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Harmonization of Accounting of Enterprises' Income and Expenses IFRS

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Abstract. The peculiarities of harmonization of Ukrainian accounting standards with IFRS are described in this article. It gives some practical recommendations on how to present income and expenses in accordance with the international standards in the financial statements.

Keywords: financial statements/reporting; income/profit/ revenue; expenses; IFRS.

Introduction. The international market entry process, the integration of the world economy and the globalization of financial markets are the things that stimulate the countries to introduce the uniform methods, principles and approaches to preparation and presentation of financial statements of economic entities. A so-called convergence progress tends to occur, i.e. no difference in the standards of financial statements between the countries. In order to improve the investment climate in Ukraine, to have a possibility to enter the world markets and to eliminate the economic contradictions, it is inevitable to harmonize the accounting and reporting with the international standards.

The international financial reporting standards are an effective tool for increasing the transparency and understandability of the information on business affairs of economic entities. The indicators presented in the financial statements are a source for creating a database to recognize incomes and expenses. They help value assets and liabilities, provide a possibility for objective disclosure of financial risks, and compare the results of enterprises' activity in dynamics in order to ensure the adequate assessment of the potential and to make the relevant management decisions. The integral constituent of the accounting and financial statements is accounting of incomes and expenses of economic entities, which is to be further investigated and perfected in terms of their definition, coordination and presentation in accordance with IFRS.

The issue of harmonization of the Ukrainian accounting regulations (standards) with the international financial reporting standards is described in the works of both national and foreign scientists-economists. They are M. Belukha, F. Butynets, S. Golov, N. Gura, I. Drozd, V. Parkhomenko, V. Shvets, M. van Breda, Y. Sokolov, I. Urtenkova, E. Hendrixen, M. Matthews and others. However, the transition of Ukraine to the international standards (IFRS) needs to be further investigated and recommendations on harmonization of accounting of income and expenses in accordance with IFRS are to be developed.

The **object** of the research is the income and expenses of the economic entities, approaches to definition and harmonization of the accounting with international standards.

The **aim** of the research is to study the problems of transition to the international standards, to develop the directions of improvement of the financial statements of economic entities in terms of income and expenses in accordance with IFRS.

The aim of the article is achieved due to fulfilling the following **objectives**:

- exploring the problems of harmonization of accounting of incomes and expenses with the international standards;
- offering the directions of improvement of acknowledgement and accounting of incomes and expenses in accordance with IFRS;
- giving the recommendations on transformation of reporting indicators in accordance with IFRS in practice.

During the research the following **methods** were used: analysis and synthesis, induction and deduction, system research, methods of comparison, evaluation and grouping.

The main part. The national accounting system in each country has its own specifics, which differs in principles of construction, the level of regulations, etc [1]. The specificity of issuing

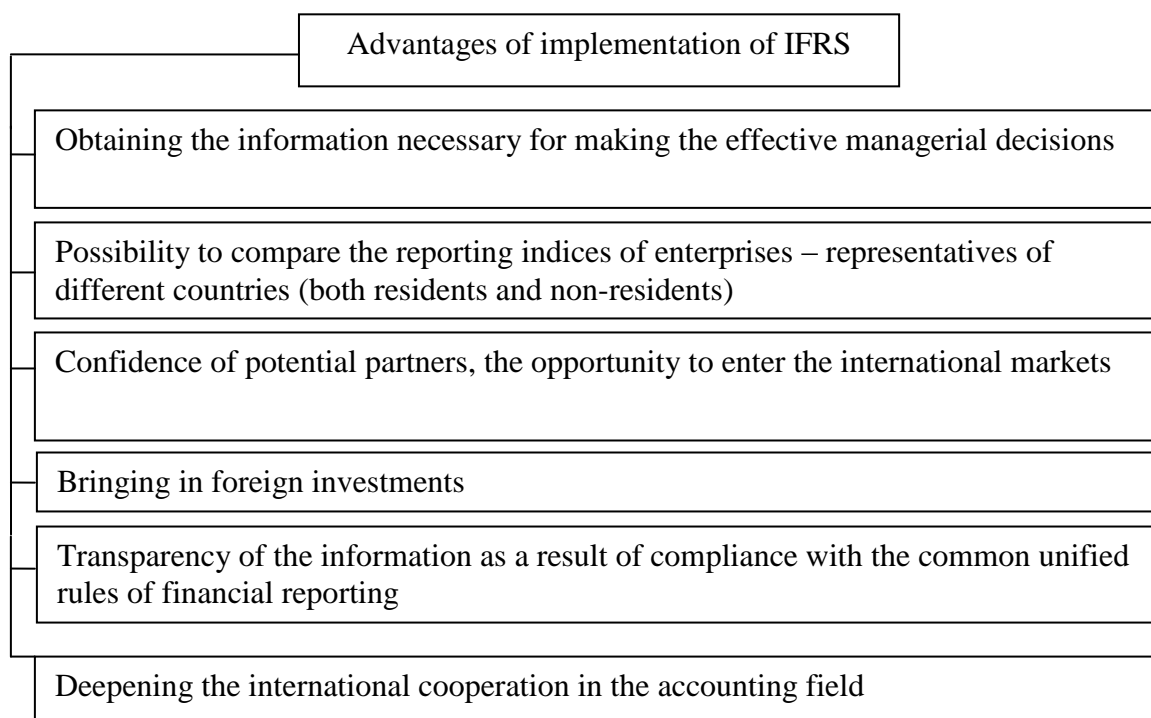
financial statements in this or other country is determined by the economic, legal, social and other factors. As a result, the difference in approaches to issuing financial statements and assessment of their items is the cause of the inaccurate analysis of the information on the activities of business entities and decision-making in the globalization environment, as well as the development of the international trade. In the modern economic conditions the financial statements is the source of information on owners' investments to obtain economic benefits in the future.

