fees and commissions paid to brokers, advisors and stock exchanges. The purchase price does not include particularly credit interests for the purchase of securities and shares, foreign exchange differences and costs associated with holding securities or shares. The various components of the purchase price of securities and shares purchased are during orders posted to account 043 - Long-term investment in progress or in respect of current financial assets to account 259 - Short-term investments in progress.

Securities and shares are accounted for as

- financial assets in respect of securities and shares in the subsidiary accounting entity, securities and shares in associates, shares and interest realized and debt securities held to maturity
- current financial assets in terms of equity securities held for trading and debt securities held for trading, debt securities with maturity up to one year held to maturity, own shares and own business shares, own bonds and other shares realized.

Securities and shares are monitored on the analytical accounts according to the type of securities, issuers and currencies, for which securities and shares were issued.

Change in fair value of equity securities held for trading is accounted for as a reduction in value crediting the account of current financial assets with a corresponding entry debited to 564 – Loss on revaluation of securities. The increase in value is debited to the account of financial assets with a corresponding entry to account 664 – Gain on revaluation of securities.

Change in fair value of debt securities held for trading is posted as follows:

- reduction in the nominal value of coupon bonds is charged to account 566 - Loss on investments in correlation with the account of financial assets,
- increase in the nominal value of coupon bonds is credited to account 666 - Income from short-term investments in correlation with the account of financial assets.

In case of discounted securities, the change in valuation by fair value is part of interest income.
Changes in fair value of securities and shares, which are part of share capital of another accounting entity and are not securities or shares in a subsidiary accounting entity or associates, are debited to the relevant asset account with a corresponding entry crediting account 414 - Assets and liabilities revaluation.

Derivatives are classified according to the application as

- derivatives held for trading,
- hedging derivatives.

Derivatives are classified according to type of financial instruments

- fixed term operations, which are forwards, futures and swaps,
- options, from which the buyer benefits in terms of the favorable evolution of prices of underlying financial instruments, but which can negatively affect the financial position of the buyer in case of adverse changes in prices of the underlying instruments.

The derivatives are not

- repo transactions,
- purchase or lease agreements, or agreements to sale tangible assets, intangible assets, inventories excluding commodities, traded or possibly traded on the secondary market, such e.g., agricultural products, mineral products including oil, precious metals and energy, when one of the parties is authorized to settle financially; the exemption does not apply to contracts entered into for the commodity purchase, sale or use of commodities, which are expected to be settled by supply of commodities,
- Acquisition agreements of own shares in exchange,
- Section 8 Letter d) of Act No. 566/2001 Coll., on Securities and Investment Services and amending other acts (The Securities Act).
- insurance agreements or usual agreements requiring payment in relation to climatic, geological or other physical factors.

Derivatives are monitored in off-balance sheet accounts, recorded in the balance sheet accounts and income statement accounts from the date of the transaction until the final settlement, completion, and application of the law, sale or repurchase. The transaction date is the date of conclusion of agreement.
Receivables and liabilities recorded in the balance sheet on analytical accounts are divided according to the derivatives. Changes in fair value are entered during the term transactions as a receivable or liability to account 373 - Receivables and liabilities from term transactions. The purchased option premium is posted to account 376 - Long options and the received option premium to account 377 - Short options. Changes in their fair values are also entered in these accounts.
If a derivative is classified as a derivative held for trading in domestic stock exchange, international stock exchange or other public market, it is accounted on the date on which the financial statements are presented accompanied by a change in fair value supported by the data from the public market to accounts 567 - Loss on derivative transactions and 667 - Income from derivative transactions with a corresponding entry to accounts 373, 376, 377. Financial settlement in the implementation of transaction is carried out in correlation with accounts 373, 376 and 377.
Change in fair value of derivatives tradable in a non-public market is charged or credited, on the date on which the financial statements are presented according to the nature, to account 373, 376, and 377 with a corresponding entry to account 414 – Assets and liabilities revaluation.
If it is not possible to revaluate the derivatives by the fair value that is the market price of the public market, a qualified estimate is applied. To determine the fair value, a valuation model is used including proven data such as reference exchange rates determined and announced by the European Central Bank or interest rates from the interbank market published by the National Bank of Slovakia, publicly available credit ratings of rating agencies. If the qualified estimate cannot be elaborated, or if the cost of obtaining information about the revaluation is disproportionate to its importance, then the fair value is not accounted unless it is clear that there is an impairment of the derivative.

Changes in fair value of hedging derivatives are recorded in account 414 - Assets and liabilities revaluation with a corresponding entry to the relevant derivate account. Changes in the fair value of the hedged asset or liability due to the hedged risk are posted to account 414 - Assets and liabilities revaluation with a corresponding entry to the relevant account of assets or liabilities.
On the date of the end of provision, the revaluation to fair value of the hedged assets or liabilities is charged or credited to the assets or liabilities account with a corresponding entry to 414 - Assets and liabilities revaluation.
Shall the assets and liabilities be provided and the hedging derivative is traded in a public market and changes in fair value can be supported by data from the public market, or hedging derivative is not traded in the public market, but it will be settled under concluded agreement by the end of next financial period, at the latest, then the changes in fair value of hedged assets and liabilities and also hedging derivates are either debited to the account of the expenses and credited to the relevant account of revenues.

4.5 Receivables

Accounting Act specifies two options for measurement of receivables, namely:

- At nominal value at inception,
- At purchase price are valued receivables acquired against payment, or receivables acquired by contribution to share capital
- At the present value are valued long-term receivables in the possession of fund. Fund receivables, which are not payable in payments and their agreed maturity is less than one year, can be valued by the nominal value.

Depreciation of receivable is the way of its withdrawal from the accounts, not the way of its termination. The adjusting item is a temporary adjustment of the value of receivable and expresses the probability that the receivable will not be paid (cost at the amount of the adjusting item will be created) [5].

4.6 Inventories

An inventory is included in current assets. It is further divided into:

- Material
- Work in progress, semi-finished products, products and animals
- Goods.

The material involves entries of raw materials, auxiliary materials and operating materials, spare parts and packaging, whereas:

- materials, which are merged wholly or in part into a product and form its substance during the manufacturing process, are recorded as a raw material
- under auxiliary materials are accounted materials, which are directly transferred into a product, but do not form its substance (e.g., varnish)
- materials necessary for running of the accounting entity as a whole (e.g., lubricants, fuel, detergents) are posted as operating materials
- articles determined for placing the tangible assets into their original state or operationally-capable state are accounted as spare parts
- the packaging is recorded when it serves to protect and transport purchased materials, goods and products, and if non-returnable packaging is delivered to a customer, or is passed within the accounting entity together with the delivered content
- movable assets with a useful life not exceeding one year are entered as an inventory regardless of the cost
- work in progress is accounted for products that have passed one or more production operations and are no longer a material, but not a finished product either. The work in progress comprises the incomplete performance of other activities which do not produce tangible products (e.g., judicial executorial or architectural services)
- semi-finished products are posted in respect of separately registered products that have not yet passed all stages of production and will be finished or completed in the next manufacturing process
- own products for sale outside the accounting entity or consumption within the accounting entity are recorded as products

- in inventories are determined mainly animals, which are in particular young breeding animals, fattening animals, fish, fur animals, colonies of bees, hens, ducks, turkeys, guinea fowls and geese for fattening and dogs.
- goods are entered if purchased for sale, whereas the goods purchased shall be kept in the same condition as received, not to be used, not to be leased, and not to undergo technical evaluation. Goods are also own products, which have been capitalized and passed to own accounting entity.
- In inventories established by their own activity, the working costs are valued either at their actual amount or an amount of the working costs under operating (planned) calculations. Such costs are intended under specific technical, technological, economic and organizational conditions determined by the technical preparation of production for performance realization, and therefore are almost identical to the actual working costs. To the purchase price are capitalized transport charges and working costs of material processing only [5].

4.7 Cash and Equivalents

Cash and cash equivalents are components of current financial assets. Current financial assets are divided into three categories:

- Cash of an accounting entity and cash equivalents (e.g., stamps, vouchers, checks)
- Bank accounts
- Current-asset securities
- Cash-in-transit.

Current financial assets are liquid and tradable immediately, where the expected period is not exceeding one year from the date of the accounting transaction. All these items may be taken as cash or cash equivalents.

4.8 Equity

Equity is an essential part of liabilities. Equity is divided into:

- Share capital
- Capital reserves
- Reserve funds
- Retained earnings
- Profit or loss for the current period after taxation

Share capital in Slovak accounting includes: share capital, own shares and business shares, receivables from equity subscribed and changes in share capital. Capital reserves are further divided into: share premium, other capital reserves, legal reserve, assets and liabilities revaluation, equity investments revaluation and the valuation of the merger, consolidation and distribution. The share premium is accounted in the case of a difference between the nominal value of issued shares and the amount paid for the shares (issue price) or in investments raising share capital through subscription of new shares. When establishing a limited liability company, a minimum amount of share capital must be 5 000 EUR, in the case of joint stock company a minimum of 25 000 EUR. The law also specifies the obligation of joint stock companies and limited liability companies to maintain a legal reserve. In the case of joint stock companies, the legal reserve must be established at amount of at least 20% of share capital and the minimum contribution to this reserve is 10% of net profit. A legal reserve for a limited liability company may not be created when the company is founded, but the law determines for contributions to be at least 5% of net profit and the minimum value must be 10% of the share capital. Other terms and conditions are specified by the partnership agreement.
Another item of equity is reserve funds. They are divided into the following groups: legal reserve, indivisible reserve, statutory reserves and other reserves. Items Retained earnings and • Profit or loss for the current period after taxation are not further subdivided.
When recording the share capital of the accounting entity that is a joint stock company, the procedure is as follows:

- to account 411 - Share capital is recorded with a credit to the Share capital on the date of registration in the Commercial Register, based on the abstract of the Commercial Register,
- increase in the share capital, which has not yet been entered in the Commercial Register shall credit account 419 - Changes in share capital and is settled by posting to account 411 - Share capital, on the date of registration in the Commercial Register.

- to account 411 - Share capital is recorded with a debit to the Share capital on the date of registration in the Commercial Register, based on the abstract of the Commercial Register,
- reduction in the share capital, which has not yet been entered in the Commercial Register shall debit account 419 - Changes in share capital and is settled by charging to account 411 - Share capital, on the date of registration in the Commercial Register.

When entering the share capital of the accounting entity that is a limited liability company, the procedure is as follows:

- share compensation is credited to account 365 as a liability to the partner - Other liabilities to partners and members with a corresponding entry charged to account 252 - Own shares and own business shares
- non-cash payment of share compensation shall be entered in correlation with the salvage value of depreciated fixed assets and cost of non-depreciated fixed assets or in correlation with other asset account
- if a difference in the liabilities accounts arises, it is credited to account 668 - Other financial income.

The set up of a legal reserve fund at the partnership establishment is charged to account 353 - Receivables from equity subscribed with a corresponding entry credited to account 417 - Legal reserve of capital investments. The set up of a legal reserve fund from accounting income is charged to account 431 – Profit (loss) for the current period in the approval process or 428 - Retained earnings from previous years with a corresponding entry credited to account 421 - Legal reserve [5,8].

4.9 Provisions

Provisions are in the Slovak accounting reported in liabilities as part of external resources. Provisions are comprised as follows:

- non-current legal provisions
- other non-current provisions
- other current provisions.

Provisions are built up on the principle of prudence to risk and losses. Provision is a liability representing the present obligation of an accounting entity that arose from past events. It is probable that it will reduce economic benefits of the accounting entity in the future, whereas if the exact amount of this liability is not known, it will be valued in the sum sufficient to meet the existing liabilities on the date on which financial statements are prepared taking into account the risks and uncertainties. A liability with a specific time definition and specific amount is not recorded to the provisions account, but to the relevant liabilities account.
A method of creation and utilization of provisions is stated in the accounting entity’s internal regulation, whereas the provision may be used only for the purpose for which it was created. Provisions can be also used in terms of insurance - mathematical methods and value of these provisions is adjusted to their value at the time of posting and reporting.
Creation of provisions associated with the acquisition of assets, such as an uninvoiced delivery of material, an uninvoiced supply of fixed assets, is debited with a corresponding entry to the relevant asset account and its use with a corresponding entry credited to the relevant liabilities account, for example, after receiving an invoice from the supplier.
Provision balances are transferred to the following accounting period. Provisions do not have a credit balance. Provisions are subject to book inventory and their amount and appropriateness is assessed during inventory. Due to adjusting closing accounting transactions, the creation of provision is accounted or their amount adjusted on the date when financial statements are presented.
Provisions apply to the obligations arising from generally binding legal regulations, conducted contracts, from the accounting entity’s voluntary decision to meet its duty to the third parties. For example, if on the basis of the accounting entity’s previous activity, publication of rules or notification of acknowledgment of responsibility of the accounting entity, the third party expects that this duty will be met:

- costs associated with the elimination of environmental pollution,
- complaints and warranty repairs,
- disposal of waste and packaging,
- land reclamation,
- demolition of buildings,
- compensation,

- remaining days of vacation, refund of social insurance,
- remuneration of members of the Supervisory Board and other corporate bodies,
- uninvoiced deliveries and services,
- contribution fees to the unions, associations, chambers, etc., relating to the reported fiscal period,
- bonuses, discounts, rebates, etc., relating to products, goods and services provided before the end of the reported accounting period,
- costs of preparation, verification and presentation of financial statements and annual reports from the reported financial period,
- costs of preparation of tax returns for the fiscal period,
- fines and penalties,
- financial obligations arising from guarantees and warranties,
- the obligation to repurchase packaging,
- actual and pending litigations,
- payment of premiums and remunerations,
- payment of severance pay, payment to employees celebrating life or work anniversaries and other payments to employees (employee benefits),
- commission for sales representatives,
- loss-making contracts and onerous contracts in which costs necessary to meet contractual obligations exceed the economic benefits that are expected from the contract,
- loss-making contracts and onerous contracts,
- emissions released into the air,
- other risks and losses associated with the activities of the accounting entity.

The Slovak accounting does not allow creating a provision for repair of fixed assets. The creation of provision for costs is posted to the appropriate cost account to which the liability relates. If a provision covers more cost types or a cost type for which a cost account has not been set, it is charged to the account Other expenses on ordinary activity or Other expense on financial activity. The utilization of provision is debited to the relevant provisions account with a corresponding entry credited to the relevant liabilities account. Repeal of unnecessary provision or its part is posted as a reverse accounting entry than when the provision creation was entered. To the provisions is applied the principle of the right enumerating of the closing balance of provisions balance sheet account and the relevant closing balance of costs. Provision for bonuses, rebates, discounts and refund of the purchase price at the claim is formed as the reduction of initially achieved revenues with a corresponding entry credited to the provisions balance sheet account [5].

4.10Liabilities

The liabilities are part of external resources. Liabilities of the accounting entity are in term of time divided into non-current liabilities and current liabilities. A non-current liability is an obligation, which agreed maturity or settlement in any other way in accounting transaction occurrence is longer than one year. A current liability is an obligation, which agreed maturity or settlement in any other way in accounting transaction occurrence is one year at the most [5,10].