In Ukraine the process of transition to IFRS started in 1999 with the adoption of the Law of Ukraine "On Accounting and Financial Reporting" [2] and National Accounting Regulations (Standards) (NR(S)AU). The norms of these documents determined the principles and methods of accounting and preparation of the financial statements which do not contradict the international standards [3]. With the amendments made in the Law [4], in 2012 in Ukraine IFRS will be binding for a number of national business entities. They will have to prepare financial statements and consolidated financial reporting applying the IFRS in full, but not only their individual postulates. They are public joint-stock companies, banks, insurance companies and other enterprises. It stipulates the harmonization process in accordance with the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19.07.2002. It means following the generally accepted rules which are clear to the partners and foreign investors.

The international financial reporting standards are as follows:

- ✓ International Financial Reporting Standards (IFRS);
- ✓ International Accounting Standards (IAS);
- ✓ Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the Standing Interpretations Committee (SIC).

The picture below shows the advantages of implementation of IFRS and issuing financial statements in accordance with the rules of the international standards.



Pic. Main advantages of implementation of IFRS worldwide

* - it is compiled by the author using the materials [5]

Ensuring transparency in disclosure of the information on the activities of the business entities on the capital market value is of great importance. It is determined by two main factors – income and future risks. Usually the risks can be typical for enterprises, but there are some which arise in case of absence of the specific information, e.g. the data on the return on investments. As the practice shows, lenders and investors sometimes agree to receive even less profit from their

business for the sake of confidence that the true and fairly defined information will reduce their risks.

Peculiarities of recognition of profits from transactions and events that lead to their acquisition are presented in IAS 18 "Revenue". In Ukraine its analogue is NR(S)AU 15 "Revenue". However, the norms of this standard do not fully comply with the requirements of IAS 18, and some of its norms are completed and covered in NR(S)AU 3 "Statement on financial results" and NR(S)AU 18 "Construction contracts" in the part of income determination received from works and services provided. The main aim of the standards is to formulate the approaches to revenue recognition, as well as of its accounting. The main provisions of the national standards fairly comply with the provisions of IFRS in terms of use, terminology, estimates of revenue and identification of transactions.

According to IAS 18, the revenue is interpreted as "the gross inflow of economic benefits arising from the ordinary operating activities of the entity when the own equity increases as a result of this income, but not as a result of contribution of the shareholders" [6].

The definition of revenue in NR(S)AU 15 is the same as that in IFRS: "revenue is an increase in economic benefits in the form of proceeds of the assets or the reduction of liabilities that result in the growth of the own capital (except for the capital increase through contributions of shareholders)" [7].

Below are the common features for the formation and definition of revenue [8]:

- raising the revenue from sales of goods;
- recognition of revenue as of date of making-out a balance sheet on execution of works, rendering the services only on the condition of their completion, if it is possible to estimate;
- receiving the revenue in the form of interests, royalties and dividends from the use of the assets by other parties.

However, the classification of revenue by type of activity in national standards is covered more widely. According to the international standards, revenue is divided into two types: revenue from the main activity and income from other operations. A considerable attention is paid to the definition of the activity type, which produced the revenue.

The main aspects covered in IAS 18 are:

- 1) assessment of revenue;
- 2) definition of the criteria for revenue recognition;
- 3) the conditions under which certain criteria will be met.

The postulates of NR(S)AU 15 and IAS 18 in terms of revenue definition are almost identical. According to IFRS, the revenue should be measured at fair value, which was received or which is planned to be received in the future. Recognition of revenue is carried out simultaneously with the recognition of expenses incurred to receive them. The most pressing problem of the transition of economic entities to issuing financial statements in accordance with the requirements of the international standards is inconsistency of approaches and principles of recognition and reflection of the expenses in the Statement on profits and losses. It can be explained, first of all, by the absence of the specific international standard, which would determine the principles of recognition and methods of calculation and determination of expenses. Separate provisions concerning the notion, assessment of expenses and their classifications are covered in the Concepts that underlie the preparation and presentation of financial statements, IAS 1 "Presentation of financial statements", IAS 2 "Inventories" and IAS 16 "Fixed assets". Expenses are treated as "a decrease in economic benefits during the reporting period in the form of disposal or depreciation of assets or in the form of obligations, the result of which is the reduction of the equity capital, except for the decrease related to the payment to the participants" [6].

According to paragraph 10 IAS 2 "Inventories", "the prime cost of inventories should include all the costs for purchasing, processing and other costs incurred in the process of delivery of inventories to their present location and bringing them to their current state. NR(S)AU 16 (9) contains the provisions which are not covered in a separate international standard, but are in its framework. The notion "initial value" in NR(S)AU 6 and the notion "prime cost" in IAS 16 are virtually the same:

- historical (actual) prime cost in the cash amount or the fair value of other assets (NR(S)AU);
- historical (actual) prime cost is mentioned while determining the amortized amount (IAS).

When determining the prime cost (initial value) of the products, the paid-in funds compared to NR(S)AU are replenished with their equivalents. As for other assets, there are other forms of compensation – it is a broader notion than the assets.

The differences between NR(S)AU and IAS in terms of determination of expenses are as follows:

1. absence of the rules of assessing the expenses of entities in the specific international standard, although some standards contain the norms of evaluation of the relevant expenses in the Statement on profits and losses;
2. in the international standards the category of "damage" is considered;
3. the separation between fixed and variable costs of general operating expenses in the international standards, in contrast to NR(S)AU, is considered in the context of the inventories evaluation.

The common thing for NR(S)AU and the international standards is the fact that the costs are recognized as expenses in the reporting period if revenue is recognized for which they were incurred.

At the end of the reporting period, the indicators of business activities of entities are shown in the financial statements. The International Financial Reporting Interpretations Committee has not adopted the unified reporting forms. Therefore, some entities will continue preparing financial statements unified in accordance with NR(S)AU, and the others – in the forms unified in accordance with NR(S)AU and non-unified in accordance with IFRS.

N. Gura states that the main problems and barriers for accounting and reporting harmonization are as follows [9]:

- the regulations on accounting and reporting have not been fully improved;
- the requirements of NR(S)AU are not met by business entities;
- the norms of the tax legislation and the international standards tend to vary.

Nowadays the norms of the tax legislation in determining the profits and expenses with the purpose of taxation are harmonized at maximum with the accounting, and the issue of improvement of the normative documents for harmonization with IFRS remains a key challenge.

The international standards provide the possibility of issuing the Statement on profits and losses using one of the following forms:

1. by the nature of expenses (the grouping of expenses by elements is assumed: material costs, expenses for salaries, amortization, staff costs, etc.). It is possible to use the form only by small and medium-sized enterprises, where there is no need in allocation of costs in accordance with the functional classification. This version of the report is called "Spending".
2. by the functions of expenses (it is anticipated to group expenses by the activity types that allows to determine the interim financial results). The expenses associated with sales, prime costs of sales, administrative expenses, expenses for paying the tax for a profit, etc are determined separately. This version of the report is called "Operational".

Whatever the version of the report has been used by economic entities, the following indicators (8) must be presented in the items:

- profit (revenue) from the sales of products (works, services) (IAS 18);
- revenue from the operating activities;
- expenses incurred to financing (IAS 23);
- the share of revenue of the associated companies and enterprises calculated by the method of participation in the equity (IAS 28, IAS 31);
- expenses to pay the taxes (IAS 12);
- profit from ordinary activities;
- profit/loss earned/incurred as a result of extraordinary events;
- net profit/loss (IAS 1).