Non-current liabilities are divided into:

- long-term trade payable
- long-term uninvoiced deliveries
- long-term advances received
- long-term liabilities – controlled entities/subsidiaries
- other long-term liabilities within consolidation unit
- long-term bills of exchange payable
- bonds issued
- social fund payable
- deferred tax liability
- other long-term liabilities

Current liabilities are divided into:

- trade payables
- uninvoiced deliveries

- liabilities to subsidiary and parent accounting equities
- other liabilities within consolidation unit
- liabilities to partners and associations
- liabilities to employees
- social security insurance payable
- tax liabilities and subsidies payable
- other liabilities

5 Official Forms of Financial Statements

5.1 Balance Sheet

Official structure of Balance Sheet according to Slovak accounting legislature is following:

001		**TOTAL ASSETS**	**r.002 + r.031 + r.061**
002	***A.***	***Non-current assets***	***r.003 + r.012 + r.022***
003	A.I.	Long-term intangible assets	total (r.004 to 011)
004	*A.I.1.*	*Incorporation expenses*	
005	*A.I.2.*	*Capitalized development costs*	
006	*A.I.3.*	*Software*	
007	*A.I.4.*	*Valuable rights*	
008	*A.I.5.*	*Goodwill*	
009	*A.I.6.*	*Other long-term intangible assets*	
010	*A.I.7.*	*Acquisition of long-term intangible assets*	
011	*A.I.8.*	*Advance payments made for long-term intangible assets*	
012	A.II.	Long-term tangible assets	total (r.013 to 021)
013	*A.II.1.*	*Land*	
014	*A.II.2.*	*Structures*	
015	*A.II.3.*	*Individual movable assets and sets of movable assets*	
016	*A.II.4.*	*Perennial crops*	
017	*A.II.5.*	*Livestock*	
018	*A.II.6.*	*Other long-term tangible assets*	
019	*A.II.7.*	*Acquisition of long-term tangible assets*	
020	*A.II.8.*	*Advance payments made for long-term tangible assets*	
021	*A.II.9.*	*Adjusting entry to acquired assets*	
022	A.III.	Long-term financial assets	total (r.023 to 030)
023	*A.III.1.*	*Shares and ownership interests in a subsidiary*	
024	*A.III.2.*	*Shares and ownership interests with significant influence over enterprises*	
025	*A.III.3.*	*Other long-term shares and ownership interests*	
026	*A.III.4.*	*Loans to accounting entity within the consolidated unit*	
027	*A.III.5.*	*Other long-term financial assets*	
028	*A.III.6.*	*Loans with maturity up to one year*	
029	*A.III.7.*	*Acquisition of long-term financial assets*	
030	*A.III.8.*	*Advance payments made for long-term financial assets*	
031	***B.***	***Current assets***	***r.032 + r.040 + r.047 + r.055***
032	B.I.	Inventory	total (r.033 to 039)
033	*B.I.1.*	*Row material*	
034	*B.I.2.*	*Work in progress and semi-finished products*	
035	*B.I.3.*	*Construction contracts where the expected time of completion exceeds one year*	
036	*B.I.4.*	*Finished goods*	
037	*B.I.5.*	*Animals*	
038	*B.I.6.*	*Merchandise*	
039	*B.I.7.*	*Advance payments made for inventory*	

040	B.II.	Long-term receivables total (r.041 to 046)
041	*B.II.1.*	*Trade receivables*
042	*B.II.2.*	*Receivables from subsidiary and parent accounting entity*
043	*B.II.3.*	*Other receivables within the consolidated unit*
044	*B.II.4.*	*Receivables from partners, members, and association*
045	*B.II.5.*	*Other receivables*
046	*B.II.6.*	*Deferred tax asset*
047	B.III.	Short-term receivables total (r.048 to 054)
048	*B.III.1.*	*Trade receivables*
049	*B.III.2.*	*Receivables from subsidiary and parent accounting entity*
050	*B.III.3.*	*Other receivables within the consolidated unit*
051	*B.III.4.*	*Receivables from partners, members, and association*
052	*B.III.5.*	*Social insurance*
053	*B.III.6.*	*Tax assets and subsidies*
054	*B.III.7.*	*Other receivables*
055	B.IV.	Financial accounts total (r.056 to 060)
056	*B.IV.1.*	*Cash in hand*
057	*B.IV.2.*	*Bank accounts*
058	*B.IV.3.*	*Bank accounts with notice period exceeding one year*
059	*B.IV.4.*	*Short-term financial assets*
060	*B.IV.5.*	*Acquisition of short-term financial assets*
061	***C.***	***Accruals/deferrals total (r.062 to r.065)***
062	C.1.	Long-term prepaid expenses
063	C.2.	Short-term prepaid expenses
064	C.3.	Long-term accrued income
065	C.4.	Short-term accrued income

066		**TOTAL EQUITY AND LIABILITIES r.067 + r.088 + r.119**
067	***A.***	***Equity r.068 + r.073 + r.080 + r.084 + r.087***
068	A.I.	Share capital total (r.069 to 072)
069	*A.I.1.*	*Share capital*
070	*A.I.2.*	*Own shares and own ownership interests*
071	*A.I.3.*	*Change in share capital*
072	*A.I.4.*	*Receivables related to unpaid share capital*
073	A.II.	Capital funds total (r. 074 to 079)
074	*A.II.1.*	*Share premium*
075	*A.II.2.*	*Other capital funds*
076	*A.II.3.*	*Legal reserve fund (Indivisible fund) from capital contributions*
077	*A.II.4.*	*Differences from revaluation of assets and liabilities*
078	*A.II.5.*	*Investment revaluation reserves*
079	*A.II.6.*	*Differences from revaluation at merger, fusion, or division*
080	A.III.	Funds created from profit total (r.081 to r.083)
081	*A.III.1.*	*Legal reverse fund*
082	*A.III.2.*	*Indivisible fund*
083	*A.III.3.*	*Statutory funds and others funds*
084	A.IV.	Profit/loss from previous years (r.085 + r.086)
085	*A.IV.1.*	*Retained earnings from previous years*
086	*A.IV.2.*	*Accumulated losses from previous years*
087	A.V.	Profit/loss for the accounting period after taxation /+-/ r.001 - (r.068 + r.073 + r.080 + r.084 + r.088 + r.119)
088	***B.***	***Liabilities r.89 + r.94 + r.105 + r.115 + r.116***
089	B.I.	Provisions total (r.090 to r.093)
090	*B.I.1.*	*Long-term legal provisions*

091	*B.I.2.*	*Short-term legal provisions*
092	*B.I.3.*	*Other long-term provisions*
093	*B.I.4.*	*Other short-term provisions*
094	B.II.	Long-term liabilities total (r.095 to r.104)
095	*B.II.1.*	*Long-term trade liabilities*
096	*B.II.2.*	*Unbilled long-term supplies*
097	*B.II.3.*	*Long-term liabilities to subsidiary and parent accounting entity*
098	*B.II.4.*	*Other long-term liabilities within consolidated unit*
099	*B.II.5.*	*Long-term advance payments received*
100	*B.II.6.*	*Long-term bills of exchange to be paid*
101	*B.II.7.*	*Bonds issued*
102	*B.II.8.*	*Liabilities related to social fund*
103	*B.II.9.*	*Other long-term liabilities*
104	*B.II.10.*	*Deferred tax liability*
105	B.III.	Short-term liabilities total (r.106 to r.114)
106	*B.III.1.*	*Trade liabilities*
107	*B.III.2.*	*Unbilled supplies*
108	*B.III.3.*	*Liabilities to parent accounting entity and subsidiary*
109	*B.III.4.*	*Other liabilities within the consolidated unit*
110	*B.III.5.*	*Liabilities to partners and association*
111	*B.III.6.*	*Liabilities to employees*
112	*B.III.7.*	*Liabilities related to social insurance*
113	*B.III.8.*	*Tax liabilities and subsidies*
114	*B.III.9.*	*Other liabilities*
115	B.IV.	Short-term financial assistance
116	B.V.	Bank loans (r.117 + r.118)
117	*B.V.1.*	*Long-term bank loans*
118	*B.V.2.*	*Current bank loans*
119	***C.***	***Accruals/deferrals total (r.120 to r.123)***
120	C.1.	Long-term accrued expenses
121	C.2.	Short-term accrued expenses
122	C.3.	Long-term deferred income
123	C.4.	Short-term deferred income

5.2 Profit/Loss Statement

Structure of the Profit/Loss Statement using the division of costs and expenses by nature, according to Slovak legislature is following:

01	I.	Revenue from the sale of merchandise
02	A.	Cost of merchandise sold
03	***+***	***Trade margin (r.01 - r.02)***
04	II.	Production (r.05 + r.06 + r.07)
05	II.1.	Revenue from the sale of own products and services
06	II.2.	Changes in internal inventory
07	II.3.	Own work capitalised
08	B.	Production costs (r.09 + r.10)
09	B.1.	Consumed raw materials, energy consumption and consumption of other non-inventory supplies
10	B.2.	Services
11	***+***	***Added value (r.03 + r.04 - r.08)***
12	C.	Personnel costs total (r.13 to 16)
13	C.1.	Wages and salaries
14	C.2.	Remuneration of board members of company and cooperative
15	C.3.	Social insurance expenses
16	C.4.	Social expenses

17	D.	Taxes and fees
18	E.	Amortization of long-term intangible assets and depreciation of long-term tangible assets and value adjustment
19	III.	Revenue from the sale of non-current assets and raw material
20	F.	Carrying value of non-current assets sold and raw material sold
21	G.	Creation and reversal of value adjustment to receivables
22	IV.	Other operating income
23	H.	Other operating expenses
24	V.	Transfer of operating income (-)
25	I.	Transfer of operating expenses (-)
26	*	*Profit/loss from economic activities [r.11 - r.12 - r.17 - r.18 + r.19 - r.20 - r.21 + r.22 - r.23 + (- r.24) - (- r.25)]*
27	VI.	Revenue from the sale of securities and shares
28	J.	Securities and shares sold
29	VII.	Income from long-term financial assets (r.30 + r.31 + r.32)
30	VII.1.	Income from securities and shares in a subsidiary and in a company where significant influence is held
31	VII.2.	Income from other long-term securities and shares
32	VII.3.	Income from other long-term financial assets
33	VIII.	Income from short-term financial assets
34	K.	Costs of short-term financial assets
35	IX.	Income from revaluation of securities and income from derivate operations
36	L.	Costs from revaluation of securities and expenses related to derivative operations
37	M.	Creation and reversal of value adjustments to financial assets (+/-)
38	X.	Interest income
39	N.	Interest expense
40	XI.	Exchange rate gains
41	O.	Exchange rate losses
42	XII.	Other revenue from financial activities
43	P.	Other expenses related to financial activities
44	XIII.	Transfer of financial income (-)
45	R.	Transfer of financial expenses (-)
46	*	*Profit/loss from financial activities [r.27 - r.28 + r.29 + r.33 - r.34 + r.35 - r.36 - r.37 + r.38 - r.39 + r.40 - r.41 + r.42 - r.43 + (- r.44) - (- r.45)]*
47	**	***Profit/loss from ordinary activities before taxation (r.26 + r.46)***
48	S.	Income tax on ordinary activities (r.49 + r.50)
49	S.1.	- current
50	S.2.	- deferred (+/-)
51	**	***Profit/loss from ordinary activities after taxation (r. 47 - r. 48)***
52	XIV.	Extraordinary income
53	T.	Extraordinary expenses
54	*	Profit/loss from extraordinary activities before taxation (r.52 - r.53)
55	U.	Income tax on extraordinary activities (r.56 + r.57)
56	U.1.	- current
57	U.2.	- deferred (+/-)
58	*	***Profit/loss from extraordinary activities after taxation (r.54 - r.55)***
59	***	**Profit/loss for the accounting period before taxation (+/-) [r.47 + r.54]**
60	V.	Transfer of net profit/net loss shares to partners (+/-)
61	***	**Profit/loss for the accounting period after taxation (+/-) [r.51 + r.58 - r.60]**

5.3 Cash Flow Statement

For the preparation of Cash Flow Statement, there is possible to use both direct and indirect methods. Following text provides the information about the structures of this statement for each method.

Direct method

Cash flow from operational activity	
A.1.	Revenues from sale of merchandise (+)
A.2.	Expenses for purchase of merchandise (-)
A.3.	Revenue from sale of own products (+)
A.4.	Revenue from sale of services (+)
A.5.	Expenses for acquisition of material, energy and other non-storable supplies (-)
A.6.	Expenses for services (-)
A.7.	Expenses for personnel (-)
A.8.	Expenses for taxes and fees, except for expenses for income tax of the accounting entity (-)
A.9.	Revenues from the sale of securities determined for sale or trading (+)
A.10.	Expenses for the purchase of securities determined for sale or trading (-)
A.11.	Revenues from signed contracts whose subject matter is a right, determined for sale or trading (+)
A.12.	Expenses from signed contracts whose subject matter is a right, determined for sale or trading (-)
A.13.	Revenues from loans granted to the accounting entity by a bank or branch of a foreign bank, if the loans were granted for securing the main scope of business (+)
A.14.	Expenses for the repayment of loans granted to the accounting entity by a bank or branch of a foreign bank, if the loans were granted for securing the main scope of business (-)
A.15.	Other revenues from operational activities, except for those given specifically in other parts of the cash flow report (+)
A.16.	Other expenses for operational activities, except for those given specifically in other parts of the cash flow report (-)
.	***Cash flow from operational activity except for revenues and expenses that are given specifically in other parts of the cash flow report (+/-), (subtotal A.1. to A.16.)***
A.17.	Received interest, except for those incorporated in investment activities (+)
A.18.	Expenses for paid interest, except for those incorporated in financial activities (-)
A.19.	Revenues from dividends and other profit shares, except for those incorporated in investment activities (+)
A.20.	Expenses for paid dividends and other profit shares, except for those incorporated in financial activities (-)
..	***Cash flow from operational activity (+/-), (subtotal A.1. to A.20.)***
A.21.	Expenses for income tax of the accounting entity, except for those incorporated in investment or financial activities (-/+)
A.22.	Extraordinary revenues related to operational activity (+)
A.23.	Extraordinary expenses related to operational activity (-)
A.	***Net cash flow from operational activity (subtotal A.1. to A.23.)***
Cash flow from investment activity	
B.1.	Expenses for the acquisition of long-term intangible assets (-)
B.2.	Expenses for the acquisition of long-term tangible assets (-)
B.3.	Expenses for the acquisition of long-term securities and shares in other accounting entities, except for securities considered as monetary equivalents and securities determined for sale and trading (-)
B.4.	Revenues from the sale of long-term intangible assets (+)
B.5.	Revenues from the sale of long-term tangible assets (+)
B.6.	Revenues from the sale of long-term securities and shares in other accounting entities, except for securities considered as monetary equivalents and securities determined for sale and trading (+)
B.7.	Expenses for long-term loans granted by the accounting entity to another accounting entity belonging to a consolidated whole (-)
B.8.	Revenues from the repayment of long-term loans provided by the accounting entity to another accounting entity belonging to a consolidated whole (+)
B.9.	Expenses for long-term loans granted by the accounting entity to third persons, except for long-term loans granted to an accounting entity belonging to a consolidated whole (-)
B.10.	Revenues from the repayment of loans granted by the accounting entity to third persons, except for