Taking into account that the business activity of the economic entities differs by type and nature, it can be of high or minimal risk. The statement on profits and losses can additionally cover intermediate items and amounts for obtaining the more reliable information for internal and external users.

If the expenses meet one of the following conditions, they must be presented in the report:

- the expenses with no economic benefits in the future;
- the economic benefits fail to meet the recognition as an asset in the balance sheet;

- liabilities arise without recognition of the asset.

As an example, it can be the recognition and presentation in the statement on profits and losses the expenses (losses) incurred from the damage of goods, which led to inability of goods to bring economic benefits in the future.

The expenses are assumed to be recognized in the period in which they are incurred and economic benefits are expected from them. Expenses can be included into the cost of products (goods, works, services) or immediately be reflected in the items "administrative expenses", "selling expenses (distribution costs)" in the statement on profits and losses. Expenses can arise as a result of writing off the assets from the balance sheet of the enterprise, charging the future expenses, etc. Approaches to the recognition of profits and expenses are different. Therefore, accountants have to adjust the accounting entries and transform the indicators for financial statements in accordance with IFRS.

The implementation of IFRS stipulates the presentation all revenues and expenses in the statement on profits and losses, without any exception. The result of the activity is to receive the revenue, which is the main source of capital accumulation. Therefore, the structure of capital must include the costs for special-purpose funding, special-purpose receipts, capitalized earnings of the future periods, non-current assets received free of charge, etc. In terms of economic content, the above-mentioned resources belong to the own capital, and in the process of their usage they are included in the profits of the entity.

Considering the information presented above, it would be expedient to eliminate the differences in the norms of NR(S)AU and IFRS:

- to add the methodology on recognition of profits of business entities, taking into account the probabilities of risks for a seller in case of the return of goods by a buyer. To develop the methodology for calculating a risk coefficient and setting its limits;

- to fix the norms for evaluating the moment of transfer of rewards to customers or risks arising from ownership of the assets received. If in accordance with IFRS the company reserves the significant risks of assets ownership, then the operation is not treated as a sale and the revenue is not recognized;

- to eliminate discrepancies between NR(S)AU and IFRS when the products (goods, works performed, services rendered) are sold with a warranty. Recognition of the revenue takes place on the day of the sale, but there is a possibility of arising expenses to provide a guarantee in the future.

Results. The transition of enterprises to IFRS is regulated by IFRS 1. According to paragraph 23 of IFRS 1, when going over to IFRS the enterprises must provide the information on the impact of the transition to international standards on its financial results, cash flows and the overall financial state of the enterprise. It is assumed that by the date of the transition it is necessary to provide the information on the items of the financial statements with the highlighted difference in the items, which have been revalued and their so-called reclassification has been carried out.

Considering the recommendations of practitioners in the accountancy field [10], I give the example of how to present the data (see Table 1 and Table 2).

When transforming the financial statements (which are prepared in accordance with the requirements of NR(S)AU) to IFRS, in Ukraine the business entity has adjusted the following reporting indicators:

- the capitalized costs of software, which was used to ensure the operation of the web-page, is written off to expenses – 35 000 UAH;

- the unfinished construction object is transferred from the item of unfinished capital investments to the item of inventories (work in-progress) – 55 000 UAH;

- the amount of the reserve of the doubtful debts accrued in 2010 has been moved from the list of other operating expenses to the sale expenses – 43 000 UAH;

- as a result of discounting a non-interest bearing long-term debt, which was accrued in 2010, 45 000 UAH are related to financial expenses.

If the entity starts to prepare financial statements for the year 2011 using IFRS, then the date of transition to IFRS is 2010 with the reporting drawn up in accordance with the norms of NR(S)AU. When enterprises switch over to IFRS, decoding and coordination of the transformation of certain items should be applied additionally to the statements, according to items 23-25 of IFRS

1. The example of harmonization of the own capital with the aggregate profit of the enterprise is shown in Table 1 below.

Table 1
Harmonization of the own capital with the aggregate profit of the enterprise as of 01.01.2010.
(ths. UAH.)