	loans granted to an accounting entity belonging to a consolidated whole (+)
B.11.	Revenues from the lease of a set of tangible and intangible assets used and depreciated by the lessee (+)
B.12.	Received interests, except for those incorporated in operational activities (+)
B.13.	Revenues from dividends and other profit shares, except for those incorporated in operational activities (+)
B.14.	Expenses related to derivatives, except for those determined for sale or trading, or if the expenses are considered as the cash flow from financial activity (-)
B.15	Revenues related to derivatives, except for those determined for sale or for trading, or if the revenues are considered as cash flow from the financial activity (+)
B.16.	Expenses for income tax of the accounting entity, if they can be incorporated in investment activities (-)
B.17.	Extraordinary revenues related to investment activity (+)
B.18.	Extraordinary expenses related to investment activity (-)
B.19.	Other revenues related to investment activity (+)
B.20.	Other expenses related to investment activity (-)
B.	***Net cash flow from investment activity (subtotal B.1. to B.20.)***
Cash flow from financial activity	
C.1.	Cash flow generated in the shareholders' equity (subtotal C. 1. 1. to C. 1. 8.)
C.1.1.	Revenues from subscribed shares and business shares (+)
C.1.2.	Revenues from other investments in the shareholders’ equity by partners or a natural person that is an accounting entity (+)
C.1.3.	Received monetary donations (+)
C.1.4.	Revenues from payment of a loss by partners (+)
C.1.5.	Expenses for acquisition or repurchase of own shares and own business shares (-)
C.1.6.	Expenses related to decrease of funds created by the accounting entity (-)
C.1.7.	Expenses for payment of a share in the shareholders’ equity by a partner or natural person that is an accounting entity (-)
C.1.8.	Expenses for other reasons related to decrease of the shareholders’ equity (-)
C.2.	Cash flow from long-term liabilities and short-term liabilities from financial activity (subtotal C. 2.1. to C. 2. 10.)
C.2.1.	Revenues from the issue of bonds (+)
C.2.2.	Expenses for payment of liabilities from bonds (-)
C.2.3.	Revenues from loans granted to the accounting entity by a bank or branch of a foreign bank, except for loans granted for securing the main scope of activity (+)
C.2.4.	Expenses for the repayment of loans granted to the accounting entity by a bank or branch of a foreign bank, except for the loans granted for securing the main scope of activity (-)
C.2.5.	Revenues from accepted loans (+)
C.2.6.	Expenses for the repayment of loans (-)
C.2.7.	Expenses for the payment of liabilities from use of property that is the subject matter of a contract of purchase of a leased thing (-)
C.2.8.	Expenses for the payment of liabilities for lease of a set of tangible assets and intangible assets used and depreciated by the lessee (-)
C.2.9.	Revenues from other long-term liabilities and short-term liabilities from financial activity, except for those given specifically in another part of the cash flow report (+)
C.2.10.	Expenses for the payment of other long-term liabilities and short-term liabilities from financial activity, except for those given specifically in another part of the cash flow report (-)
C.3.	Expenses for paid interest, except for those incorporated in operational activities (-)
C.4.	Expenses for paid dividends and other profit shares, except for those incorporated in operational activities (-)
C.5.	Expenses related to derivatives, except for those determined for sale or trading, or if they are considered as cash flow from the investment activity (-)
C.6.	Revenues related to derivatives, except for those determined for sale or trading, or if they are

	considered as cash flow from the investment activity (+)
C.7.	Expenses for income tax of the accounting entity, if they can be incorporated in financial activities (-)
C.8.	Extraordinary revenues related to financial activity (+)
C.9.	Extraordinary expenses related to financial activity (-)
C.	***Net cash flow from financial activity (subtotal C. 1. to C. 9.)***
D.	**Net increase or net decrease of financial means (+/-) (subtotal A + B + C)**
E.	**The state of financial means and monetary equivalents at the beginning of the accounting period (+/-)**
F.	**The state of financial means and monetary equivalents at the end of the accounting period before taking into account exchange rate differences, quantified as of the day that the financial statement is set up (+/-)**
G.	**Exchange rate differences, quantified to financial means and monetary equivalents as of the day that the financial statement is set up (+/-)**
H.	**The balance of financial means and monetary equivalents at the end of the accounting period, adjusted by exchange rate differences, quantified as of the day that the financial statement is set up (+/-)**

Indirect method

Cash flow from operational activity	
P/L	***Profit or loss from current activity before income tax (+/-)***
A.1.	Non-monetary transactions affecting profit or loss from current activity before income tax (subtotal A. 1. 1. to A. 1. 13.) (+/-)
A.1.1.	Amortization of long-term intangible assets and depreciation of long-term tangible assets (+)
A.1.2.	Carrying value of long-term intangible assets and long-term tangible assets accounted at retirement of these assets into expenses for current activity, except for their sale (+)
A.1.3.	Depreciation of adjusting entry of acquired assets (+/-)
A.1.4.	Change in the state of long-term provisions (+/-)
A.1.5.	Change in the state of adjusting entries (+/-)
A.1.6.	Change in the state of items of deferred expenses and accrued revenues (+/-)
A.1.7.	Dividends and other profit shares accounted into revenues (-)
A.1.8.	Interest accounted into expenses (+)
A.1.9.	Interest accounted into revenues (-)
A.1.10.	Exchange rate gain quantified to financial means and monetary equivalents as of the day that the financial statement is set up (-)
A.1.11.	Exchange rate loss quantified to financial means and monetary equivalents as of the day that the financial statement is set up (+)
A.1.12.	Results from sale of long-term assets, except for assets considered as monetary equivalents (+/-)
A.1.13.	Other non-monetary items affecting profit or loss from current activity, except for those given specifically in other parts of the cash flow report (+/-)
A.2.	Impact of changes in the state of the working capital, which, for the purposes of this Measure, is understood to be the difference between current assets and short-term liabilities, except for the items of current assets that belong to financial means and monetary equivalents, on economic results from current activity (subtotal A. 2. 1. to A. 2. 4.)
A.2.1.	Change in the state of receivables from operational activity (-/+)
A.2.2.	Change in the state of liabilities from operational activity (+/-)
A.2.3.	Change in the state of inventories (-/+)
A.2.4.	Change in the state of financial assets, except for assets belong to financial means and monetary equivalents (-/+)
	Cash flow from operational activity, except for revenues and expenses reported specifically in other parts of the cash flow report (+/-), (subtotal P/L + A1 + A2)
A.3.	Received interests, except for those incorporated in investment activities (+)
A.4.	Expenses for paid interest, except for those incorporated in financial activities (-)

A.5.	Revenues from dividends and other profit shares, interest, except for those incorporated in investment activities (+)
A.6.	Expenses for paid dividends and other profit shares, except for those incorporated in financial activities (-)
	Cash flow from operational activity (+/-), (subtotal P/L + A.1. to A. 6.)
A.7.	Expenses for income tax of the accounting entity, except for those incorporated in investment activities or financial activities (-/+)
A.8.	Extraordinary revenues related to operational activity (+)
A.9	Extraordinary expenses related to operational activity (-)
	Net cash flow from operational activity (+/-), (subtotal P/L + A.1. to A. 9.)
Cash flow from investment activity	
B.1.	Expenses for the acquisition of long-term intangible assets (-)
B.2.	Expenses for the acquisition of long-term tangible assets (-)
B.3.	Expenses for the acquisition of long-term securities and shares in other accounting entities, except for securities considered as monetary equivalents and securities determined for sale or trading (-)
B.4.	Revenues from the sale of long-term intangible assets (+)
B.5.	Revenues from the sale of long-term tangible assets (+)
B.6.	Revenues from the sale of long-term securities and shares in other accounting entities, except for securities considered as monetary equivalents and securities determined for sale or trading (+)
B.7.	Expenses for long-term loans granted by the accounting entity to another accounting entity belonging to a consolidated whole (-)
B.8.	Revenues from the repayment long-term loans granted by the accounting entity to another accounting entity belonging to a consolidated whole (+)
B.9.	Expenses for long-term loans granted by the accounting entity to third persons, except for long-term loans granted to an accounting entity belonging to a consolidated whole (-)
B.10.	Revenues from the repayment of loans granted by the accounting entity to third persons, except for long-term loans provided to an accounting entity belonging to a consolidated whole (+)
B.11.	Revenues from the lease of a set of tangible assets and intangible assets used and depreciated by the lessee (+)
B.12.	Received interest, except for those incorporated in operational activities (+)
B.13.	Revenues from dividends and other profit shares, except for those incorporated in operational activities (+)
B.14.	Expenses related to derivatives, except for those determined for sale or trading, or if these expenses are considered as the cash flow from financial activity (-)
B.15.	Revenues related to derivatives, except for those determined for sale or trading, or if these revenues are considered as the cash flow from financial activity (+)
B.16.	Expenses for income tax of the accounting entity, if it can be incorporated in investment activities (-)
B.17.	Extraordinary revenues related to investment activity (+)
B.18.	Extraordinary expenses related to investment activity (-)
B.19.	Other revenues related to investment activity (+)
B.20.	Other expenses related to investment activity (-)
B.	***Net cash flow from investment activity (subtotal B. 1. to B. 20.)***
Cash flow from financial activity	
C.1.	Cash flow in the shareholders' equity (subtotal C. 1. 1. to C. 1. 8.)
C.1.1.	Revenues from subscribed shares and business shares (+)
C.1.2.	Revenues from other investments in the shareholders’ equity by partners or a natural person that is an accounting entity (+)
C.1.3.	Received monetary donations (+)
C.1.4.	Revenues from payment of a loss by partners (+)
C.1.5.	Expenses for the acquisition or repurchase of own shares and business shares (-)
C.1.6.	Expenses related to decreases of funds created by the accounting entity (-)
C.1.7.	Expenses for payment of a share in the shareholders’ equity by partners of the accounting entity and

	a natural person that is an accounting entity (-)
C.1.8.	Expenses for other purposes related to decrease of the shareholders' equity (-)
C.2.	Cash flow from long-term liabilities and short-term liabilities from financial activity (subtotal C. 2. 1. to C. 2. 10.)
C.2.1.	Revenues from the issue of bonds (+)
C.2.2.	Expenses for the payment of liabilities from bonds (-)
C.2.3.	Revenues from loans granted to the accounting entity by a bank or branch of a foreign bank, except for loans granted for securing the main scope of business (+)
C.2.4.	Expenses for the repayment of loans granted to the accounting entity by a bank or branch of a foreign bank, except for loans granted for securing the main scope of business (-)
C.2.5.	Revenues from accepted loans (+)
C.2.6.	Expenses for repayment of loans (-)
C.2.7.	Expenses for the payment of liabilities from the use of assets that are the subject matter of a contract on purchase of a leased thing (-)
C.2.8.	Expenses for the payment of liabilities for lease of a set of tangible assets and intangible assets used and depreciated by the lessee (-)
C.2.9.	Revenues from other long-term liabilities and short-term liabilities from financial activity of the accounting entity, except for those given specifically in another part of the cash flow report (+)
C.2.10.	Expenses for the payment of other long-term liabilities and short-term liabilities from financial activity of the accounting entity, except for those given specifically in another part of the cash flow report (-)
C.3.	Expenses for paid interests, except for those incorporated in operational activities (-)
C.4.	Expenses for paid dividends and other profit shares, except for those incorporated in operational activities (-)
C.5.	Expenses related to derivatives, except for those determined for sale or trading, or if they are considered as the cash flow from investment activity (-)
C.6.	Revenues related to derivatives, except for those determined for sale or trading, or if they are considered as the cash flow from investment activity (+)
C.7.	Expenses for income tax of the accounting entity, if they can be incorporated in financial activities (-)
C.8.	Extraordinary revenues related to financial activity (+)
C.9.	Extraordinary expenses related to financial activity (-)
C.	***Net cash flow from financial activity (subtotal C. 1. to C. 9.)***
D.	**Net increase or net decrease of financial means (+/-) (subtotal A + B + C)**
E.	**The state of financial means and monetary equivalents at the beginning of the accounting period (+/-)**
F.	**The state of financial means and monetary equivalents at the end of the accounting period before taking into account exchange rate differences, quantified as of the day that the financial statement is set up (+/-)**
G.	**Exchange rate differences, quantified to financial means and monetary equivalents as of the day that the financial statement is set up (+/-)**
H.	**The balance of financial means and monetary equivalents at the end of the accounting period, adjusted by exchange rate differences, quantified as of the day that the financial statement is set up (+/-).**

6 Major Differences from IFRS for SMEs

Following table summarizes the differences between IFRS for SMEs and Polish Accounting Regulation [1, 12]:

IFRS For SMEs	Slovak Accounting Regulation
INTANGIBLE ASSETS	
All research and development expenses according to the IFRS for SME are filled into costs category. Intangible assets are measured at cost, reduced of their depreciation value and/or adjusting entry, (loss from value reduction) It is not permitted to revaluate them. On the contrary, according to IFRS acquisition value of intangible assets from own activities in research phase are always recognized as costs. Acquisition value of such assets in research phase can be used as an assets value under certain conditions.	Slovakian legislation is domain of acquisition pricing for internally generated assets solving this way: Long-term intangible assets from own research is activated on account “Activated costs of research”, if there is possible to document conditions similar to the IFRS. Otherwise they are entered according to the period of their origin.
DEPRECIATION AND AMORTIZATION	
Standard IFRS for SME requires that business shall test Intangible and tangible assets depreciation whenever there is a possible sign of assets value decrease. Goodwill is tested for depreciation only when there are signs of such situation. Residual value, lifespan and depreciation methods are revised only where there are signs of their changes compared with last financial statement (full IFRS is required only after yearly revision).	Slovakian legislation is regulation details about assets valuation in § 21 of Accounting Procedures. Depreciation of long-term tangible and intangible assets is accounted as extraordinary balance items for long-term assets. Permanent tangible and intangible assets are accounted using amortization, if it is not a damage loss.
PROPERTY, PLANT AND EQUIPMENT	
According to IFRS for SME land, buildings and equipment are appraised by their purchase cost, reduced by depreciation reserves and discretionary reserves (losses from value). Overvaluation is not emitted. Investment in real estate must be appraised by their real value. If it is not possible to determine such a real value securely and without excessive cost, such investment is accounted for as a long-term intangible, land, buildings and equipment. Cost model is not permitted. Cost capitalization is over when asset did reach its place and is functional. Costs include the original estimate of dismantling costs and property clearing as well as placing the land to its original state. IFRS for SME are giving a special attention to the matter of spare parts. Most of the assets serving for buildings repair are accounted for as inventories. Their use is entered as consumption of material that means as a cost influencing a normal financial period. But there are spare parts where business is expecting their use in more than one period. Such entry is according to IFRS for SME specified as land, buildings and equipment. If a different part of assets exists with different lifespan, it is better to account for them separately. In reality a building can be divided into more parts, such as windows, heating, and roof according to their usable life. To asses depreciation,	Slovakian accounting regulation does not organize property investments. Long-term tangible assets and Long term intangible assets are appraised by purchase price/own cost, reduced by depreciation reserves and discretionary reserves. Long-term tangible assets are appraised by reproduction purchase price as well. It is not permitted to apprise to the real value (permitted by IFRS). Investment into real property and leased property are part of long-term tangible assets. When a value of tangible asset is lower or equal to 1000 EUR and life period longer than one year, such asset is treated as an inventory. Spare parts are always part of inventory and not long-term intangible assets. Cost of dismantling and putting into original state is not a part of property appraisal. Costs activation is over when property is put into use. To put into use means to secure all the asset functions needed for its use and fulfil the obligation from personal regulations.

<table>
<tr><td>component approach is used, each position of long-term asset is depreciated during its life (standards are not using a reason for reserve forming for long-term assets repairs.) Other assets are depreciated during their life-span as whole. With some exceptions (quarry or dumping ground) land properties are not depreciated, since they have unlimited life.</td><td></td></tr>
<tr><td colspan="2">INVESTMENT PROPERTIES</td></tr>
<tr><td>According to the IFRS for SMEs, an entity valued at initial recognition investment property is carried at cost. Investments in property, whose fair value is reliably determinable without disproportionate cost and effort must be valued at fair value reporting at each balance sheet date. If fair value cannot be reliably and without undue cost and effort to provide these investments are accounted for as fixed assets. Cost model cannot be used.</td><td>Slovakian accounting regulations are not specifying investment into real property. Tangible or intangible assets are appraised by purchasing price/own cost, decreased by depreciation reserves and extraordinary remedies</td></tr>
<tr><td colspan="2">FINANCIAL LEASES</td></tr>
<tr><td>Financial leasing is if all risks and advantages of ownership are transferred to leaseholder and ownership itself can (or not) is transferred. Leaseholder must report such leasing in its balance sheet as an asset and liability. Lease is entered in fair value of leased asset at the beginning of leasing. If the present value of minimum lease payments is lower, this value is used.
To calculate fair value of minimum lease payments as a discount factor there is used the implicit leasing interest rate, if it is available or incremental leasing rate from leaseholder.
Asset value is advanced by the original direct costs spend by leaseholder. Leaseholder will divide minimal lease payments among financial costs and depreciated unpaid liabilities using effective interest rate method.
Leaseholder recognizes financial costs to each period during the leasing term the way that for remaining liabilities a constant interest rate is guaranteed.
Leaseholder with financial leasing will recognize an asset as a claim with value of leasing net investment. Leasing payments are than lowering the claim value and are recognized as financial gain.</td><td>According to the legislation for accounting purposes as a financial leasing is classified a long-term leasing of tangible goods with contracted right for its purchase if leaseholder is using it during this period for lump-sum payment or more payments, paid during leasing period. To recognize a financial leasing in taxation, certain conditions must be met in Slovakia:
• Financial leasing must be properly entered into accounting system of a fiscal entity and must show its connection with achieving, ensuring or maintaining its earnings.
• Leasing period of leased item must be longer than 60% of depreciation period, but 3 years minimum.
• Item purchase price cannot be higher than depreciated price using even depreciation according to the income tax law
• Lease holder will depreciate leased item value during the lease period to 100% principal, evenly and proportionally each month of leasing period.
• After the leasing end, the ownership shall without undue delay be passed from lease to the leaseholder
• In case of lease payment to the personal entity, it must be paid.</td></tr>
<tr><td colspan="2">INVENTORIES</td></tr>
<tr><td>Accounting unit is assessing inventory acquisition value using arithmetic mean average calculation or FIFO. LIFO is not permitted. Any borrowing costs connected with inventory are entered directly as costs and it is not possible to activate them.</td><td>LIFO method is not used according to the Slovakian legislation. Inventory decrease of the same assortment can be accounted using arithmetic mean average calculation based on acquisition value or own costs.
Other possible way is when first value after inventory gain evaluation is used as a first value for inventory decrease evaluation (FIFO).</td></tr>
</table>

<table>
<tr><th colspan="2">FINANCIAL INSTRUMENTS</th></tr>
<tr><td>SME can choose their financial and accounting tools according to SME Standard or Regulation IAS 39, Financial Tools, Accounting and Appraisal. SME standard is distinguishing only two groups of financial tools: basic financial tools (debt tools, non-derivative character) are appraised with their residual value; others (derivatives, capital tools) are appraised with their real value. It’s possible to show changes in income and loss statement. Not entering financial assets is possible when accounting entity transmitted all asset related risks and benefits to another subject and control over it as well. Regulations were simplified for hedge accounting. Thanks to this SME does not need to fulfil many criteria to be able to use hedge accounting.</td><td>SAR is not containing a detailed classification of all assets and liabilities. But securities and derivatives are primary appraised by purchasing price if it is not a security broker. All derivatives are primary appraised by real value. Securities up to 20% value of equity capital are in individual financial statement appraised with their real value, others (of more than 20% equity capital value) are not. (According to IFRS this is possible).Equities (over 20% included) can be appraised by intrinsic equity method. In case of financial investment based on property investment is possible to revaluate invested property to the recognized value, where the difference between accounting value and recognized value is entered into intrinsic equity as an appraisal difference from capital interest.</td></tr>
<tr><th colspan="2">PROVISIONS</th></tr>
<tr><td>Provisions shall be entered when:
• all business liabilities are the results of past events
• It is probable that to fulfil an obligation a decrease of resources is needed
• A reliable appraisal of liabilities can be made
If such conditions are not met, no reserve can be stated. According to IFRS for SME businesses can state the reserves if they can withstand the test. Fiscal entity must show a reserve as a liability and simultaneously as a cost. But if another part of IFRS for SME is treating the reserve as a part of assets pricing, it is included in their value.
To form reserves for restructuring is allowed when detailed formalized restructuring plan is available and it was published or initiated.</td><td>Provisions are a liability presenting accounting entity existing obligations formed in the past. It is probable, that in the future it will decrease fiscal benefits of such entity and if this liability size is not precisely known, it will be estimated by appraisal as a value substantial to fulfil such an obligation.
Reserve is formed on principle of caution for risks and losses. Reserve for restructuring is not used by Slovak Accounting Law. But it is precisely defining each liability type, for example severance pay or severance benefits, where reserves are permitted.</td></tr>
<tr><th colspan="2">DEFERRED TAX</th></tr>
<tr><td>All accounting entities must keep accounts with a deferred tax system. Deferred tax is entered for transient difference with the exception of deferred tax liability from primary statement of goodwill or primary assets or liabilities statement in transactions not of business combination or during the transaction is not influencing accounting earnings, taxable earnings or losses.</td><td>The obligation to keep accounts with deferred tax is related only to those accounting entities where a final statement must be verified by an auditor. Others can use deferred tax method voluntary. Deferred tax is used in primary assets and liabilities statement if the transaction is not business combination and is not influencing accounting earnings, taxable earnings or losses.</td></tr>
<tr><th colspan="2">BORROWING COSTS</th></tr>
<tr><td>According to IFRS for SME businesses must all borrowing cost enter directly into cost in period of their origination and it is not possible to activate them.</td><td>Slovakian legislation is not solving this question in any manner.</td></tr>
</table>

7 Sample Case

ACCOUNTANT Ltd started its business in Slovakia in November 2010. The core business of the company is sale of goods as well as professional consulting.
The formula for derecognition of the goods is FIFO; company applies linear accounting depreciation as well as linear tax depreciation (based on local Income Tax Act or other act specifying the tax depreciation). From the differences between accounting and tax depreciation will be calculated deferred tax. Company is a VAT payer (basic rate, i.e. 19 %).
For the simplicity of postings there will be used "MU" (monetary unit).

At the very beginning there were paid the incorporation expenses 5 000 MU and there was deposited 145 000 MU on the bank account. Incorporation expenses were paid by one of the owners of Accountant Ltd against which he provided a short-term loan payable in June 2011.
From March 2009 start up costs are capitalized as intangible assets, however shall be recorded as an expense.

Initial Balance Sheet

Balance Sheet as at 1st November 2010			
Bank account	145,000	Registered capital	145,000
Incorporation expenses	5,000	Short-term loans	5,000
ASSETS	**150,000**	**EQUITY+LIABILITIES**	**150,000**

Tangible Assets
On 12th November 2010 has been purchased computer for 2 000 MU (due date is 12th January 2011).

Financial Leases
Company has decided to purchase the car in the form of 5-years financial lease. Financial lease was negotiated from 1st December 2010 with the monthly based rental payments 350 MU (all payable at the end of each month). Incremental interest rate of lessee is 10 %; fair value of the car is 17 500 MU.

Inventories
Throughout the period of November and December 2010 there were made following purchases and sales of goods:

1	Purchase of 6 500 pieces of goods @ 7.50 MU
2	Purchase of 4 200 pieces of goods @ 8.00 MU
3	Sale of 5 000 pieces @ 12 MU (payable on February 2011)
4	Purchase of 3 300 pieces of goods @ 9.00 MU
5	Sale of 3 600 pieces @ 12 MU (payable on March 2011)
6	Sale of 2 400 pieces @ 12 MU (payable on March 2011)

All purchases have been paid directly from company's bank account.
Fair value of goods as at 31st December 2010 is 22 500 MU.

Receivables and Payables
In November 2010 was negotiated long-term (3Y) contract for consulting services. The total amount of contract 180 000 MU is payable at the end of the contract, i.e. 30th November 2013.
Company has one employee, Miss Anna. Her gross monthly salary is 800 MU. Salary is payable on 10th day of the next month.

Other Costs and Expenses

- rental payments – 1 200 MU/monthly (payable on 20th for the next month),
- tax consulting – 200 MU/monthly (payable on 25th of the next month),
- telecommunication services – 1 000 MU/monthly (payable on 15th of the next month),
- road tax – 100 MU (payable on 15th December 2010)
- interests received – 920 MU
- bank charges – 5 300 MU

Solution of the study
Fixed Assets and Financial Leases

Accounting depreciation of computer:

$$monthly\ depreciation = \frac{2000}{48} = 41.7$$

Tax depreciation of computer:

$$depreciation\ 2010 = \frac{2000}{4} = 500$$

Accounting depreciation of financial lease:

$$monthly\ depreciation = \frac{18900}{60} = 315$$

Tax depreciation of financial lease:

$$depreciation\ 2010 = \frac{18900}{60} = 315$$

Accounting depreciation for 2010 is 83 MU.
Tax depreciation for 2010 is 500 MU.
Net book value> ⇒ the tax book value deferred tax liability arises.

Calculation of deferred tax

Year	**Net value (accounting)**	**Net value (taxes)**	**Difference**	**Tax rate**	**Deferred tax liability**
2010	83	500	417	0.19	83

Op.	**Text**	**Amount**			**Account**
1	Purchase of computer	2,000 380 2,380	Dr Dr	 Cr	Movables VAT Trade payables
2	Depreciation of computer (2 months)	83 83	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)
3	Calculation of deferred tax	83 83	Dr	 Cr	E – Income Tax (deferred) Deferred Tax Liability
4	Statement of financial interest	35 35	Dr	 Cr	E- Financial expense Finance lease liabilities
5	1st installment of financial lease	350 350	Dr	 Cr Cr	Trade payables Bank account
6	Financial lease	18,900 3,591 22,491	Dr Dr	 Cr	Movables VAT Trade payables
7	Financial costs	420 420	Dr	 Cr	Short-term accrued costs Trade payables
8	Financial costs	1,645 1,645	Dr	 Cr	Long-term accrued costs Trade payables
9	Depreciation of financial lease	315	Dr	 Cr	E – Depreciation Movables (Ac. depreciation)

Inventories

Op.	pieces			Cost	MU		
	+	-	Δ		+	-	Δ
1	6,500		6,500	7.50	48,750		48,750
2	4,200		10,700	8.00	33,600		82,350
3		5,000	5,700			37,500	44,850
4	3,300		9,000	9.00	29,700		74,550
5		3,600	5,400			28,050	46,500
6		2,400	3,000			19,500	27,000

Op.	Text	Amount			Account
1	Purchase of goods (6,500 @ 7.50 MU)	48,750	Dr		Goods
		9,263	Dr		VAT
		58,013		Cr	Bank account
2	Purchase of goods (4,200 @ 8.00 MU)	33,600	Dr		Goods
		6,384	Dr		VAT
		39,984		Cr	Bank account
3a	Sale of goods (5,000 @ 12.00 MU)	60,000		Cr	R – Sold goods
		11,400		Cr	VAT
		71,400	Dr		Trade receivables
3b	Goods issue	37,500	Dr		E – Sold goods
		37,500		Cr	Goods
4	Purchase of goods (3,300 @ 9.00 MU)	29,700	Dr		Goods
		5,643	Dr		VAT
		35,343		Cr	Bank account
5a	Sale of goods (3,600 @ 12.00 MU)	43,200		Cr	R – Sold goods
		8,208		Cr	VAT
		51,408	Dr		Trade receivables
5b	Goods issue	28,050	Dr		E – Sold goods
		28,050		Cr	Goods
6a	Sale of goods (2,400 @ 12.00 MU)	28,800		Cr	R – Sold goods
		5,472		Cr	VAT
		34,272	Dr		Trade receivables
6b	Goods issue	19,500	Dr		E – Sold goods
		19,500		Cr	Goods
7	Calculation of impairment	4,500	Dr		E – Impairment
		4,500		Cr	Goods (impairment)

Receivables and payables

Op.	Text	Amount			Account
1	Long-term contract (12/2010)	5,000	Dr		Long-term deferred income
		5,000		Cr	R – Sold services

Salaries

Calculation of salary

Gross salary	800
Social insurance (9.4 %)	75
Health insurance (4 %)	32
Income tax	131
Net salary	**561**

Social insurance (25.2 %)	201

Health insurance (10%)	80

Op.	Text	Amount			Account
Nov1	Gross salary	800 800	Dr	 Cr	E – Salaries Payroll
Nov2	Social and health insurance (employee)	107 107	Dr	 Cr	Payroll SHI payables
Nov3	Income tax	131 131	Dr	 Cr	Payroll Income tax payables
Nov4	Social and health insurance (company)	281 281	Dr	 Cr	E – Social insurance SHI payables
Nov5	Pay-off	561 561	Dr	 Cr	Payroll Bank account
Nov6	Payment of insurance	388 388	Dr	 Cr	SHI payables Bank account
Nov7	Payment of income tax	131 131	Dr	 Cr	Income tax payables Bank account
Dec1	Gross salary	800 800	Dr	 Cr	E – Salaries Payroll
Dec2	Social and health insurance (employee)	107 107	Dr	 Cr	Payroll SHI payables
Dec3	Income tax	131 131	Dr	 Cr	Payroll Income tax payables
Dec4	Social and health insurance (company)	281 281	Dr	 Cr	E – Social insurance SHI payables

Other costs and expenses

Op.	Text	Amount			Account
1a	Rental payment (in December for November 2010)	1,200 228 1,428	Dr Dr	 Cr	E – Services VAT Bank account
1b	Rental payment (in January for December 2011)	1,200 228 1,428	Dr Dr	 Cr	E-Sevices VAT Short-term accrued expenses
2a	Tax advisory (November 2010)	200 38 238	Dr Dr	 Cr	E – Services VAT Bank account
2b	Tax advisory (December 2010)	200 38 238	Dr Dr	 Cr	E – Services VAT Short-term accrued expenses
3a	Telecommunication services (November 2010)	1,000 190 1,190	Dr Dr	 Cr	E – Services VAT Bank account
3b	Telecommunication services (December 2010)	1,000 190 1,190	Dr Dr	 Cr	E – Services VAT Short-term accrued expenses
4	Road tax	100 100	Dr	 Cr	E – Road tax Bank account
5	Interests received	920 920	Dr	 Cr	Bank account R – Interests received
6	Bank charges	5,300 5,300	Dr	 Cr	E – Financial expenses Bank account

Calculation of corporate income tax

Revenues	137,920
Expenses	105,429
Accounting profit	***32,491***
Tax inefficient expenses: • impairment	4,500
Tax base	36,991
Corporate income tax (19 %)	**7,028**

Op.	Text	Amount			Account
1	Income tax (due)	7,028	Dr		E – Income tax (due)
		7,028		Cr	Income tax payables

Closing of accounts:

Profit / Loss Account as at 31st December 2010			
Sold goods	85,050	Revenues from sold services	5,000
Services	9,800	Revenues from sold goods	132,000
Salaries	1,600	Interests received	920
Social insurance	563		
Road tax	100		
Depreciation, amortization	398		
Impairment	4,500		
Financial expenses	5,335		
Income tax (due)	7,028		
Income tax (deferred)	83		
EXPENSES	***114,457***	***REVENUES***	***137,920***
Profit	**23,463**		

Balance Sheet as at 31st December 2010					
Assets	*Gross*	*Corr*	*Net*	***E+L***	*Net*
Movables	2,000	83	1,917	Registered capital	145,000
Financial lease	18,900	315	18,585	Profit	23,463
Trade receivables	157,080	0	157,080	Deferred tax liability	83
Goods	27,000	4,500	22,500	Trade payables	26,586
Bank account	2,858		2,858	Payroll	562
VAT	1,093		1,093	Soc. and health insurance payable	389
				Corporate income tax payable	7,028
Short-term deferred expenses	420		420	Income tax payable	131
Long-term deferred expenses	1,645		1,645	Short-term loan	5,000
Long-term deferred income	5,000	0	5,000	Short-term accrued expenses	2,856
TOTAL	**215,996**	**4,898**	**211,098**	**TOTAL**	**211,098**