Reporting item	NR(S)AU	Impact of switching to IFRS	IFRS
Intangible assets (depreciation value) ¹	45	(35)	10
Fixed assets (depreciation value)	9500	0	9500
Unfinished capital investments ²	55000	(55000)	0
Long-term receivables	35	0	35
Deferred tax assets	76	0	76
Noncurrent assets – Total	64656	(55035)	9621
Inventories	2583	55000	57583
Accounts receivable for goods, works, services	930	0	930
Other accounts receivable	44	0	44
Cash assets	83	0	83
Current assets – Total	3640	55000	58640
Assets – Total	68296	(35)	68261
Authorized capital	60188	0	60188
Undivided profit ³	7134	(35)	7099
Own capital – Total	67322	(35)	67287
Long-term bank loans	77	0	77
Lock-away	31	0	31
Long-term obligations – Total	108	0	108
Short-term loans	34	0	34
Debt to employees	109	0	109
Tax liabilities	67	0	67
Debts for goods, works, services	562	0	562
Current funds	94	0	94
Current obligations - Total	866	0	866
Obligations - Total	974	0	974
Total liabilities (Owned capital and obligations)	68296	(35)	68261
<p>The adjustment of some reporting items:</p> <p>¹ – according to NR(S)AU 8 "Intangible assets", the cost of creating a web-page is subject to capitalization. In the explanation of SIC-32 "Intangible assets" these expenses are not subject to capitalization, because the page is used for advertising purposes. Therefore, one has to reduce the reporting item "Intangible assets" by the cost of the web-page.</p> <p>² – according to the Ukrainian legislation one is allowed to include the unfinished construction into non-current assets, even if its sales are planned in the future. But according to IFRS these expenses are presented in the current assets which are to be reclassified to inventories.</p> <p>³ – writing-off the cost of the web-page - (35 ths. UAH) the total amount of the adjustment of the retained earnings - (35 ths. UAH.)</p>			

Thus, the total revenue for the year 2010 is to be adjusted to IFRS as presented in Table 2.

Table 2

Harmonization of the total revenue of the enterprise

(ths. UAH)

Item	NR(S)AU	Impact of switching to IFRS	IFRS
Net profit (net revenue)	4800	0	4800
Cost of sales	3470	0	3470
Gross profit	1330	0	1330
Other operating profits	32	0	32
Administrative expenses	350	0	350
Sales expenses ¹	60	43	103
Other operating expenses ¹	50	43	7
Profit from operating activities	902	0	902
Financial expenses ²	39	45	84
Profit from ordinary activity before tax	863	45	818
Tax on profit from ordinary activity	199	0	199
Profit from ordinary activity	664	45	619
Other consolidated returns	0	0	0
Total consolidated returns	664	45	619
<p>¹ – according to NR(S)AU 3 "Statement on financial results", the expenses on generation of the reserve of doubtful debts are attributed to other operating expenses. But considering the purpose of the reserve, these expenses, in the opinion of the enterprise management, do not comply with the requirements of IFRS and are subject to adjustment.</p> <p>² – according to NR(S)AU 10 "Accounts receivable", the present cost is used to estimate only the long-term debt with the calculated interest. In the example there are interest-free receivables, which are measured at a historical prime cost. In accordance with IFRS requirements for valuating the financial instruments, the revaluation of the relevant accounts receivable is to be performed and the financial expenses are to be shown in the financial statement.</p>			

Conclusions. Thus, since in Ukraine there are no clear criteria, which would allow us to accurately determine the financial state of enterprises according to the requirements of international companies, one of the ways to cope with this situation is to prepare the reporting according to IFRS requirements. The main constituents of the formation of indicators of the financial performance are profits and expenses. Harmonization of their accounting with IFRS is to be further developed and practical recommendations are to be given by ministries and departments of the country. Presentation of profits and expenses of enterprises in compliance with the IFRS requirements allows us to compare the indicators of enterprises' statements, to develop trust of potential partners, to attract foreign investments and to expand export-import operations, and to enter the international markets. The comparative analysis between NR(S)AU and IFRS in respect of profits and expenses of enterprises has given the opportunity to offer a procedure of transformation of the reporting data prepared according to the requirements of NR(S)AU to the financial statements in accordance with IFRS requirements.

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Согласование учета доходов и расходов предприятий с МСФО

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Аннотация. Раскрыты особенности согласования стандартов бухгалтерского учета Украины с МСФО. Приведены практические рекомендации отражения доходов и расходов в финансовой отчетности по международным стандартам.

Ключевые слова: отчетность; доходы; расходы; МСФО.