Ratio analysis

Assets (total)	211,098
EBIT	32,491
EAT	23,463
Equity	168,463
Current assets	183,531
Current liabilities	39,696
Inventories	22,500

Profitability ratios:

$$ROA = \frac{EBIT}{Assets} = \frac{32491}{211098} = 15.39\ \%$$

$$ROE = \frac{EAT}{Equity} = \frac{23463}{168463} = 13.93\ \%$$

Liquidity ratios:

$$CL = \frac{Current\ assets}{Current\ liabilities} = \frac{183531}{39696} = 4.62$$

$$ATR = \frac{Current\ assets - Inventories}{Current\ liabilities} = \frac{183531 - 22500}{39696} = 4.06$$

8 Dictionary

English	**Slovak**
Accelerated Depreciation	zrýchlené odpisy
Account	účet
Account Payable	záväzok
Account Receivable	pohľadávka
Accountant	účtovník
Accounting	účtovníctvo
Accounting Change	účtovná zmena
Accounting Policies	účtovné pravidlá
Accounting Profit	účtovný zisk
Accrual Basis	akruálny princíp
Accumulated Depreciation	oprávky
Additional Paid in Capital	ďalší vložený kapitál
Amortization	amortizácia, odpis nehmotného majetku
Annual Report	výročná správa
Annuity	anuita
Asset	majetok, aktívum
Auditor	audítor
Auditors' Report	audítorská správa
Available-For-Sale Financial Assets	finančné aktíva k dispozícii na predaj
Balance Sheet	súvaha
Bond	dlhopis
Book Value, Carrying Amount	účtovná hodnota
Borrowing Costs	pôžičkové náklady, nájomné z hnuteľností
Budget	rozpočet
Business	obchod
Business Combinations	spájanie obchodných spoločností
Business Segment	podnikateľský segment
Capitalized Cost	investičné náklady, aktivované náklady
Capitalized Interest	kapitalizovaný úrok
Cash	peňažné prostriedky
Cash Basis	hotovostný princíp
Cash Equivalents	peňažné ekvivalenty
Cash Flows	peňažné toky
Cash-generating Unit	peňazotvorná jednotka
Closing Rate	záverečný kurz

Consistency	konzistencia
Consolidated Financial Statements	konsolidovaná účtovná závierka
Consolidation	konsolidácia
Contingent Asset	podmienené aktívum
Contingent Liability	podmienené záväzky
Contingent Rent	podmienené nájomné
Continuing Operations	pokračujúca činnosť
Control	ovládanie, kontrola, regulácia
Convertible Share	konvertibilný podiel
Cost	náklady
Cost Accounting	nákladové účtovníctvo
Cost Method	metóda nákladov
Costing	výpočet nákladov
Costs of Disposal	náklady na likvidáciu
Credit Risk	úverové riziko
Creditor	veriteľ
Currency Risk	menové riziko
Current Asset	obežné aktívum
Current Liability	obežný záväzok
Current Tax	splatná daň
Debit	na ťarchu
Debt	dlh
Debt Security	dlžobný cenný papier
Debtor	dlžník
Deferred Income	výnosy budúcich období
Deferred Income Taxes	odložené dane z príjmov
Deferred Tax Assets	odložené daňové pohľadávky
Deferred Tax Liabilities	odložené daňové záväzky
Depreciable Amount	odpisová základňa
Depreciation	odpisovanie
Derecognition	odúčtovanie
Derivative	derivát
Detection Risk	zisťovacie riziko
Development	vývoj
Direct Costs	priame náklady
Disclosure	uverejnenie
Discontinued Operation	prerušená operácia
Discount	zľava
Discount Rate	diskontná sadzba
Discounted Cash Flow	diskontovaný peňažný tok
Dividends	dividendy
Double–Entry Bookkeeping	podvojné účtovníctvo
Due Date	termín
Earnings Per Share (EPS)	zisk na akciu
Economic Life	životnosť
Effective Interest Rate	efektívna úroková miera
Equity	vlastný majetok
Equity Instrument	majetkový nástroj
Equity Method	metóda ekvivalencie
Equity Securities	majetkové cenné papiere
Estimated Tax	odhadovaná daň
Estimation Transactions	odhad transakcie
Events after the Balance Sheet Date	udalosti po dátume účtovnej závierky

Exchange Difference	kurzový rozdiel
Exchange Rate	kurz
Expenditure	výdavok
Expense	náklad
External Reporting	externé výkazníctvo
Extraordinary Items	mimoriadne položky
Factoring	factoring
Fair Market Value	trhová hodnota
Fair Value	reálna hodnota
Finance Lease	finančný prenájom (lízing)
Financial Asset	finančné aktívum
Financial Institution	finančná inštitúcia
Financial Instrument	finančný nástroj
Financial Liability	finančný záväzok
Financial Risk	finančné riziko
Financial Statements	účtovná závierka
Financing Activities	finančné činnosti
First in, First out (FIFO)	prvý dnu, prvý von
Fiscal Year	fiškálny rok
Fixed Asset	dlhodobé aktívum
Forecast	predpoveď
Foreign Currency	cudzia mena
Fraud	podvod
Functional Currency	funkčná mena
Funding	financovanie
Future Contract	budúca zmluva
Gain	zisk, výnos
General Journal	denník
General Ledger	hlavná účtovná kniha
Generally Accepted Accounting Principles	všeobecne uznávané účtovné zásady
Going Concern	príncip nepretržitosti trvania účtovnej jednotky
Goodwill	goodwill
Gross Income	hrubý príjem
Group	skupina
Guaranty	záruka
Hedge	zaistenie
Hedge Effectiveness	efektívne zaistenie
Hedged Item	zaistená položka
Hedging Instrument	zaisťovací nástroj
Held-To-Maturity Investments	investície držané do splatnosti
Highly Probable	vysoko pravdepodobné
Historical Cost	historická cena
Impairment Loss	strata zo zníženia hodnoty
Impracticable	neuskutočniteľný
Improvement	zhodnotenie
Inception of the Lease	začiatok lízingu
Income	príjem, zisk, výnos
Income Statement	Výkaz ziskov a strát
Indirect Costs	nepriame náklady
Initial Direct Costs	počiatočné priame náklady
Installment	splátka
Intangible Asset	nehmotné aktívum
Interest	úrok

Interest Cost	úrokové náklady
Interest Rate Risk	úrokové riziko
Interim Financial Report	priebežná účtovná správa
Interim Financial Statements	priebežná účtovná závierka
Interim Period	priebežné obdobie
Internal Audit	interný (vnútorný) audit
Internal Control	vnútorná kontrola
Internal Rate of Return	vnútorná miera výnosnosti
International Accounting Standards Board	Rada pre medzinárodné účtovné štandardy
International Financial Reporting Standards (IFRSs)	Medzinárodné štandardy finančného výkazníctva
Intradepartmental Price, Internal Transfer Price	vnútropodniková cena
Inventories	zásoby
Investing Activities	investičné činnosti
Investment Property	investície do nehnuteľnosti
Investor in a Joint Venture	investor v spoločnom podniku
Joint Venture	spoločný podnik
Last in, First out (LIFO)	posledný dnu, prvý von
Lease	prenájom, lízing
Lease Term	doba prenájmu
Lessee	nájomca
Lessor	prenajímateľ
Liability	záväzok
Liquid Assets	likvidný majetok
Liquidation	likvidácia
Liquidity Risk	riziko likvidity
Loans and Receivables	úvery a pohľadávky
Loans Payable	úvery splatné
Long–Term Debt	dlhodobý dlh
Loss	strata
Lower of Cost or Market	nižšia z obstarávacej ceny alebo trhovej
Management Accounting	manažérske účtovníctvo
Margin	marža
Market Risk	trhové riziko
Marketable Securities	obchodovateľné cenné papiere
Mark–to–Market	typ účtovníctva - oceňovanie aktív aktuálnou trhovou cenou
Master Budget (Company Budget)	podnikový rozpočet
Materiality	významnosť
Matching Principle	princíp priraďovania nákladov výnosom
Merger	fúzia
Minority Interest	menšinová účasť
Monetary Assets	peňažné aktíva
Monetary Items	peňažné položky
Net Assets	čistý majetok, čisté aktíva
Net Income	čistý príjem, čistý zisk
Net Realizable Value	čistá realizovateľná hodnota
Non-cancellable Lease	nevypovedateľný prenájom
Non-current Asset	dlhodobý majetok
Non–for–Profit Organization	nezisková organizácia
Notes	Príloha, poznámky, komentár
Notional Value, Face Value	menovitá hodnota
Objectivity	objektívnosť
Obligations	záväzky, obligácie, dlhopisy

Onerous Contract	nevýhodná zmluva
Operating Activities	prevádzkové činnosti
Operating Cycle	prevádzkový cyklus
Operating Lease	operatívny lízing
Option	opcia
Other Comprehensive Income	ostatný úplný výsledok
Parent Company	materská spoločnosť
Partnership	partnerstvo
Penalty	pokuta, penále
Plan Costing	plán kalkulácie (nákladový plán)
Preferred Share	prioritná akcia
Present Value	súčasná hodnota
Presentation Currency	prezentačná mena
Prior Period Errors	chyby za predchádzajúce obdobie
Probable	pravdepodobný
Profit or Loss	zisk alebo strata
Property, Plant and Equipment	pozemky, budovy a zariadenia
Prospective Application	prospektívne použitie
Provision	rezerva
Public Offering	verejná ponuka
Qualifying Asset	majetok splňajúci kritéria
Ratio Analysis	pomerová analýza
Receivables	pohľadávky
Reconciliation	zúčtovanie
Recoverable Amount	spätne získateľná hodnota
Reinsurance	zaistenie
Related Party Transaction	transakcie medzi spriaznenými stranami
Reorganization	reorganizácia
Repairs	opravy
Reporting Date	dátum vykazovania
Reporting Entity	vykazujúca spoločnosť
Repurchase Agreement	dohoda o spätnom odkúpení
Research	výskum
Residual Value	zvyšková hodnota
Responsibility Accounting	zodpovednostné účtovníctvo
Restructuring	reorganizácia
Retained Earnings	nerozdelený zisk
Return on Investment (ROI)	návratnosť investícií
Revenue Recognition	uznanie výnosu
Revenues	výnosy
Risk Management	riadenie rizika
Securitization	sekuritizácia
Security	cenný papier
Separate Financial Statements	individuálna účtovná závierka
Settlement Method	spôsob vysporiadania
Share (Stock)	akcia
Short–Term	krátkodobý
Significant Influence	podstatný vplyv
Spot Exchange Rate	spotový výmenný kurz
Start–up Costs	zriaďovacie náklady
Statement of Cash Flows	Prehľad o peňažných tokoch
Statement of Comprehensive Income	Výkaz o úplnom výsledku
Statement of Financial Position	Výkaz o finančnej situácii (súvaha)

Statement of Changes in Equity	Prehľad o zmenách vlastného imania
Straight–Line Depreciation	lineárna metóda odpisovania
Subsequent Event	následné udalosti
Subsidiary	dcérsky podnik
Swap	swap
Tangible Asset	hmotný majetok, hmotné aktívum
Tax	daň
Tax Base	základ dane
Tax Expense	daňový náklad
Tax Income	daň z príjmov
Tax Loss	daňová strata
Tax Year	daňový rok
Taxable Income	zdaniteľný príjem, príjem podliehajúci dani z príjmov
Taxable Profit	zdaniteľný zisk
Taxpayer Identification Number (TIN)	daňové identifikačné číslo
Temporary Differences	dočasné rozdiely
Term Loan	termínovaná pôžička
Total Comprehensive Income	celkový úplný výsledok
Transaction Costs	transakčné náklady
Unearned Income	nerealizovateľný príjem
Useful Life	doba životnosti
Value in Use	hodnota z používania, úžitková hodnota
Venture Capital	rizikový kapitál
Work in Progress	nedokončená výroba
Working Capital	pracovný kapitál
Yield to Maturity	výnos do splatnosti
Zero–Coupon Bond	obligácia s nulovým kupónom

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International Accounting Harmonization as Part of the Worldwide Globalization Process

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Abstract: - This part of book focuses on emphasizing the manner in which econometric instruments can serve the development of accounting research. Introductory thoughts are set on offering an overview on current realities and underline the effects of such a complex process, as globalization. It is therefore shown how the ability to measure accounting harmonization can be helpful from the perspective of a globalized world. The main part reviews empirical studies in accounting literature in order to document the role econometric tools play in this regard. Finally there is provided a comparative analysis between all sets of national accounting regulations discussed within this book and IFRS for SMEs. Results show high compatibility level between Baltic accounting systems with this international referential.

Key-Words: - International accounting, globalization, harmonization process, comparative analysis, econometric tools, CEE countries.

1 Introductory Thoughts on Accounting Harmonization and Its Forms

The process of international accounting harmonization is directly and positively correlated with the globalization phenomenon, influencing each other, even though there is a certain tendency to only perceive harmonization as an effect of globalization. International accounting harmonization represents a complex and well defined process that relies on actions of international bodies[11], especially those using well settled accounting technologies or approaches [32]. Enhancing accounting harmonization constituted the major objective of the International Accounting Standards Committee. Its follower, the International Accounting Standards Board (IASB) therefore further assumed a leading role in this direction. The Financial Accounting Standards Board (FASB) also emphasized the objective of the international accounting system:

> Global competition has led many firms to look increasingly to new investors markets to finance the expansion and modernization needed to keep pace and advance in world markets. Likewise, investors look increasingly to other countries to broaden their investment opportunities and diversify

[11] In accordance to this approach we make reference to standard setting bodies such as the IASB, FASB, SEC, IFAC, etc.

risks. As a consequence, the demand for internationally comparable financial statements and, therefore, internationally comparable accounting standards, has never been greater [7, 26].

As long as standard setting bodies lack the power to enforce the use of their accounting standards, promoting international accounting harmonization to level they desire depends on a significant number of other variables in the international arena. Accounting systems reflect the economic environment they are serving while reinforcing it and evolving together with it. It is therefore considered that the international accounting system's development is due to the globalization of financial markets and the international economic integration [7, 24, 39]. It is such circumstances that led to modern accounting focusing on the process of accounting harmonization with purposes such as reducing differences in accounting and increasing comparability of accounting information. On one hand national accounting systems are dealing with reducing the number of alternative treatments for a particular item within national accounting regulations through the process of standardization. On the other they must also manage the process of accounting harmonization that aims at reducing dissimilar treatments for a particular item between two different regulations, process that requires further attention and planning. As expected, the process of accounting harmonization has its fair share of proponents as well as opponents, but it seems that both the first and the latter have come to reconsider their arguments when faced with turbulent times such as that of the recent financial crisis. We find it quite natural that accumulating risk exposure that finally led to worldwide recession without the corresponding signals being given through accounting systems would make the world question financial reporting, including financial accounting standards. Some opinions even consider that imposing a single form of accounting, designed for a particular form of capitalism, runs the risk of preventing alternative forms of financial, economic, and legal governance from evolving, such restrictions of institutional choice representing one of the worst forms of restrictive practice [83]. Further development of the accounting harmonization process is for sure to be even more challenging due to the effects of the recent financial crisis that raised even more questions. On the long run we might end up finding that searching for precisely those answers were beneficial for the entire process.

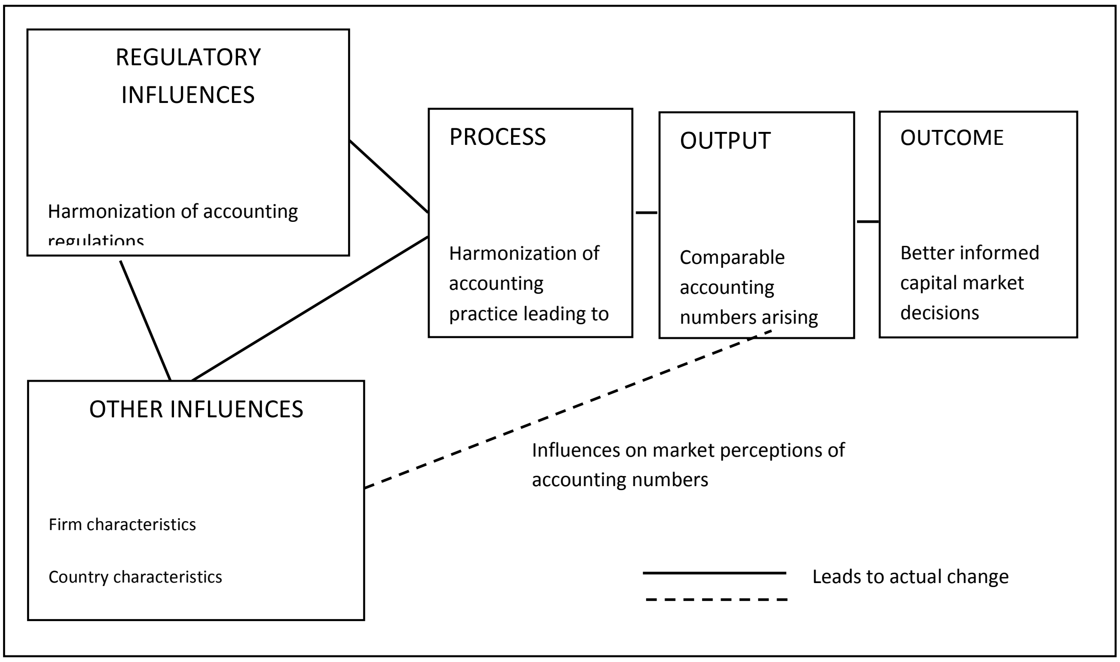
As documented through our previous discussion, interesting times are still ahead for the international accounting harmonization process. Without making any forecasts we will stop at analyzing accounting literature on harmonization, trying to capture some conceptual essentials and underpinnings, manners for quantifying accounting harmonization, as well as developing some empirical analysis based on the considered National Accounting Regulations and the International Financial Reporting Standard for Small and Medium-sized Entities.

A significant number of international accounting studies within research literature focus on issues related to formal and material harmonization. Formal harmonization or de jure harmonization studies mainly deal with quantifying the compatibility degree between the international accounting regulations (IFRS) and different national accounting regulations (NAS). On the other hand material or de facto harmonization studies mainly analyze, quantify and interpret to what extent the foresights of the international accounting regulations (IFRS) are actually found within entities' accounting practices [18, 28, 30, 43, 64, 77]. The difference between the two types of accounting harmonization is clearly surprised on a conceptual level and emphasized by [28]. Therefore formal harmonization focuses on how accounting standards are developed while material harmonization analyzes the level of comparability and concordance proven by actual accounting practices in relation to the implementation process of accounting standards when considering national accounting systems.

Moving forward we can state that formal harmonization actually represents a first indispensable step in achieving material harmonization. Even though we accept the existence of alternative solutions and realities we believe that reaching the objective of financial reporting practices that are globally accepted requires an intermediate phase of harmonizing accounting regulations. Under these circumstances we consider that accounting harmonization represents a real process [77, 81] and seems to be essential in order to improve international comparability of financial statements, therefore increasing cash flows' mobility and reducing costs in terms of financial statements' preparation especially in the case of multinational companies [12, 14].

[71] consider that accounting harmonization assumes four essential aspects as follows: (1) the influences, (2) the process, (3) the result and (4) the consequences. The influences comprise those factors that have a certain impact on accounting practices' harmonization. The process assumes the assembly of steps or efforts that are developed by companies in order to reduce existent differences of accounting practices. The result refers to the level of harmony being reached at a certain moment in time. Consequences refer to subsequent effects of the harmonization process. The relationship between these elements is reflected through the below presented figure:

Figure 1: Aspects of accounting harmonization



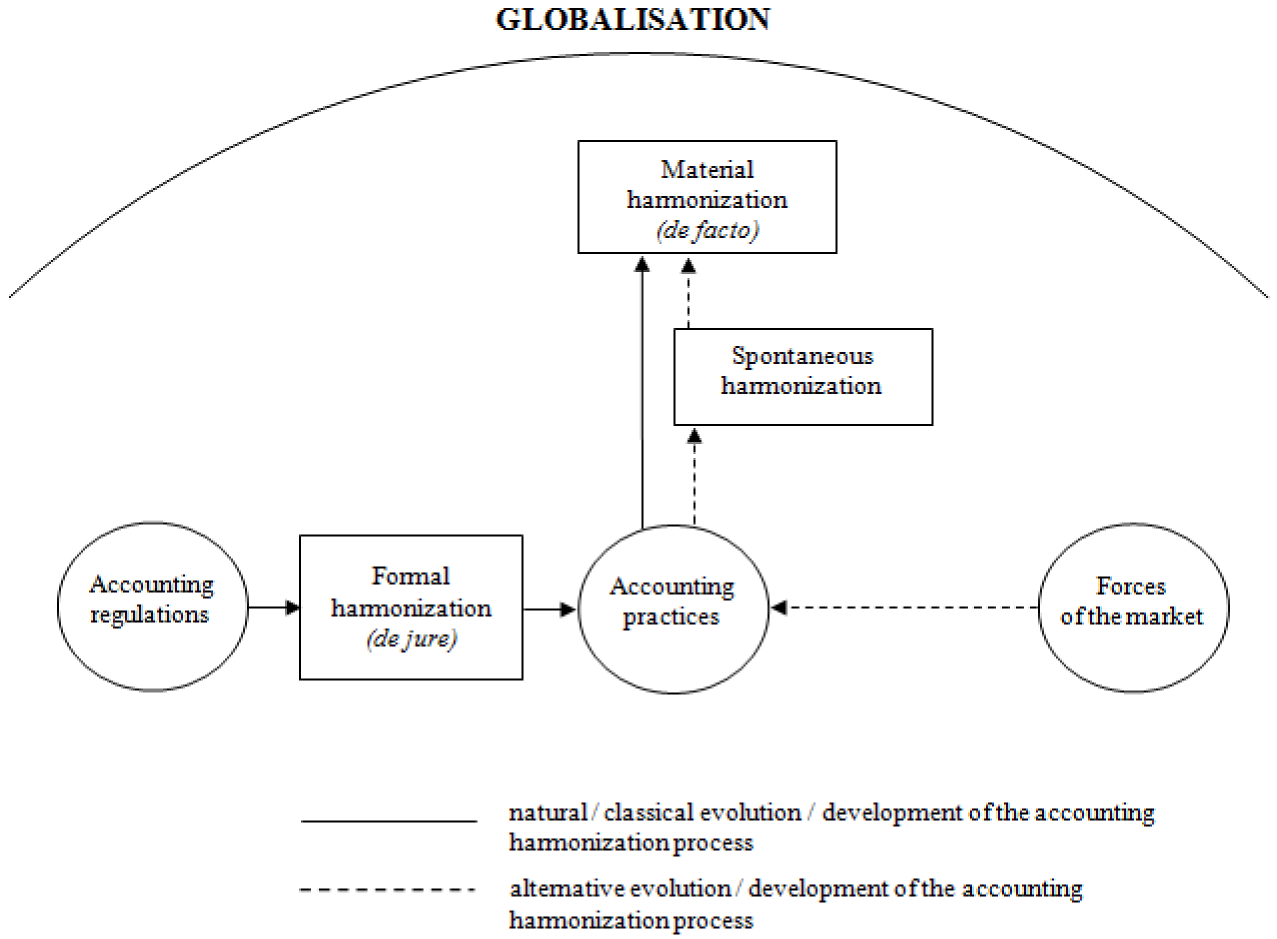
Source: [71]

Beyond the above discussed elements of the accounting harmonization process we must also consider the fact that in case those aspects that are generally considered as other influences, at one moment in time, benefit of strong attributes and develop a high ability to influence the accounting harmonization process, then we can assist the manifestation of a different form of this process, known within research literature as spontaneous harmonization. A series of studies [11, 30, 38, 49, 51, 78] develop the theoretical framework and/or empirical evidences for the spontaneous harmonization tendency that was found at the level of accounting practices of the so-called global players.

It is therefore necessary to make the distinction between the two main types of harmonization that are de facto or material harmonization and de jure or formal harmonization. References with regard to the increase of the comparability degree are based on a high degree of conformity of accounting practices and afterwards on harmonizing regulations [11]. [11] also consider that formal harmonization usually generates or favors material harmonization without this representing the only solution. More precisely, material harmonization can develop without being generated through formal harmonization as its predecessor, through the so-called spontaneous harmonization.

[77] also make a clear distinction between de jure harmonization and de facto harmonization. Through harmonization of accounting regulations (de jure harmonization) they analyze to what extent accounting standards and regulations are comparable. The latter concept (de facto harmonization) mostly analyzes to what extent accounting regulations are found within companies accounting practices [67]. [79, 81] also distinguish spontaneous harmonization besides formal harmonization and material harmonization. Similar approaches [72] see formal harmonization as in fact representing harmonization of existent accounting regulations, while material harmonization referring to accounting practices that are influenced by these regulations or by forces of the market. Furthermore, spontaneous harmonization represents a subcategory or a particular form of material harmonization [68]. The approach in accordance to which material harmonization can be reached without first going through formal harmonization is also argued by [81]. The following figure synthesizes the two paths to material accounting harmonization as grounded through research literature:

Figure 2: Forms of accounting harmonization



Source: authors' projection

Concluding upon the above presented figure we can say that two main forces are involved within the international accounting harmonization process: (1) institutional efforts for international accounting harmonization through the development of common accounting rules and standards and (2) spontaneous efforts of global players in order to adopt accounting methods that should improve their communication with accounting information's users in other countries [11]. This two forces act simultaneously, consolidating each other, but in some cases acting independently under the umbrella of the globalization phenomenon.

Spontaneous accounting harmonization can be considered as a deviation from or alternative to the natural/classical evolution of the accounting harmonization process. Such a deviation incurs when some deficiencies characterize the process of harmonizing regulations or when the pace of this harmonization process does not correspond to financial reporting's need for comparability as expressed through accounting practices and realities. In other words we can consider that spontaneous harmonization is a reaction of response to the need for accounting harmonization coming from accounting practice. Spontaneous accounting harmonization therefore develops due to forces of the market and not to accounting regulations [68] and their harmonization.

2 Trends in Measuring Accounting Harmonization: Research Literature in Review

The area of international accounting offered a highly disputed field for research during the last decades, generating a significant number of studies with corresponding variety and importance of the obtained results. A distinct positioning and importance must be given to those studies focusing on different aspects of the international accounting harmonization process since this research field represents the major objective of

research activities being developed by many accounting professionals and universities during the last 40 decades [6]. Before identifying and briefly presenting the main tendencies of research studies being developed in the field of accounting harmonization we consider it useful to also identify the main direction for analysis and debate that became known until the beginning of year 2000.
A remarkable synthesis of studies in the field of international accounting is that developed by [6]. Their paper actually allows the identification and positioning of studies on the international accounting harmonization. [6] identify three main research periods and a series of major topics of studies developed during the 1965-2004 period. We will further focus on studies analyzing and measuring the degree of accounting harmonization since this also represents the objective of the following section of this chapter.

As previously mentioned we will be using [6] dividing into periods. Therefore a main research direction can be identified starting with the 1965-1973 period when the first reflections on the international accounting harmonization process started to appear [3, 8, 34, 52, 54, 55, 56, 73, 84]. These studies mainly focus on the existence and necessity of a process that would make national accounting regulations compatible. This research direction was further continued during the 1974-1989 period through studies analyzing and dimensioning the degree of accounting uniformity between different national accounting regulations and international accounting standards [10, 19, 20, 27, 33, 63, 81]. Initial preoccupations in the field of accounting harmonization research were further amplified and diversified within the following period of 1990-2004. Previously established research directions were maintained, but some new preoccupations also emerged [18, 31, 36, 37, 45, 46, 48, 50, 65, 66, 68, 69, 74, 75, 83].
Among these we must mention:

- comparisons between the international accounting standards (IFRS) and American accounting regulations (US GAAP);
- measuring the degree of harmonization between different accounting systems;
- implementation of IFRS by some national accounting systems.

We will further complete the picture of studies in the field of accounting harmonization by mentioning new research directions that characterized the period following year 2004. We must also mention the fact that previous research directions that were identified by [6] were also continued within the following period.

A first topic whose importance was emphasized through the attention being paid to it within research literature refers to studying accounting harmonization in direct correlation and association with the globalization phenomenon. Some studies document that the interaction between the field of accounting and the globalization phenomenon was kind of neglected by critical research despite the potential benefits for research activities and the global economy [13, 25, 29, 32, 44]. One of the arguments brought by [29] in this regard is that globalization and its context offer real possibilities for the development of progressive and emancipating changes within the economy. Therefore if we look at accounting in association with globalization it might help us dimension the potential role and implication of accounting systems when considering current realities of an economy under globalization.
Another significant aspect that should be considered when discussing the international accounting harmonization process is that of the costs it generates for entities. There is a large variety of forms for these costs, but we must keep in mind that entities' financial efforts should be seen as long term investments and well managed investments should finally generate benefits that are higher that the corresponding efforts. The issue of dimensioning the costs of IFRS implementation also represents a highly debated topic within studies dealing with the international accounting harmonization process [9, 40]. [40] for example identify and measure the costs of harmonizing the Romanian accounting system with the European Directives and IFRS, documenting the existence of three main categories of such costs as follows: (1) costs of personnel training, (2) consultants' commissions and taxes, and (3) necessary costs in order to adjust the existent informational systems [40]. Their study also argues that the benefits of accounting harmonization are mostly visible for those entities that frequently use external financing, entities benefiting from external equity and shareholders.
We must also mention that category of studies focusing on national accounting systems' need for harmonization with international accounting standards. Studies being developed in this area [47, 58, 62] have two main objectives: (1) dimensioning and positioning the need for harmonization in relation to the dimension of the global economy and to the accounting profession's status at a certain moment in time, and (2) quantifying the degree of a national accounting system's need for harmonization with international accounting standards [59]. We therefore consider it is possible to develop a complex system that would measure a national

accounting system's harmonization process with international accounting standards by considering the following dimensions:

- the need for accounting harmonization (pre-formal harmonization);
- accounting harmonization at the level of accounting regulations (formal harmonization);
- the degree of harmonization when considering accounting practices (material harmonization); and
- the costs of implementing international accounting standards (post-material harmonization).

If all these dimensions were quantified a complete diagnosis of a national accounting system in relation to the international accounting referential.

Studies in the area of international accounting harmonization focusing on measuring accounting harmonization document the fact that different measurement systems have been used over time up until the point where making a clear distinction in nowadays research is no longer possible. We must mention that it was accounting practices which first represented the object of analysis in terms of quantifying the compatibility degree between accounting systems. It is therefore interesting to observe how material harmonization which actually represents the finish line of the accounting harmonization process was also the bloc start for research on accounting harmonization measurement.

The objective of analyzing research literature's main trends in terms of measuring accounting harmonization is also undertaken by [58, 60, 61]. [58] document that two major periods can be dimensioned in the evolution of studies on formal harmonization measurement as follows: the initial period can be placed in time beginning with 1981, until 1985 (according to the [77]); and the mature period, starting in 1996 until now. Two studies must be emphasized within the initial period [19, 63], and also five within the mature period [17, 28, 30, 43, 72]. Such a dividing would be more difficult to do for studies on material harmonization measurement due to the extremely high number of such studies.

[58] develop a separation of the existing scientific steps in the material harmonization measurement based on the influence of previous studies, documenting the following two categories: (1) studies influenced by van der Tas's research activities in this field [2, 4, 5, 11, 23, 35, 41, 53, 68], and (2) studies that can be considered as bringing new approaches to material harmonization measurement [1, 16, 71, 76]. Looking towards the character of these researches [58] assess that the majority has a less positive approach [43], leading them to interpreting this aspect through a high degree of critical approach, within the existent empiric research.

We will further synthesize main types of accounting harmonization measurement systems starting from the three above mentioned studies that undertook this objective. [60, 61] approach accounting harmonization measurement in general while [58] focus on material harmonization measurement.

A first category of studies and therefore measurement instruments is that based on measuring options' concentration. We will further detail these category based on [58].

Reviewing studies on international accounting harmonization sphere [19, 63], we must underline the idea that first attempts to measure accounting harmonization were based on elements of descriptive statistics nature and diversity analysis. All of these studies have proven in time their incapacity of satisfying the need for pertinent and complete information regarding the existent harmonization degree at a certain moment or regarding the evolution of this process. The natural evolution of scientific knowledge when reaching this situation is to develop in such a manner that helps find solutions in order to overcome so far documented limits and obstacles. In this context, the subsequent researches after the previously mentioned have been developed based on the results from [81]. At the level of his study, van der Tas has developed 3 indexes for measuring the harmonization degree as follows:

- **H Index** – for measuring the degree of harmonization at a state level;
- **C Index** – for measuring the degree of harmonization at a state level where several reporting systems exist;
- **I Index** – for measuring the degree of harmonization between states.

The last two indexes represent in fact derived forms from H Index, developed by van der Tas for measuring the degree of material harmonization. Actually, all three indexes were used by van der Tas in his following studies [79, 80], but also by other researchers [21, 22, 23, 35] that looked deeply into the accounting harmonization phenomena. Going further, we can consider that beginning with van der Tas's research [81] a considerable inflow of studies have analyzed and evaluated the accounting practices harmonization, at a national level, as well as at an international one [53].

Considering that the degree of harmony depends not only on the number of used alternative accounting methods, but also on the degree in which every method is applied at practice level [81] we can state that H Index (Herfindahl Index) represents in fact a ***statistical instrument for measuring the concentration degree***. This index is valid to be used when the utilized accounting nature methods imply a concentration around a single or a limited number of alternative methods. In this context, using the frequency of an accounting method represents in fact the number of companies that opted for that specific method. On the other side, the relative frequency represents in fact the number of companies that have chosen that certain accounting method, reported to the total number of companies implied in the study [81].
The entire analysis and measurement reasoning of the material harmonization, developed by van der Tas is based on the **Herfindahl Index (H Index)** whose computing formula is:

$$H = \sum_{i=1}^{n} p_i^2 \qquad (1)$$

where:
H = Herfindahl Index; n = the number of alternative accounting methods; p_i = the relative frequency of method i.

The values H can take are between [1/n; 1]. The modification in the value of this index can be interpreted as a degree of harmonization or degree of diversity[12]. To better understand the utilization of this index, and also of the obtained results interpretation manner, [81] formulated a simplistic example, presented below.
As an example, we consider a certain element of accounting factor to which we associate a number of two methods – A and B. From the group of selected entities, formed from 100 companies, half apply method A, and the other half, method B, within the period 1 of analysis. At the level of the period 2 of analysis, the situation modifies as follows: 70 companies apply method A and only 30 apply method B, and at the level of the last analysis period (3) only 10 companies from the selected ones still apply method B. In these conditions, starting from the data above, the relative frequency and the value of H Index is presented as follows:

Table 1: Determining the H Index (example)

Period	**Method**		**H Index**
	A	**B**	
1	0.5	0.5	0.52 + 0.52 = 0.5
2	0.7	0.3	0.72 + 0.32 = 0.58
3	0.9	0.1	0.92 + 0.12 = 0.82

Source: [81]

Without considering the simplicity of the formulated example, we can observe that the determinant values for the H index are increasing, from the period 1 to the period 3 of analysis. This result can be interpreted as follows: the increase in the H Index value proves a concentration of opinion for a certain method, and on the other part an increase in the degree of consensus at the level of accounting practice.

As [81] highlighted from the beginning, H Index represents only one of the methods of measuring or quantifying the degree of concentration. On the other side, the advantage of using such methods is their simple character and the accuracy of the furnished information, in comparison to element of descriptive statistics nature.
Starting from this method of material harmonization degree quantification, van der Tas has developed another two indexes – **C Index** and **I Index**. The first one measures the degree of harmonization at a national level, when a company offers information for several utilized alternative accounting methods, with direct reference to a certain accounting practice. On another side, I Index measures the degree of material harmonization at an international level or in other words, the harmonization degree existent at the level of two or more countries [35].
The measuring system based on C Index comes to answer three major requests:

- the quantification of the harmony degree is directly associated to the comparability degree;

[12] As representing the opposite process of accounting harmonization.

- has the ability to consider several reporting systems and the data afferent to the reconciliations between diverse accounting treatments;
- offers the possibility to compute the degree of significance of the harmony level modifications, based on some relevant significance tests (e.g. regression analysis) [79].

On another side, this index measures the degree of comparability for each element from the financial reports (e.g. purchase of tangible assets), starting from the number of situations that are comparable at the level of analyzed elements.

Another measuring system based on the C Index is based on the idea according to which the degree in which the selected entities apply the same measuring method is quantified by dividing the number of pair-companies that apply the same measuring method, having in view the typology of the activities pursued by these companies, to the total number of pair-companies existent at the level of the entire sphere of research (as an example, at a national level, at a regional level, at the level of 3 selected states etc.)

For understanding this reasoning, [79] formulated the following example: we consider towards analysis the following three companies (A, B and C), for which the total number of companies is three: A vs. B, A vs. C and B vs. C. If we assume that at the level of company A method 1 is applied, and for the other two companies method 2 is applied, than the harmonization degree is equal to 1/3, because for example, the number of pairs compatible is 1 (B vs. C) and the total possible number is of 3 pairs.

If we start from this simple example, we can generalize that the number of pairs of elements afferent to the financial references at the level of the entire studied population, for n financial references, is equal to:

$$0.5 \times (n^2 - n) \qquad (2)$$

where:

n = the number of considered financial referring

Going further, we can determine the sum of the number of comparisons possible at the level of the group of analyzed elements, sum which is equal to:

$$0.5(\mathrm{a}_1^2 - \mathrm{a}_1) + 0.5(\mathrm{a}_2^2 - \mathrm{a}_2) + \cdots + 0.5(\mathrm{a}_\mathrm{m}^2 - \mathrm{a}_\mathrm{m}) \qquad (3)$$

where:

a_i = the number of companies that apply the method of evaluation i, m = the number of alternative evaluation methods.

If this sum, computed as seen above, is divided in proportion to the total number of possible comparisons, the computation formula for C Index is:

$$C = \frac{0.5(a_1^2 - a_1) + 0.5(a_2^2 - a_2) + \cdots + 0.5(a_m^2 - a_m)}{0.5 \times (n^2 - n)} \qquad (4)$$

$$C = \frac{0.5(\sum_{t=1}^{m} a_t^2) - 0.5(\sum_{t=1}^{m} a_t)}{0.5 \times (n^2 - n)} \qquad (5)$$

in addition, the final form of C Index is:

$$\mathrm{C} = \frac{\sum_{\mathrm{t}=1}^{\mathrm{m}} \mathrm{a}_\mathrm{t}^2 - \mathrm{n}}{\mathrm{n}^2 - \mathrm{n}} \qquad (6)$$

In this context, based in this formula, we can appreciate that an increase in the harmonization degree is associates to the increase in the number of companies that apply the same accounting method, even if the number of applied alternative methods remains the same or increases. C Index takes into consideration both the aspects [79].

Even if this index is based on the concentration-measuring index H Index, van der Tas appreciates that **C Index** is not a concentration index, even if a mathematical relation exists between the two indicators, and the proportion criteria is satisfied in this manner.

If C Index is an indicator that permits the quantification of the accounting material harmonization degree within a selected state for the analysis, than the I Index is another index from the two proposed by [81], which permits the measurement of the accounting harmonization at an international level. The computation formula for this index is [35]:

$$I = \left[\sum_{m=1}^{M} \left(\prod_{n=1}^{N} p_{m,n} \right) \right]^{\frac{1}{N-1}} \tag{7}$$

where:
I = I Index; m = the alternative accounting method m; n = country number n; $p_{m,n}$ = the relative frequency of the utilization of method m within country n.

The I index is determined by the multiplication at the level of the selected states of the share of the companies which apply a certain alternative method, than by summing these entire alternative accounting practices. The existent correction factor as an exponent in formula no. 7 is used when more than two countries are considered towards analysis [35].

At the level of this study, the research made by [79] is based on the study of the harmony degree at the level of policies afferent to the postponed taxes. The chosen sample is of 154 European companies listed on the capital markets, and the analyzed period is of 10 years[13]. The selection of the companies was based on the criterion of the states[14] that have implemented the 4th Directive before 1989. Van der Tas has considered the issue of postponed taxes and taking into consideration the data afferent to the necessary reconciliation between the accounting treatments, as well as the existing differences between the individual financial reports and the consolidate ones, the results prove the existence of a high equilibrium and of a positive image of the harmonization degree at the level of the European Union [79].

If we refer to van der Tas's first research [82] in which he developed the indexes derived from the H index, we can state that the primordial objective of the research is the identification of the quantification modalities of the existent harmonization degree at the level of the financial reporting practice. In this direction, van der Tas presents a series of coherent and relevant examples.

On the other side, based on the proposed indexes, van der Tas has measured a degree of harmonization existent at the level of the analyzed elements, for three problems of accounting factor, as follows: (1) the postponed taxes at UK's level, (2) the accounting reflection of the investment activities and (3) the evaluation of the fields and buildings, and the obtained results permitted the realization of a delimitation between the periods characterized through a high level of harmonization, and the ones considered to have a low or minimum degree of harmonization [22].

Beyond the benefits from these indexes, [79] identified a series of boundaries of Herfindahl Index, meant to sustain the conceptualization of the new proposed indexes. From these boundaries, we mention:

- the difficulty of computing the significance degree of the modifications afferent to the harmonization degree. This boundary has been identified also by [77];
- the incapacity to permit the analysis of the situations with multiple financial reports or with existent supplementary information at the level of the explicative notes, as a following of some alternative evaluation methods.

Considering all these elements, we can state that the measuring systems based on the analysis of the option concentration represent a scientific measure with a major importance in the material harmonization degree measurement studies' evolution; even if, the studies existent at the level of last years came to prove that systems based on concepts of similarity and correlation can be used for quantifying the degree of material harmonization. These tend to have a high degree of reliability, and their utilization permits the realization of diagnostics regarding the reached level of material harmonization level.

A second category of studies and therefore measurement instruments is that based on measuring the distance. We will further detail these category based on [61].

The first studies being developed in this particular research area have their econometric grounding in two distinctive methods: the Mahalanobis Distance Method [72] and the Euclidian Distances [28, 30]. The study developed by [72] is the first scientific demarche to be using an accounting harmonization measurement instrument that is based on the philosophy of distance between considered elements. On the other hand, Euclidian Distances represent a particular form of the Mahalanobis Distance Method.

[13] More precisely the period being analyzed by [79] is 1978-1988.

[14] Van der Tas analyzed nine EU member states: Belgium, Denmark, France, Germany, Greece, Ireland, Luxemburg, Holland and Great Britain.

[30] was the first to use this instrument for measuring accounting harmonization in order to quantify the harmonization degree between distinctive sets of accounting regulation. From a conceptual point of view, the **Euclidian Distance** between two points X and Y, having the coordinates X = (x_1, x_2, x_3, ..., x_k) and Y= (y_1, y_2, y_3, ..., y_k) it is defined as follows [28, 42]:

$$D(X,Y)\sqrt{\sum_{k=1}^{p}(x_k - y_k)^2} \qquad (8)$$

where:
in the considered pattern, x_k represents the analyzed value of the variable k for the element x; and k may take values from 1 to p (where p is the number of order of the characteristic attribute attached to the analyzed element).

Particularizing this computation formula in the field of accounting by also using the study developed by [28], the Euclidian Distance is better suited when using the following computation formula:

$$D_m^{ID/ND} = \sum_{i=1}^{n} d_{k,m}^{ID/ND} \qquad (9)$$

where:
$D_m^{ID/ND}$ = represents the harmony degree between ID and ND periods, m = represents the analyzed period (international periods and national periods), k = the four categories of features characteristic to the considered accounting methods and treatments, n = the number of accounting elements being considered within the pattern.

Euclidian Distances can record values from infinite to zero, therefore lacking a maximum possible value in certain circumstances. The zero value of this indicator represents the existence of the same number of accounting methods or treatments within both considered sets of accounting regulation. Therefore, the lower the ED value the highest is the degree of harmonization between the two sets of accounting regulation [30]. Moreover, a decrease in ED's value from one period to another reflects an increase of the compatibility degree between the two considered sets of accounting regulation.
Using measurement instruments based on measuring the distance between the considered elements has one significant problem. This is that in only considers quantitative aspects without considering the qualitative dimension of accounting harmonization. Therefore, the Euclidian Distance does not consider which accounting treatment or method is adopted at one moment in time, while also neglecting its character (e.g. mandatory, recommended, etc.) [28]. Even if [30] considered this instrument as being suitable in order to measure accounting harmonization, following studies [15, 17, 28] have appealed to using association coefficients in order to determine the similitude degree between two distinctive sets of accounting regulation.
Once again another category of studies therefore developed using measurement instruments based on measuring the similitude degree. We will further detail these category based on [61].
After a series of studies trying to measure accounting harmonization based on the indicators that were developed by [79, 80, 81], it was naturally to feel the need of using other instruments that were capable of eliminating or at least diminishing previous limitations and shortcomings. The main problem being identified for the previously discussed indicators is the lack of some associated robustness tests, as well as of a confidence interval for the obtained results [58]. Through the studies being developed by [1, 16, 71, 76] we witness the movement to using the correlation and association coefficients in measuring the degree of accounting harmonization.
We can therefore observe that instruments measuring the compatibility degree of accounting practices and of different sets of accounting regulation actually record a convergent time evolution towards the common point given through measurement instruments based on similarity. Moreover, a clearer dimensioning of the accounting harmonization degree is obtained when using either association coefficients (Jaccard's Coefficients, Roger-Tanimoto Coefficient, Lance-Williams Coefficient), either correlation coefficients (Pearson Coefficient, Spearman Coefficient).

Jaccard's Coefficients are mostly known in the form being used by [28], as follows:

$$S_{ij} = \frac{a}{a+b+c} \quad (10)$$

and

$$D_{ij} = \frac{b+c}{a+b+c} \quad (11)$$

where:
S_{ij} represents the similarity degree between the two sets of analyzed accounting regulations or practices; D_{ij} represents the degree of dissimilitude or diversity between the two sets of analyzed accounting regulations or practices; a – the number of elements which take the 1 value for both sets of regulations or practices; b – the number of elements which take the 1 value within the j set of regulations or practices and the 0 value for the i set of regulations or practices; c – the number of elements which take the 1 value within the i set of regulations or practices and the 0 value for the j set of regulations or practices.

The values that can be recorded by these coefficients go from 0 to 1, where 1 represents a maximum level of harmonization when considering the similarity coefficient. Also, the sum of the two Jaccard's Coefficients, Jaccard S_{ij} and D_{ij}, is obviously always equal to 1. Jaccard's Coefficients will further be used within the next section of this chapter in order to measure formal accounting harmonization between National Accounting Regulations and the International Financial Reporting Standard for Small and Medium-sized Entities.

As another model for measuring the consistencies between accounting systems could be considered **Roger-Tanimoto coefficient**. The computation formula is following:

$$\mathrm{R\&T} = \frac{\mathrm{d+a}}{\mathrm{d+a+2(b+c)}} \quad (12)$$

where:
d – the number of elements which take the 0 value for both sets of regulations or practices.

Alternatively for measuring of dissimilarities could be used **Lance-Williams coefficient**. The computation formula is following:

$$\mathrm{L\&W} = \frac{\mathrm{b+c}}{\mathrm{2a+b+c}} \quad (13)$$

In terms of the correlation coefficients, the study developed by [28] appealed to using **Spearman's coefficient** in order to dimension the comparability degree between a set of national accounting regulation and International Financial Reporting Standards. The corresponding computation formula is as follows:

$$rs = \frac{\sum_{i=1}^{n} R(NC_i)R(IC_i) - n\left(\frac{n+1}{2}\right)^2}{\sqrt{\sum_{i=1}^{n} R(NC_i)^2 - n\left(\frac{n+1}{2}\right)^2} - \sqrt{\sum_{i=1}^{n} R(IC_i)^2 - n\left(\frac{n+1}{2}\right)^2}} \quad (14)$$

where:
n = total number of accounting methods included in the study; $R(NC_i)$ = the rank of the accounting method i within national accounting standards (NC), i = 1, ..., n; $R(IC_i)$ = the rank of the accounting method i within international accounting standards (IC), i = 1, ..., n.

Being used in the field of accounting, Spearman's coefficient can record values going from -1 to +1. The closest the value of the coefficient to +1 the higher is the harmonization degree between the considered elements.

We cannot conclude this section of our chapter without mentioning the most recent and innovative research methodologies used in measuring accounting harmonization. [70] propose using a new method of matching and fuzzy clustering analysis to assess the convergence progress of national accounting standards (NAS) with International Financial Reporting Standards (IFRS) from whole and single standards, respectively. Single standards are clustered according to their convergence level, which may indicate further convergence emphasis. Fuzzy clustering analysis represents a method used in multivariate statistical analysis. Using this method is suited when aiming to divide a data set into groups or clusters that consist of similar data. Close or estranged relationships of cases are classified objectively by the measurements of similarity or distance. The former is usually measured by simple relevant coefficients while the latter is measured by absolute distances. [70] analyze how to measure the similarity or dissimilarity between any two sets of accounting standards, so coefficients could be the most suitable method. The method they propose is also tested by considering China as an illustrative example. Their results reveal that this new method can measure the convergence level of NAS with IFRS more clearly and informatively.

3 Measuring Formal Harmonization: National Accounting Regulations and IFRS for SMEs

We will discuss now the compatibility levels between all sets of national harmonization with international referential. For the compatibility calculation were used Jaccard's coefficients (for measurement of similarities and dissimilarities), Roger-Tanimoto coefficient (for measurement of similarities) and Lance-Williams coefficient (for measurement of dissimilarities).

All sets of national regulations (as well as IFRS for SMEs) we tested within 8 particular areas: *(i) intangible assets, (ii) PPE, (iii) investment properties, (iv) financial leases, (v) inventories, (vi) financial assets and liabilities, (vii) financial derivatives, and (viii) financial statements*. Discussed issues are part of Appendix.

Table 1 provides evidence about measurement of similarity level between all accounting regulations.

Results show that the **most compatible** systems with international referential are accounting systems of all Baltic countries, mentioning the TOP 3 – **Estonian, Latvian and Lithuanian** accounting regulation.

Table 1. Analysis of Similarities

		CZE	**EST**	**LAT**	**LIT**	**POL**	**ROM**	**SVK**	**IFRS**
Czech Republic	*JC*	1.0000	0.5484	0.5625	0.4839	0.6400	0.4828	0.6538	0.5667
	RT	1.0000	0.4510	0.4510	0.3962	0.6087	0.4231	0.6087	0.4800
Estonia	*JC*	0.5484	1.0000	0.7419	0.7241	0.6667	0.4688	0.6786	0.8214
	RT	0.4510	1.0000	0.6444	0.6444	0.6087	0.3704	0.6087	0.7619
Latvia	*JC*	0.5625	0.7419	1.0000	0.6774	0.6207	0.5806	0.6897	0.7667
	RT	0.4510	0.6444	1.0000	0.5745	0.5417	0.4800	0.6087	0.6818
Lithuania	*JC*	0.4839	0.7241	0.6774	1.0000	0.5357	0.6071	0.5517	0.7500
	RT	0.3962	0.6444	0.5745	1.0000	0.4800	0.5417	0.4800	0.6818
Poland	*JC*	0.6400	0.6667	0.6207	0.5357	1.0000	0.6000	0.7391	0.5714
	RT	0.6087	0.6087	0.5417	0.4800	1.0000	0.5745	0.7209	0.5102
Romania	*JC*	0.4828	0.4688	0.5806	0.6071	0.6000	1.0000	0.6154	0.5333
	RT	0.4231	0.3704	0.4800	0.5417	0.5745	1.0000	0.5745	0.4510
Slovakia	*JC*	0.6538	0.6786	0.6897	0.5517	0.7391	0.6154	1.0000	0.6429
	RT	0.6087	0.6087	0.6087	0.4800	0.7209	0.5745	1.0000	0.5745
IFRS	*JC*	0.5667	0.8214	0.7667	0.7500	0.5714	0.5333	0.6429	1.0000
	RT	0.4800	0.7619	0.6818	0.6818	0.5102	0.4510	0.5745	1.0000

Source: our analysis

Table 2 emphasizes on measurement of dissimilarity level. Results show that the **less compatible systems** with international referential are Romanian, Czech and Polish one.

Table 2. Analysis of Dissimilarities

		CZE	EST	LAT	LIT	POL	ROM	SVK	IFRS
Czech Republic	*JC*	0.0000	0.4516	0.4375	0.5161	0.3600	0.5172	0.3462	0.4333
	LW	0.0000	0.2917	0.2800	0.3478	0.2195	0.3488	0.2093	0.2766
Estonia	*JC*	0.4516	0.0000	0.2581	0.2759	0.3333	0.5313	0.3214	0.1786
	LW	0.2917	0.0000	0.1481	0.1600	0.2000	0.3617	0.1915	0.0980
Latvia	*JC*	0.4375	0.2581	0.0000	0.3226	0.3793	0.4194	0.3103	0.2333
	LW	0.2800	0.1481	0.0000	0.1923	0.2340	0.2653	0.1837	0.1321
Lithuania	*JC*	0.5161	0.2759	0.3226	0.0000	0.4643	0.3929	0.4483	0.2500
	LW	0.3478	0.1600	0.1923	0.0000	0.3023	0.2444	0.2889	0.1429
Poland	*JC*	0.3600	0.3333	0.3793	0.4643	0.0000	0.4000	0.2609	0.4286
	LW	0.2195	0.2000	0.2340	0.3023	0.0000	0.2500	0.1500	0.2727
Romania	*JC*	0.5172	0.5313	0.4194	0.3929	0.4000	0.0000	0.3846	0.4667
	LW	0.3488	0.3617	0.2653	0.2444	0.2500	0.0000	0.2381	0.3043
Slovakia	*JC*	0.3462	0.3214	0.3103	0.4483	0.2609	0.3846	0.0000	0.3571
	LW	0.2093	0.1915	0.1837	0.2889	0.1500	0.2381	0.0000	0.2174
IFRS	*JC*	0.4333	0.1786	0.2333	0.2500	0.4286	0.4667	0.3571	0.0000
	LW	0.2766	0.0980	0.1321	0.1429	0.2727	0.3043	0.2174	0.0000

Source: our analysis

Tables 3 – 9 focus on the analysis of local accounting systems with IFRS for SMEs for all eight analyzed areas of financial reporting showing the most and less harmonized parts of accounting legislature within all national standards.

Table 3. Measurement of Similarities and Dissimilarities in Particular Areas (Czech Republic versus IFRS for SMEs)

	CZE/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	1.0000	0.0000
3 Investment Property	0.3333	0.6667
4 Financial Lease	0.0000	1.0000
5 Inventories	1.0000	0.0000
6 Financial Assets and Liabilities	0.8000	0.2000
7 Financial Derivatives	0.5000	0.5000
8 Financial Statements	0.5000	0.5000
TOTAL	**0.5667**	**0.4333**

Source: our analysis

According to the results there could be seen the major differences in reporting of investment properties (Czech accounting treatment do not use fair value approach), and financial leases. The total inconsistency in reporting of financial leases is given by the fact, that under IFRS approach is used “substance-over-form” rule, thus under Czech legislation has the leading power the legal (and not economic) point of view.

Table 4. Measurement of Similarities and Dissimilarities in Particular Areas (Estonia versus IFRS for SMEs)

	EST/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	1.0000	0.0000
3 Investment Property	0.6667	0.3333
4 Financial Lease	1.0000	0.0000
5 Inventories	1.0000	0.0000
6 Financial Assets and Liabilities	0.6667	0.3333
7 Financial Derivatives	0.5000	0.5000
8 Financial Statements	1.0000	0.0000
TOTAL	**0.8214**	**0.1786**

Source: our analysis

As already mentioned before, according to the results of performed analysis, Estonian accounting system is considered as a most harmonized one with IFRS for SMEs. Estonian regulation is even the only one requiring the preparation of Statement of Comprehensive Income as it is required by IFRSs as well as IFRS for SMEs.

Table 5. Measurement of Similarities and Dissimilarities in Particular Areas (Latvia versus IFRS for SMEs)

	LAT/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	0.6667	0.3333
2 PPE	0.6667	0.3333
3 Investment Property	0.6667	0.3333
4 Financial Lease	0.6667	0.3333
5 Inventories	1.0000	0.0000
6 Financial Assets and Liabilities	0.8000	0.2000
7 Financial Derivatives	0.7500	0.2500
8 Financial Statements	0.8333	0.1667
TOTAL	**0.7667**	**0.2333**

Source: our analysis

Latvian accounting regulation could be also considered as a one of the most harmonized with IFRS for SMEs. There could be seen just slight differences when reporting fixed assets.

Table 6. Measurement of Similarities and Dissimilarities in Particular Areas (Lithuania versus IFRS for SMEs)

	LIT/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	0.3333	0.6667
3 Investment Property	1.0000	0.0000
4 Financial Lease	0.5000	0.5000
5 Inventories	0.7500	0.2500
6 Financial Assets and Liabilities	0.6667	0.3333
7 Financial Derivatives	1.0000	0.0000
8 Financial Statements	0.8333	0.1667
TOTAL	**0.7500**	**0.2500**

Source: our analysis

Despite the fact, that Lithuanian legislature is close to IFRS for SMEs, there could be mentioned the differences in reporting of PPE, where Lithuanian accounting system prefers fair value approach and reporting of inventories, where it is possible to use LIFO cost formula for derecognition of purchased inventories.

Table 7. Measurement of Similarities and Dissimilarities in Particular Areas (Poland versus IFRS for SMEs)

	POL/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	1.0000	0.0000
3 Investment Property	0.3333	0.6667
4 Financial Lease	1.0000	0.0000
5 Inventories	0.7500	0.2500
6 Financial Assets and Liabilities	0.4000	0.6000
7 Financial Derivatives	0.2500	0.7500
8 Financial Statements	0.5000	0.5000
TOTAL	**0.5714**	**0.4286**

Source: our analysis

Polish accounting system offers as a possible cost formula for derecognition of purchased inventories also LIFO, which is impossible to use according to IFRS for SMEs. There could be seen also some differences in reporting of investment properties, which do not represent a separate group under Polish regulation and therefore are applied the very same rules like for PPE. Fair differences are also in reporting of financial instruments (derivatives inclusive).

Table 8. Measurement of Similarities and Dissimilarities in Particular Areas (Romania versus IFRS for SMEs)

	ROM/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	0.3333	0.6667
3 Investment Property	0.3333	0.6667
4 Financial Lease	0.2500	0.7500
5 Inventories	0.7500	0.2500
6 Financial Assets and Liabilities	0.4000	0.6000
7 Financial Derivatives	1.0000	0.0000
8 Financial Statements	0.5000	0.5000
TOTAL	**0.5333**	**0.4667**

Source: our analysis

According to the results of performed analysis, Romanian accounting legislature is less harmonized with IFRS for SMEs. Differences can be seen especially in the area of tangible assets. Romanian legislation is also the one (with Polish and Lithuanian) offering as a possible derecognition formula for purchased inventories LIFO. Like under majority of accounting regulation also in Romania investment properties do not form a special reporting group and are considered as a part of PPE.

Table 9. Measurement of Similarities and Dissimilarities in Particular Areas (Slovakia versus IFRS for SMEs)

	SVK/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	1.0000	0.0000
2 PPE	1.0000	0.0000
3 Investment Property	0.3333	0.6667
4 Financial Lease	0.3333	0.6667
5 Inventories	1.0000	0.0000
6 Financial Assets and Liabilities	0.4000	0.6000
7 Financial Derivatives	0.5000	0.5000
8 Financial Statements	0.8333	0.1667
TOTAL	**0.6429**	**0.3571**

Source: our analysis

Slovakian accounting legislation is less harmonized in certain areas of reporting for tangibles (using the similar approach for reporting of PPE as well as investment properties) and financial instruments.

4 Conclusive Remarks

Adoption of IFRS for SMEs could be vital for true-and-fair view and for the higher comparability of accounting information in globalized world. The crucial necessity will be the wider spread of IFRS for SMEs knowledge. Generally, IFRS for SMEs is based on different concept than continental accounting regulation, so it'll be not only about the training of new accounting regulation, but about the training of the different accounting thinking and different approach for posting of accounting transaction. There will be also necessary to provide regular information for professional accountants about the evolution and changes in IFRS for SMEs and the long-life training.

> Absence of description of detailed postings in IFRS brings higher demand on the professional and ethic level of accountants. If you take in account the very limited legislation requirements on the qualification of accountants, none requirements on the long-life education and ethic level and very difficult role of professional chambers trying to deal with this problem, it'll be a long journey and lot of work for us...
>
> Martin Unzeitig (President of Chamber of Certified Accountants Czech Republic)

As a possible limit for the current adoption of IFRS for SMEs could be considered the lack of motivation as the clients of professional accountants prefer rather than true-and-fair view the best solution of accounting operation from the tax point of view, due to the close connection of national accounting systems to tax regulation.

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APPENDIX – Analyzed segments

1 Intangibles
- Initial Recognition
  - historical costs
- Revaluation
  - historical costs
  - fair value (↑-equity, ↓-P/L)

2 PPE
- Initial Recognition
  - historical costs
- Revaluation
  - historical costs
  - fair value (↑-equity, ↓-P/L)

3 Investment Properties
- Initial Recognition
  - historical costs
- Revaluation
  - historical costs
  - fair value (↑-equity, ↓-P/L)
  - fair value (P/L)

4 Financial Leases
- Lessor
  - recognition of fixed asset at historical costs
  - depreciation of fixed asset
  - recognition of fixed asset at present value
- Lessee
  - recognition of fixed asset at historical costs
  - depreciation of fixed asset
  - recognition of fixed asset at present value
  - off balance sheet evidence of fixed asset

5 Inventories
- Initial Recognition
  - historical costs
- Derecognition
  - FIFO
  - LIFO
  - weighted average

6 Financial assets and liabilities
- Initial Recognition
  - historical costs
  - fair value
- Derecognition
  - historical costs
  - present value
  - amortized costs
  - fair value (P/L)

7 Derivatives
- Initial Recognition
  - historical costs
  - fair value
- Derecognition
  - fair value (P/L)
  - fair value (equity)

SUBJECT INDEX